FOR AGENDA

EBS/84/207

CONFIDENTIAL

October 3, 1984

To: Members of the Executive Board

From: The Secretary

Subject: Yugoslavia - Review Under Stand-By Arrangement

Attached for consideration by the Executive Directors is the staff report for the review under the stand-by arrangement for Yugoslavia. A draft decision appears on page 28.

It is proposed to bring this subject to the agenda for discussion on Wednesday, October 31, 1984.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion, they should contact Mr. Boorman (ext. (5)8866) or Mr. L. Hansen (ext. (5)8872).

Att: (1)

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

YUGOSLAVIA

Review Under Stand-By Arrangement

Prepared by the European Department and the
Exchange and Trade Relations Department

(In consultation with the Legal Department, the Research Department,
and the Treasurer's Department)

Approved by L.A. Whittome and Subimal Mookerjee

October 2, 1984

I. Introduction

On April 18, 1984 the Fund approved a one-year stand-by arrangement for Yugoslavia in an amount equivalent to SDR 370 million, or 60 percent of quota. Yugoslavia has made two purchases under this arrangement totalling SDR 190 million. A Fund mission visited Belgrade during the period August 27-September 7, 1984 to review developments under the stand-by arrangement. The mission met with Mr. V. Klemencic, Federal Secretary for Finance; Mr. R. Makic, Governor of the National Bank of Yugoslavia; Mr. S. Stanojevic, Deputy Governor of the National Bank of Yugoslavia; and other officials. The staff representatives were Messrs. J. Boorman (Head), L. Hansen, D. Brodsky, W. Lewis (all EUR), A. Petersen (ETR), and Miss D. Cunningham (EUR) as secretary. Mrs. H. Junz (EUR) joined the mission for discussions on September 6. Mr. Polak participated in meetings during the latter part of the week of September 3.

On August 31, 1984 Fund holdings of dinars subject to repurchase amounted to the equivalent of SDR 1,894.1 million, or 309 percent of quota (see Appendix II). Excluding purchases under the compensatory financing facility, use of Fund credit amounted to SDR 1,859.5 million, or 303 percent of quota. The first purchase under the present stand-by arrangement, SDR 100 million, was made on June 15, 1984 following the Executive Board's decision on June 6, 1984 (EBM/84/87) to grant a waiver for the maintenance until August 31, 1984 of the regulation requiring 30-day advance notification for price increases for some of the goods for which price determination is classified as fully liberalized. 1/ At the same time, the stand-by arrangement was modified to bring forward the mid-term review with the Fund by one month to October 31, 1984 at the latest. The second purchase, SDR 90 million, was made on September 14, 1984 following the Executive Board's decision on August 31, 1984 (EBM/84/131) to grant a waiver for the nonobservance of the limit on public sector revenue for the first half of 1984. The third purchase is scheduled to take place on or after December 15, 1984. If the remaining SDR 180 million available under this stand-by arrangement is purchased by April 17, 1984, when the arrangement expires, the use of Fund credit as of that date will have risen to SDR 1,997 million, or 326 percent of quota.

In June 1983 the World Bank approved a structural adjustment loan (SAL) to Yugoslavia for US$275 million. 2/ The SAL is designed to support the Government's Long-Term Stabilization Program which calls for further adjustment of the current external account in convertible currencies, as well as structural change that will lay the foundation for future growth. The SAL is consistent with the Fund's stand-by program in that it puts emphasis on adequate interest rates, appropriate relative prices, financial discipline of enterprises, export incentives through exchange rate policy coupled with reductions of direct export subsidies, and improvement in foreign exchange allocation and external debt management. There has been an extensive exchange of information and regular consultation between Bank and Fund staff over the last several months. As examples, a Bank staff member participated as a consultant in the Fund's study of the foreign exchange allocation system in Yugoslavia, and Fund staff will be attached to a forthcoming Bank mission to appraise prospects for a second SAL.

II. Economic Performance and Prospects

The policy program for 1984, which the current stand-by arrangement supports, attached the highest priority to consolidating the improvement in the external accounts in convertible currencies. The strategy adopted had three main related objectives. First and foremost, there was a need to put the capital account in convertible currencies on a sound footing, both providing for adequate refinancing of maturities falling due in 1984 and securing a major improvement in the flows of short-term capital (including errors and omissions). Interest rate policy was to be the main instrument addressed to the improvement of the capital account.

The second objective was to build upon the turnaround in the current account realized in 1983 through the establishment of strong

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1/ The relevant regulation was abolished with effect from September 1, 1984.

2/ See Appendix III for a summary of Bank lending operations in Yugoslavia.

incentives to shift resources to sectors producing export goods and import substitutes. Buttressed by restrictive demand management policies, the exchange rate would be utilized to bring Yugoslavia's international competitiveness back to its level of late 1983. The third objective was to ensure through a variety of measures that the incentives designed to foster external adjustment would be permitted to exert their intended effect on relative prices and, hence, on the adjustment process. Such measures included liberalization of the price system, more frequent and adequate adjustment to administered prices, limits on enterprise subsidies paid out by Joint Reserve Funds, restrictions on income payments by loss-making and illiquid enterprises, and reductions of direct export subsidies. This objective is furthered also by the increase in interest rates. These measures may be viewed as part of the implementation of the Government's Long-Term Stabilization Program, adopted in 1983, which is directed toward laying the foundation for sustained growth through greater efficiency of resource allocation.

1. Domestic economy

a. Demand and supply

In the first six to seven months of 1984 final domestic demand was substantially more restrained than total output. A surge of consumer buying in April in anticipation of the lifting of the price freeze was followed by a pronounced slackening of demand with the result that the volume of retail trade was 9 percent lower in July 1984 than in the same month of 1983, and substantial stocks of finished consumer goods were built up. The volume of retail trade in January-July 1984 was 3 percent lower than a year earlier, suggesting that private consumption has been better sustained than would be expected on the basis of the continued sharp drop in real personal incomes from employment in the socialized sector. 1/ This results partly from the increase in nonwage incomes (e.g., from self-employment and from interest income) which comprise about 30 percent of total household income (Table 3). Of perhaps equal or greater importance in supporting household spending, was the increase in financial assets of the household sector attributable to the revaluation of foreign currency bank deposits (not reflected in Table 3). For the year as a whole, the authorities expect a decline in the personal savings ratio to keep the volume of private consumption

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1/ The socialized sector accounted for 86 percent of gross social product in 1982, the private sector 14 percent. The socialized sector is divided into the productive and nonproductive sectors, which account for 82 percent and 18 percent, respectively, of employment in the socialized sector.

from falling. 1/ However, in view of the decline in consumption thus far in 1984 and the limited response of the savings ratio to declines in real income in past years, the staff forecasts a decline in private consumption (as defined in GSP accounts) of about 1 percent in 1984.

Gross fixed investment has continued to decline thus far in 1984. This trend is expected to continue for the rest of the year as the restraint on bank credit and constraints on imports are expected to be maintained. The fall in volume terms in the first half of 1984, estimated at 9 percent, is slightly larger than that forecast for the year as a whole. Unofficial estimates of aggregate demand in nominal terms, deflated by the retail price index, indicate that final domestic demand declined by 3-4 percent in the first half of 1984, compared with a year earlier. However, owing to a substantial build-up of stocks, total domestic demand was virtually constant in volume terms. A similar development is expected to characterize the year as a whole, although the interest rate increases in October could stimulate a drawing down of stocks. Total output in volume terms also appears to have been unchanged in the first half of 1984, compared with a year earlier. For the year as a whole, the staff forecasts an increase in GSP of 1/2 percent, comprising a small decline in total domestic demand and a 1 percentage point contribution of the foreign balance to growth. The Yugoslav authorities project a 2.5 percent increase in total output; their forecasts of aggregate demand imply the lower figure of 1.5 percent (Table 2).

The year-on-year growth of industrial output was over 5 percent in January-July 1984. This satisfactory performance is attributable primarily to buoyant export demand; also, increased imports of intermediate goods appear to have resulted in a marked reduction in supply bottlenecks in industrial production. Some slowdown is expected later in the year, partly in response to the accumulation of stocks of finished goods, but growth for the year as a whole is expected to exceed the Plan figure of 3 percent. There are some signs that the growth of industrial output is being accompanied by a shift in its composition toward export-oriented sectors (Chart 1). While the evidence remains inconclusive, there appears to be a closer correlation in 1984 than in the past between growth performance and export intensity among industries. Output of the agricultural sector is expected to increase by 2 percent, rising to the record level of 1982. Output of the construction sector is now forecast to decline by 7 percent in 1984 rather than 4 percent as forecast earlier.

The Government is in the process of preparing its economic policy plans and forecasts for 1985, and it will present a draft Economic

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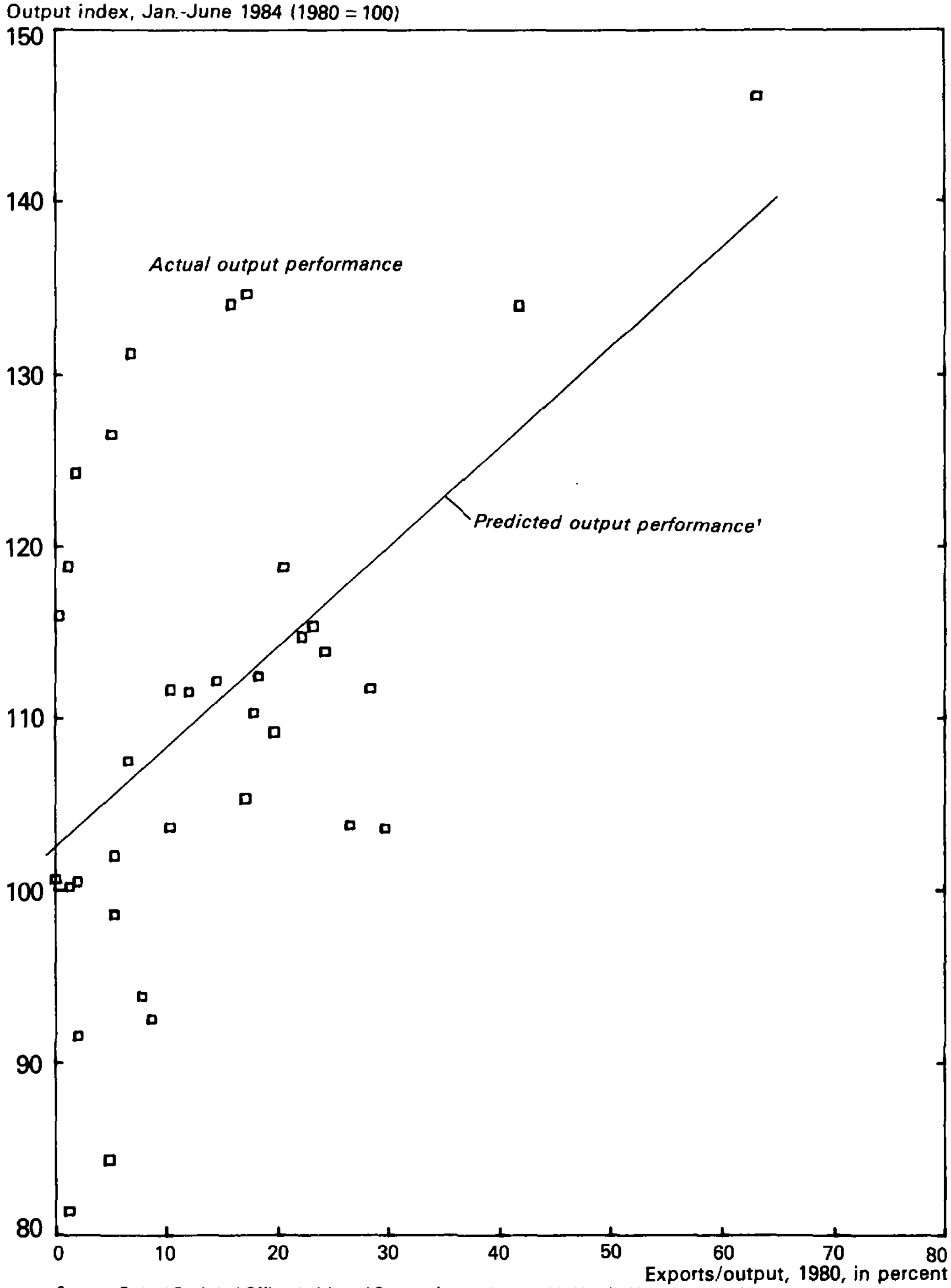
1/ The authorities also anticipate some shift in the composition of household consumption away from expenditure on "nonproductive services" which are excluded from the definition of gross social product (GSP) shown in Table 2.

CHART 1

YUGOSLAVIA

ACTUAL AND PREDICTED OUTPUT PERFORMANCE BY INDUSTRIAL BRANCH, IN RELATION TO INDICATOR OF COMPARATIVE ADVANTAGE



Sources: Federal Statistical Office, *Indeks* and *Saopstenje*; and data provided by the Yugoslav authorities.

[1]Equal to 102.55 + 0.5826 (Exports/output in 1980, in percent)
(32.89) (3.60)

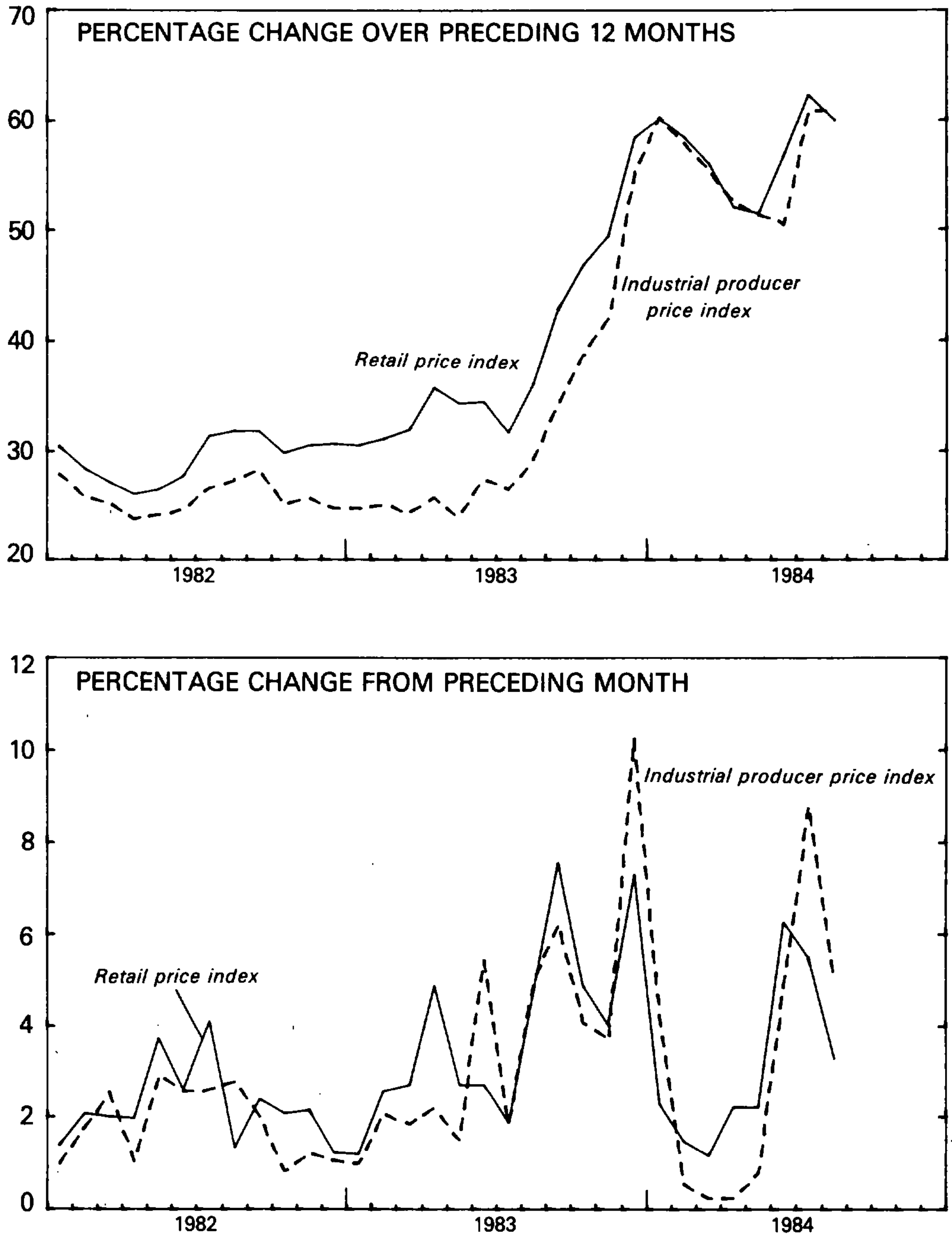
Numbers in parentheses are t-statistics.

CHART 2

YUGOSLAVIA

PRICE DEVELOPMENTS

(Percent change)



Sources: Data provided by the Yugoslav authorities.

Resolution to the Federal Assembly later in the year. Also, it is preparing a new medium-term plan for the period 1986-90, which is to be adopted in the course of 1985.

b. Prices and incomes

Domestic prices began to accelerate after the price freeze was lifted at the beginning of May 1984. Depending on the index chosen, prices were on average some 54-57 percent higher in January-August 1984 than they were a year earlier (Table 4). The pattern of monthly changes in the main price indices in 1984 (Chart 2) has been greatly influenced by administrative procedures and regulations with the result that it is difficult to gauge an underlying rate of inflation or to assess the likely rate of price increase over the next several months. Delays in the effective lifting of the price freeze stemmed from two main factors: the first was a requirement, abolished only at the beginning of September 1984, that 30 days notice be given prior to increases of certain "liberalized prices" (covering one-fourth of industrial production). Producer prices of such goods, essentially unchanged in May, rose by an estimated 3.5 percent in June and 10 percent in July. Second, delays were encountered in concluding the self-management agreements used to determine prices of a large proportion of intermediate goods (30 percent of industrial output). Prices of industrial goods determined by such agreements rose by less than 4 percent from April to June, but in July, once most of these agreements had been completed, such prices rose by more than 12 percent on average. Over the 12 months to December 1984 the staff expects an increase in industrial producer prices of some 60 percent, compared with the authorities' forecast of 50 percent (see Section III.1).

The growth of personal incomes from employment fell substantially behind that of prices in late 1983, and this pattern persisted in the first half of 1984, with the result that the decline in real personal incomes in the socialized sector of 10 percent in 1983 was followed by a 9 percent year-on-year decline in real terms in the first five months of 1984 (Table 5). This restraint of personal incomes reflects a shift from employment income to retained earnings of enterprises, partly because of the decision to increase enterprises' allocations to reserve funds (primarily the basic work unit's own fund which provides a reserve against possible future losses). The restraint was due also to a change in procedure providing that payments of personal incomes would be based on enterprise income already earned rather than, as previously, on prospective enterprise income. The Economic Resolution for 1984 provided that the growth of personal incomes should be lower in the nonproductive sector than that in the productive, but as indicated in

Table 6 there was little difference in growth rates. 1/ The decline in real income from employment has been partially offset by a greater buoyancy of nonwage incomes (Table 3); in addition, some income is not registered in the household sector accounts (e.g., private agricultural plots and valuation gains from foreign currency accounts). Nevertheless, for urban workers in the socialized sector without additional sources of income, there has been a pronounced drop in real income cumulating to nearly 30 percent since 1979.

2. External sector

a. Current account developments and prospects

During the first seven months of 1984 the current account in convertible currencies developed somewhat more favorably than expected in staff projections. A current account surplus of US$274 million in January-July 1984 represented an improvement of more than US$400 million compared with a year earlier, while for the year as a whole the current account surplus is programmed to rise to US$500 million, an increase of US$200 million (Table 14). Merchandise exports were approximately on target in volume terms while imports were being restrained more than anticipated in the staff projections. According to staff estimates, the volume of exports to the convertible currency area was 8.7 percent higher in January-July 1984 than a year earlier 2/ compared with a market growth rate in 1984 forecast at 5 percent. However, export performance has varied dramatically across export markets. The 12 percent year-on-year increase in the dollar value of all merchandise exports to the convertible currency area in January-July 1984 included a 30 percent increase in exports to developed countries and a 17 percent decrease in exports to less developed countries. Part of the latter decline reflects temporary export delays (e.g., exports of ships), but, to a large extent, it reflects factors that might persist throughout 1984 (e.g., a sharp reduction, equivalent to 5 percent of total

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1/ The socialized sector (Table 6) comprises the productive and nonproductive sectors. In general, the productive sector encompasses the production of goods and services that are themselves productive inputs, while the nonproductive sector accounts for other services, including those of the public sector.

2/ The analysis of external developments continues to be complicated by the Yugoslav practice of recording balance of payments flows on the basis of statistical, or accounting, exchange rates that generally differ from market rates. Even after rough correction to the data on changes in unit values is made, however, the official statistics implied that there had been an increase in average export and import prices in dollar terms in the first half of 1984. Since these series showed large shifts from month to month and appeared implausibly large in view of recent developments of world trade prices, the staff has re-estimated the changes in volume and price on the basis of partner country data on foreign trade prices.

convertible currency exports, in exports to Iraq and Iran). Developments for the rest of the year are uncertain, partly because preliminary data for August 1984 indicated a significant decline of exports in that month. On balance, a volume growth of nearly 9 percent for merchandise exports appears to be attainable; the revision to the program forecast for 1984 reflects primarily the downward revision of the forecast for export unit values. The authorities expressed some concern over the impact of protectionism on agricultural exports, noting in particular the adverse impact that the Greek entry into the EC has had on exports of baby beef.

Although a margin of uncertainty attaches to staff estimates of changes in the price and volume of imports, 1/ it appears that there was an increase of 1-2 percent in the volume of total merchandise imports in January-July 1984, compared with a year earlier, and a decline in import unit values (in dollar terms) of about 1/2 percent (Table 13). On the basis of data for the first half of 1984, a 3 percent decline in the value of merchandise imports comprised a 26 percent reduction in capital goods imports and a 6 percent increase in imports of intermediate goods other than petroleum products, a pattern which helps account for the buoyancy of industrial production in the face of subdued overall import levels. For the year as a whole, merchandise imports from the convertible currency area are forecast to rise by 2 percent in volume and by 1 1/2 percent in value, reflecting a weaker dollar price of imports than previously expected, and the authorities' plans to restrain imports from the convertible currency area. Total merchandise imports in 1984 are forecast to rise by about 2 1/2 percent in volume, and 1 percent in value.

Net service receipts in convertible currencies in the period January-July 1984 rose by almost 11 percent, year-on-year, to US$785 million. However, this increase was less than expected, and for the year as a whole, the forecast has been revised downward to show a decline from 1983 to 1984 of some US$100 million, or 5 percent. The downward revision stems primarily from an an unanticipated decline in receipts from construction work abroad. Taking into account the projected reduction in the trade deficit, however, the forecast for the current account in convertible currencies remains unchanged at US$500 million. For the nonconvertible area, the weaker than expected development of trade prices has resulted in lower forecasts for exports and for imports, leading to a modest current account deficit of some US$170 million, compared with US$50 million forecast earlier (Table 15).

1/ Correction of errors arising from the use of statistical exchange rates can only be approximate in the absence of detailed data on the invoicing-currency composition of exports and imports. The Government has decided to change its valuation procedures and plans to begin publishing foreign trade and balance of payments data based on market exchange rates beginning in the fall of 1984.

b. Capital account and international reserves

The deficit on capital account in convertible currencies, including errors and omissions, amounted to about US$110 million in January-July 1984, compared with a deficit of about US$280 million in the corresponding period of 1983. There was a large positive swing in short-term capital including errors and omissions, from a net outflow of US$700 million in the first seven months of 1983 to a net outflow of only US$15 million a year later. Much of the improvement in the item "Other short-term capital, errors and omissions" (Table 14) is attributable to an increase in advance payments received for construction work abroad, but an accelerated repatriation of export receipts which appears to be related to domestic interest rate increases also contributed to the improvement. At the same time, however, there was a shift in medium- and long-term capital to a net outflow of about US$90 million in January-July 1984, representing a negative swing of US$510 million from a year earlier. 1/ Drawings of medium- and long-term capital declined by US$400 million to about $570 million in the first seven months of 1984, partly reflecting the reduction in supplier credits in line with the reduction in imports of capital goods.

The medium-term outlook for the balance of payments (Appendix V) remains essentially unchanged from earlier this year (EBS/84/65, Appendix III). The authorities are in the process of drawing up their plans for external financial flows through 1990.

The substantial improvements in the current account and in errors and omissions thus far led to some increase in international reserves both of the National Bank of Yugoslavia and of commercial banks during the seasonally weak first half of the year. By August 20, 1984, the target minimum buildup of reserves for the end of September 1984 had already been achieved (Table 17). For the year as a whole, it is anticipated that the main elements of the capital account will develop generally as programmed.

III. Policies and Performance Under the Program

The comprehensive economic policy program in support of which the current stand-by arrangement was granted in April 1984 required legislative approval of significant and, sometimes, controversial measures and the establishment of several complex statistical reporting procedures. By and large, the authorities succeeded in implementing these measures and economic developments thus far under the program have generally been as anticipated. With perseverance in the charted policy course it seems that the main targets for 1984 will be achieved or in

1/ These figures for both years exclude amounts being refinanced by creditor banks and creditor governments, totalling an estimated US$2.0 billion in 1984 (see Appendix IV for details of these financing arrangements).

certain cases exceeded. However, inflation continues to be a serious problem and the improvement in the external sector needs to be consolidated. Also, there is still only limited evidence of the more basic structural adjustment necessary to return the economy to capacity growth with external balance.

1. Price policy

The main purpose of price policy under the program was to permit relative prices to be more responsive to market conditions. In view of the paramount importance attached to the medium-term external objectives, entailing structural change induced by shifts in relative prices, it was deemed more important at this stage to accept the inflationary consequences of measures to alter relative prices (notably exchange rate policy) than to reduce the inflation rate in the short run. As part of the program, the price freeze, which had been introduced in late 1983, was to be lifted on May 1, 1984 and the share of output free of price control was to be increased. In order to avoid a surge in prices when the price freeze was lifted, the authorities introduced a 30-day advance notification requirement for increases in certain prices. This requirement has now been abolished (see Section V. 1 for details). However, several other measures have been introduced to provide the authorities with some control over price developments. Mechanisms have been established to restrict credit to enterprises charging "excessive" prices or withholding goods from the market. In certain cases, the Federal Executive Council plans to allow special intervention imports of goods in short supply. Other mechanisms, perhaps involving the taxation of "excessive" profits, are under consideration. None of these sanctions is to be applied to producers or retailers dealing in products whose prices are in the "liberalized" category.

As part of the economic program, key administered prices were to be adjusted more frequently than in the past. Thus, prices for natural gas, oil and oil derivatives which were previously adjusted only infrequently are now adjusted automatically for changes in the exchange rate of the dinar vis-a-vis the dollar and for increases in international prices for these products. Further, railway and electricity tariffs are now adjusted so that they at least keep pace with the producer price index.

As noted, the authorities' price projections appear somewhat optimistic in view of the likelihood that there remain pent-up inflationary pressures still to be released; much of this inflation is expected to come into the open in September and October in response to the abolition of the advance notification requirement on September 1. More generally, while the policy of real depreciation of the exchange rate raised the rate of inflation, and maintenance of an existing real exchange rate tends to maintain inflationary pressure, it is difficult to assess the relative strength of this source of inflation. The direct boost to dinar prices of goods actually imported and exported has been followed by a delayed and still only partial response of prices for similar goods produced for the home market (exportables and import substitutes). In the past, however, similar increases in export prices in dinar terms have not been followed in a predictable, consistent fashion by commensurate increases in domestic prices of similar goods, so that it is difficult to predict with confidence the extent to which additional catch-up of prices in the tradable goods sector should be expected (Table 5).

Nevertheless, there is most probably still some degree of repressed inflation. The annualized rate of inflation from June to December 1983 was about 80 percent, at which point the price freeze was introduced. Over the following eight months to August 1984, the annualized rate of price increase was about 43 percent, but there is little to suggest that underlying inflationary pressures have been reduced dramatically during this period. Consequently, further catch-up of the price level is to be expected. For the authorities' current forecast of a 50 percent rise in the producer price index over the 12 months to December 1984 to be realized, it would be necessary for the average monthly price increases during the last four months of the year to be limited to just over 4 percent. The restraining influence of demand management policy should serve to mitigate inflationary pressure; indeed there are signs that the buildup of consumer goods inventories associated with weak demand is already easing price pressures for some consumer goods, notably durables. Nevertheless, an increase in the main price indices of some 60 percent over the 12 months to December 1984 appears likely.

2. Incomes policy

In 1983, the authorities undertook to limit the growth in nominal personal incomes, but the courts ruled that restrictions on the proportion of net enterprise income that could be distributed as personal income to employees were unconstitutional. For 1984, the authorities undertook in the letter of intent to limit payments of personal income to employees by enterprises whose financial accounts showed them to have made losses in 1983. A similar limitation was imposed on illiquid enterprises. Enterprises in a limited number of industries, mainly those subject to price controls, were to be exempted from this ruling.

A new federal law limiting personal income payments by loss-making and illiquid enterprises was passed in April. It was in certain respects stricter than called for in the letter of intent in that it limited the payments of personal income by loss-making enterprises to 50 percent of the increase in personal incomes in the relevant region (compared with 67 percent in the program) and was applicable to all loss-making basic work units whether or not they were part of a loss-making enterprise. This formulation was seen as necessary to stay within the limitation agreed in the letter of intent since legislation could not be made retroactive to the beginning of the year. Moreover, all loss-making BOALs were made subject to the limitations--whether in loss-making or profitable enterprises--in order that strict compliance with the law could be assured. The undertaking to limit personal income payments by loss-making enterprises was met for the country as a whole in the first half of 1984, but there were small deviations at the regional level. Consideration is being given to allowing certain exemptions to the law (but not from the undertaking in the letter of intent), e.g., for basic work units which have become profitable in 1984 and which have demonstrated an exceptional export performance. The stipulations for limitation of personal income payments by illiquid enterprises took effect only from July 1, 1984, 1/ but it seems already to have led to a more timely settlement of payment obligations by many enterprises. The authorities generally emphasized that both measures had already contributed to greater financial discipline and regarded them as important incentives to induce the necessary structural change.

In this connection, the limit placed on the growth of payments from the Joint Reserve Funds is a crucial complementary measure. In accordance with the letter of intent, the payments from these Funds are to be limited to one half of the percentage increase in the retail price index. This performance criterion was observed for the first half of 1984. An amendment to the law on Joint Reserve Funds is under preparation and is expected to take effect from the beginning of 1985. It would provide for a reduced role and, ultimately, the elimination, of these Funds in the financing of rehabilitation programs. It is intended that there would be less across-the-board lending to loss-making basic work organizations; credits would be extended to loss-makers only for specific purposes, such as financing the retraining of workers or the elimination of production bottlenecks, so that the causes of financial losses could be eliminated.

3. Fiscal policy

The aim of fiscal policy in 1984 was a further reduction in public sector revenue and expenditure in real terms. To achieve this, a limit was set on the cumulative quarterly increase in total public sector revenue equal to 85 percent of the increase in the retail price index and, at the same time, the public sector was required to run a financial

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1/ For these enterprises, the permissible growth of personal income payments is fixed at one half the growth of personal income in the relevant region's socialized sector, and is calculated on a per employee basis. This limitation is to be lifted once an enterprise is again current with its payments.

surplus of at least Din 40 billion. 1/ It was decided in April that the tax burden on enterprises should be reduced by an amount now estimated at about Din 70 billion in 1984 through decreases in the tax and contribution rates set by public sector entities within republics and provinces. 2/ However, final agreement on these measures was reached at the federal level only on June 22, 1984 and, consequently, the major impact of these measures, to be made retroactive to the beginning of the year, was felt only in July and August. Initial calculations of the total revenue effect of the package of tax cuts indicated that, on average, the rates of tax and contribution out of personal incomes (from employment in the productive sector) would be reduced by 2 percentage points, from 26.5 percent in 1983 to 24.5 percent in 1984. Also, tax and contribution rates on enterprise income would be reduced by 5 percent, from an average of about 8.7 percent in 1983 to about 8.3 percent in 1984. The reductions in individual tax rates could differ across republics and provinces, provided that the intended revenue effect in each republic would be achieved.

For the first half of 1984 public sector revenue exceeded the program limit. However, at the same time, the net asset position of the public sector with the banking system exceeded that programmed by an even larger amount. As a result, the restraint on public sector expenditure intended by the combination of revenue limits and minimum increases in the net asset position of the public sector with the banking system was achieved. Public sector revenue growth slowed in July and the authorities are convinced that the measures already taken, including selected reductions in turnover tax rates, are sufficient to bring the growth of revenue within the limits set for end-September.

4. Credit policy

Credit policy was carried out in line with the program in the first half of the year, but monetary growth lagged substantially behind program projections, with broad money (on the program definition) increasing by only about 10 percent during the first half of 1984, a somewhat lower rate of growth than the increase in prices during this period (Table 10). The relatively slow growth of broad money reflects, in part, some shortfall in "Other items, net" in the monetary survey

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1/ In accordance with the Government's Economic Resolution for 1984, the percentage growth in certain categories of public sector expenditure was limited to 75 percent of the growth in income of the socialized sector, calculated on a cumulative quarterly basis; revenue in excess of the indicated limits is frozen in blocked accounts in the National Bank of Yugoslavia. Approximately 45 percent of total public sector revenue and expenditure is subject to these limits.

2/ The total reduction in the financial burden on the productive sector in 1984 resulting from this package is estimated at Din 85 billion, but part of this total relates to reduced fees and charges not included in public sector revenue.

below that projected in the program and that assumed by the Yugoslav authorities when they set the limits for credit and net domestic assets for each quarter. The higher than expected increase in the net asset position of the public sector with the banking system also had a restraining impact on money growth. 1/

In the monetary program for 1984 it was assumed that broad money would grow in line with nominal GSP, i.e., that velocity would stay broadly unchanged from the end of 1983 to the end of 1984, following several years of increase. This change in trend was expected as a consequence of the substantial increase in deposit interest rates, which was programmed to bring them closer to positive levels in real terms by the end of the year. With real interest rates still significantly negative during the first half of 1984, however, velocity may have risen slightly during this period. Moreover, with the higher rate of inflation now forecast for 1984, real deposit rates are likely to be somewhat more negative by the end of the year than originally expected and some increase in velocity is now foreseen for 1984. Nevertheless, the maximum monetary growth under the agreed program for the second half of the year is still deemed appropriate to restrain price increases beyond those necessary to allow adjustment for the impact of the lifting of the price freeze and the implications of the authorities' exchange rate policy. In fact, the methodology applied by the authorities in establishing ceilings for credit and net domestic assets will most likely lead to a tighter monetary policy in the second half of the year than implied by the agreed program.

The analysis of the response of bank deposits to the increase in interest rates has been complicated by the practice of booking interest to deposit accounts only at the end of the year (see footnote 1 below). Roughly adjusting for this distortion, however, it seems that there has been a small real increase in dinar deposits of households, while their foreign currency deposits have declined significantly in real terms in the first half of 1984. A similar decline was recorded for foreign currency deposits of enterprises. Although enterprise dinar deposits declined slightly in real terms, this was much less pronounced than the year before. The share of foreign currency deposits in M2 (Yugoslav definition), which at the end of 1983 had reached almost 43 percent, had fallen back to 42 percent by the end of June 1984.

The year-on-year increase in narrow money (M1) was 31 percent in June compared with a rate of 20 percent at the end of 1983 (Table 9).

1/ The lower monetary growth also reflects the Yugoslav practice of posting interest on deposit accounts only on December 31, unless the deposit is withdrawn in the course of the year. With the substantial increase in deposit interest rates this year, the distortion of the monetary figures stemming from this practice has become more serious. This matter will be discussed with the authorities later in the year to find ways to correct for this distortion.

It was expected that the increase in interest rates for time deposits would have led to a relatively lower demand for M1, but the authorities explained this development as a response to the severe illiquidity of enterprises in 1983. Another factor which may have contributed to this development is the limitation on enterprises' access to time deposits. The self-management agreement concluded in April prevents banks from accepting time deposits from an enterprise if it has outstanding overdue obligations on previous credits, if the enterprise's own funds for working capital are less than prescribed, or if the enterprise recorded a loss for the preceding year.

5. Interest rates

At the beginning of 1984, the Yugoslav authorities decided to adjust interest rates gradually to bring them to positive real levels by April 1985. The target for nominal interest rates was defined as the twelve-month increase in industrial producer prices plus 1 percentage point and was applied to three-month deposits of households. The gap between the rate at the end of 1983 and the target rate was to be closed by 40 percent on May 1 and four further adjustments each of which was to close 15 percent of the gap until positive rates were achieved on April 1, 1985. Further, the three-month rate offered to households was to be applied to enterprise deposits as well. A self-management agreement incorporating this formula was signed by banks in April. This agreement also stipulated that one-year deposits would yield 5 percentage points, and two-year deposits 8 percentage points, more than the three-month deposits. At the same time, it was decided that the discount rate and other lending rates of the National Bank of Yugoslavia would be adjusted commensurately.

In accordance with the formula, interest rates for three-month deposits were increased from 12 percent to 30 percent on May 1 and further to 34 percent on July 1; also on July 1 the discount rate of the National Bank of Yugoslavia was increased from 30 to 34 percent and interest rates on subsidized credits from the National Bank of Yugoslavia were raised by 3 percentage points. According to the formula, interest rates for three-month deposits are to be increased by 13 percentage points to 47 percent on October 1. The discount rate is to be adjusted similarly and the rates for selective credits are to be increased by 10 percentage points. Interest rates on 1 year deposits and 2 year deposits will be 52 percent and 55 percent, respectively.

In view of the worrying inflationary situation, which to some extent seems to have been aggravated by an accumulation of stocks at the producer and retail level, the staff strongly recommended an acceleration of the rate of increase of nominal interest rates above that called for in the agreed formula. However, the authorities remained noncommittal on this issue.

While the interest rates for deposits are governed by the self-management agreement, lending rates vary considerably from bank to bank. The Yugoslav Banking Association from time to time collects statistics on the rates charged by banks. For export credits, the average rate charged in the period May 1-June 30, 1984 was 21 percent compared with 15 1/2 percent for the period February 1-September 30, 1983. For nonselective short-term credits, the corresponding figures were 38 percent and 26 percent, and for long-term credits 38 percent and 20 percent, respectively. The increased interest costs to enterprises are also evident from the quarterly enterprise accounts. In the first half of 1984, interest costs of the productive sector were twice as large as those in the corresponding period of 1983.

Interest rates for foreign currency deposits were not changed during the year, 1/ but the self-management agreement adopted in April stipulated that interest on household accounts of residents will be computed in foreign exchange but payable in dinars. For Yugoslav nationals temporarily living abroad, interest will be computed in foreign exchange and payable in foreign exchange, or, if so requested by the depositor, part or all may be paid in dinars. If such depositors have opted in advance for payment of interest in dinars, a premium interest above that payable in foreign currency is applied. 2/

6. Exchange rate policy

The dinar depreciated by about 25 percent in real terms in 1983 (Chart 3). However, from November 1983 until the end of March 1984 the dinar was allowed to appreciate significantly in real terms. In the letter of intent the authorities undertook to bring the real effective rate back to the level which obtained in late 1983 in two stages, the first by the end of April and the second by the end of June, and to maintain the real rate thereafter. This policy was fully implemented and the authorities gave firm assurances that this policy would be maintained throughout the program period.

7. External reserves and debt management

An important objective of the stabilization program for 1984 was a build-up of external reserves of US$500 million. This buildup of reserves was seen as necessary partly to meet the seasonal drain in the first half of 1985, including, possibly, the repayment of short-term debt rescheduled in January 1983, and partly to support a return to more normal capital flows. Developments so far in 1984 seem to indicate that this target will easily be met. By August 20, 1984, external reserves were more than US$200 million higher than at the beginning of the year and already exceeded the target established for the end of September.

1/ They range from 7.5 to 12.5 percent (see Table 11).

2/ The premia are 1.5 percentage points for sight deposits and 1-year deposits, 2.5 percentage points for 2-year deposits, and 3 percentage points for 3-year deposits.

The government has put a ceiling on external borrowing of US$3.5 billion in 1984. During the first seven months of the year total borrowing amounted to US$1.5 billion and there has been no short-term borrowing during this period.

IV. Foreign Exchange Allocation System

The current stand-by arrangement called for separate studies of the operation of the foreign exchange allocation system to be carried out by the Yugoslav authorities and by the Fund staff, with the assistance of expert consultants from inside and outside Yugoslavia. The report of the study by the Yugoslav authorities was discussed, and approved, by the Federal Assembly in July 1984. The Fund's study was conducted during May and June, and a report was provided to the Yugoslav authorities in August 1984 and discussed with them during the midterm review of the stand-by arrangement. 1/

The authorities' eventual aim, as stated in the Long-Term Stabilization Program, is a fully convertible dinar. The staff fully endorses this goal. The perspective from which the staff study was conducted, then, was to determine whether the current foreign exchange system--as envisaged in the law and its implementing regulations--was capable of serving as a transition mechanism to achieve that ultimate goal. This required an analysis of the legal and institutional basis of the current system, an examination of the current impediments to its operation as envisaged in the law, and proposals for correcting those observed impediments. There is no question that there are certain elements in the current system which impinge upon an efficient allocation of resources. This is inevitable in virtually any system which incorporates surrender requirements and administrative rules for determining the entitlement to foreign exchange. The authorities themselves recognize this. The issue addressed was rather whether the system was capable of playing the evolutionary role to a more efficient system foreseen for it.

1. Background

The Yugoslav foreign exchange allocation system is based on The Law on Foreign Exchange Operations and Foreign Credit Relations, enacted by the Federal Assembly in 1977. This law established the fundamental principle that "Foreign exchange realized by basic organizations of associated labor shall belong to these organizations." Surrender requirements were therefore eliminated, and exporters were henceforth free to use their foreign exchange earnings or sell them on the foreign exchange market.

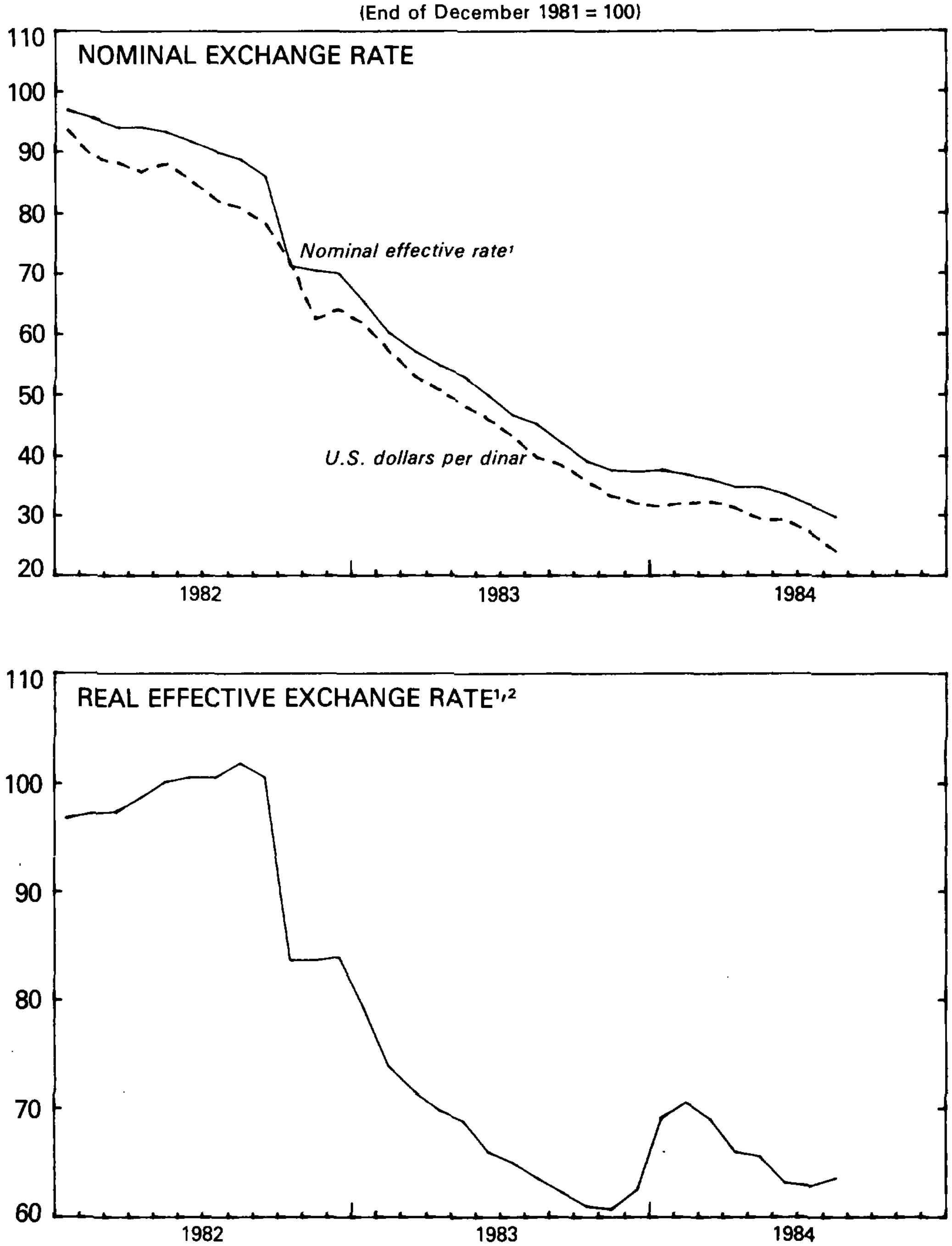
1/ A more detailed descripton of the Yugoslav foreign exchange allocation system is presented in Appendix VI, which summarizes the report of the Fund mission. The complete staff study of the foreign exchange allocation system is available to Executive Directors upon request.

CHART 3

YUGOSLAVIA

EXCHANGE RATE OF THE DINAR

(End of December 1981 = 100)



Sources: IMF, *International Financial Statistics*; and date provided by the National Bank of Yugoslavia.

[1] Effective exchange rate indices are based on the Yugoslav currency baskets utilized in the respective years.

[2] Relative producer prices adjusted for exchange rate changes.

Because of the deterioration in the overall balance of payments, 1/ in late 1979 the National Bank of Yugoslavia (NBY) sharply curtailed its sales of foreign exchange for authorized debt service and import payments on the inter-bank market; largely as a result, transactions between authorized banks in the inter-bank foreign exchange market declined by 85 percent between 1979 and 1982. The growing foreign exchange crisis led to severe debt servicing problems for a number of Yugoslav enterprises and banks, and in May 1982 the Federal Assembly enacted temporary measures placing priority on debt repayment in the use of foreign exchange. 2/ At the same time, a formal surrender requirement of export earnings to the NBY was reinstituted equal to 58.8 percent of total foreign exchange receipts. These developments strengthened the link between foreign exchange earnings and import availability at the enterprise level and contributed importantly to the compression of imports from the convertible currency area observed from 1981.

In December 1982, the law governing the foreign exchange allocation system was amended to codify a number of the temporary regulations which had been adopted in May 1982, as well as to add a number of new provisions. In general, the changes had the effect of replacing the previous emphasis on regional balances of payments of the individual republics and autonomous provinces with a more centralized focus on the combined balance of payments of the Yugoslav federation.

Despite the changes which had been introduced in 1982-83, transactions in the foreign exchange market remained at a very low level. Largely in order to increase circulation of foreign exchange through the foreign exchange market, in December 1983 a second series of amendments to the law governing the foreign exchange allocation system was adopted. Foreign exchange entitlements--denoted socially verified reproduction needs (SVRN)--were to be established for each enterprise, in a manner consistent with the projections for the overall balance of payments. Each enterprise was required to surrender 54.1 percent of its foreign exchange receipts to the NBY and to the authorities in its republic or autonomous province. If the enterprise's SVRN was less than

1/ Following surpluses in 1976-78, there was a deficit in the overall balance of payments of US$1.3 billion in 1979.

2/ The legal framework governing repayment of external debt was strengthened by the enactment in July 1983 of the Law on Payments in Convertible Foreign Currencies. This "Law of Circles" mandated that in cases in which an individual enterprise had insufficient foreign exchange to meet its external debt obligations, all associated enterprises would be called upon to supply the necessary foreign exchange; if this were not sufficient, then claims would be made, successively, on: (i) members of the enterprise's bank; (ii) other authorized banks in the republic or autonomous province of the debtor enterprise; (iii) all social and legal persons in Yugoslavia, through an obligatory allocation of a portion of their foreign exchange receipts; and (iv) authorized banks in other republics and autonomous provinces.

the remaining 45.9 percent of foreign exchange receipts, it would be required to sell the excess amount to the foreign exchange market; conversely, if its SVRN exceeded its retention of foreign exchange, the enterprise would be entitled to purchase the difference from the foreign exchange market.

2. Operation of the foreign exchange allocation system in 1984

The separate studies carried out by the Yugoslav authorities and the Fund staff arrived at similar conclusions concerning the operation of the foreign exchange allocation system during the first half of 1984. Certain aspects of the system were in place and functioning as anticipated--notably, the repayment of external obligations and the funding of specified requirements (e.g., petroleum imports and imports of essential consumer goods) from the 54.1 percent of foreign exchange receipts surrendered to the NBY (and to the republics and provinces). However, the "narrow" foreign exchange market--in which net users of foreign exchange were to purchase foreign exchange on the basis of their SVRNs--was functioning only to a limited extent.

The two studies concluded that the underlying reason for the continued low level of transactions on the foreign exchange market was that entitlements to purchase foreign exchange had been calculated on an incorrect basis at the beginning of 1984. This was in turn due principally to two factors: (i) the growing importance of exports carried out under "one-to-one" trading arrangements and the incentives thereto within the system; and (ii) the treatment of commodity credits within the foreign exchange allocation system.

a. One-to-one trade

The Decision on a Common Foreign Exchange Policy in 1984 exempted a substantial portion of exports carried out under "special arrangements" --including border trade, countertrade and long-term cooperation agreements--from the requirement to surrender 54.1 percent of export receipts to the NBY and to sell "excess" foreign exchange receipts to the foreign exchange market. These exemptions from the surrender requirements were not taken into account, however, when SVRNs were determined at the beginning of 1984. Since the share of Yugoslav exports carried out under such trading relationships during the first half of 1984 is estimated to have been as high as 40 percent, sales of foreign exchange to the market--by enterprises with SVRNs of less than 45.9 percent of projected export earnings--were far smaller than anticipated.

b. Commodity credits

When enterprises' entitlements to foreign exchange (SVRNs) were established at the beginning of 1984, the projected use of foreign commodity credits had been taken into account as one of the major sources of foreign exchange. 1/ Enterprises which made use of such credits on a net basis for the year--i.e., for which repayment was not due in 1984--should, in principle, have had their foreign exchange entitlements (SVRNs) reduced commensurately; otherwise, they would have effectively increased their entitlements to import at the expense of other enterprises which had been given rights to purchase foreign exchange from the market as part of their SVRNs. Under the system in operation during the first half of 1984, however, no such adjustments to borrowing enterprises' SVRNs were made.

3. Measures introduced by Yugoslav authorities

a. One-to-one trade

The Federal Executive Council (FEC) is currently considering a proposal to reduce SVRNs (i.e., retention and/or purchase rights) of enterprises which engage in one-to-one trading transactions, and approval is expected before the end of September. 2/

b. Commodity credits

In July 1984, the Yugoslav Community of Interest for Foreign Economic Relations adopted a measure requiring that SVRNs of enterprises making use of commodity credits be adjusted, so that the overall sum of SVRNs would remain consistent with the projected inflow of foreign exchange. As currently implemented, the measure gives enterprises the option of having the reduction take place either at the time of import or on the date of repayment of the credit. A serious problem still remains, therefore, for commodity credits which are not due until 1985, since, under the current regulations, there is no requirement that SVRNs be reduced in the course of 1984. The foreign exchange authorities are aware of this problem and have recommended to the FEC that it adopt an emergency regulation requiring such a reduction in 1984; the FEC is expected to act favorably on this proposal in September.

For commodity credits which are repayable in 1984, the authorities have acknowledged that the new procedures would be likely still to delay the flow of foreign exchange to the market, since users of credits would

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1/ At the beginning of 1984, foreign supplier credits for raw materials and intermediate inputs had been projected to be about US$700 million.

2/ In addition, the Federal Assembly is currently considering an amendment to the Decision on a Common Foreign Exchange Policy in 1984 to enforce compliance with the limit of 15 percent of border trade transactions with any one country; pending approval of these changes, in May the FEC adopted a temporary measure stipulating that whenever the 15 percent limit on border trade with a country was reached, each participant in that border trade would be required to surrender to the NBY foreign exchange equal to 44.1 pecent of the value of its exports.

initially be given an over-entitlement to foreign exchange which would be eliminated only gradually over the course of the year. In their view, however, this was necessary in order to provide a sufficient incentive for enterprises to use commodity credits.

c. Debt rescheduling

In July 1984, a reduction in the debt service component of enterprises' SVRNs was implemented in order to take into account the rescheduling of fixed and guaranteed obligations in 1984.

4. Outlook

As important modifications to the system are in the process of implementation, it appears unlikely, in the view of the staff, that significant improvement in the operation of the foreign exchange market can be expected during the remainder of 1984. The staff shared the view expressed by the Yugoslav authorities that, if the present system were to operate as intended, it was essential to ensure that the necessary mechanisms were fully in place from the beginning of 1985.

V. Performance criteria

The performance criteria remain as in the original program. Compliance with the criteria for the first half of 1984 is reviewed below. 1/

1. The lifting of the price freeze on May 1, 1984

The price freeze was lifted on May 3, 1984 (May 1 and 2 were legal holidays in Yugoslavia), and the share of output free of price control was expanded from 45 percent to 55 percent as stipulated in the letter of intent, but price increases for about 25 percentage points of this category were made subject to a new 30-day advance notification requirement. The Government later decided to abolish this requirement no later than August 31, 1984. On June 6, 1984, the Fund granted a waiver for the temporary maintenance of this regulation (EBM/84/87) and made the second purchase under the stand-by arrangement subject to its abolition. On August 31, 1984 the Government published its decision to abolish the 30-day advance notification rule for goods in the liberalized category with effect from September 1, 1984. Some small adjustments were made to other price regulations at the same time. Following this decision, 7 1/2 percent of prices in the industrial producer price index are directly controlled, 55 1/2 percent are fully

1/ The quantitative criteria are set out in Table 12.

liberalized, 1/ and 37 percent are subject to limited price control (33 percent determined according to self-management agreements and 4 percent subject to a 30-day advance notification requirement). This compares with 10 percent, 45 percent and 45 percent, respectively, before the latest price freeze.

2. Adjustment of administered prices

The adjusted electric power price index for April 1984 was about 10 percent above that required to meet the target in the letter of intent. This was achieved by keeping the winter tariffs in effect through the summer. Similarly, railway tariffs were increased in early June by more than required under the stand-by arrangement. Freight rates were increased by 28 percent and passenger fares by 20 percent for an average of about 26 percent compared with a program minimum of 9 percent. Also, prices for crude oil and petroleum products were increased in early June and prices for natural gas in early July by significantly more than called for according to the letter of intent. In the future, prices for these products will be adjusted at least quarterly by the percentage increase in the dinar/U.S. dollar exchange rate and increases in international prices for these products. In addition, a combined increase in these two indicators of more than 5 percent since the latest adjustment, will automatically trigger a commensurate increase in the corresponding domestic prices.

3. Monthly adjustments of nominal exchange rates to reach and hold a specified real rate of exchange

The index of the real effective exchange rate of the dinar, with end-December 1983 = 100, had reached 110.3 in January 1984. By the end of April, it had been reduced to 105.4 and by the end of June to 101.1, with both figures being slightly below those (105.8 and 101.3, respectively) stipulated in the letter intent. The rates for July and August have also been below the target of 101.3.

4. Limit on payments from Joint Reserve Funds

The permissible increase in payments out of Joint Reserve Funds in the first half of 1984 was 27.4 percent (one half of the percentage increase in the retail price index in the period October 1983-March 1984 compared with the same period one year earlier). The actual increase was 25.6 percent.

1/ Included in this category are prices of petroleum products which are not, strictly speaking, fully liberalized, but which are adjusted in line with world market prices (see section V.2 below).

5. Quarterly schedule of increases in interest rates on bank deposits to raise them to real positive levels

According to the agreed formula, interest rates on three-month deposits were increased from 12 percent to 30 percent on May 1, 1984. On July 1, 1984 these rates were increased further to 34 percent. No change was required in the interest rates of the National Bank of Yugoslavia on May 1, but on July 1 the discount rate was increased from 30 to 34 percent and interest rates for selective credits were increased by 3 percentage points as stipulated by the stand-by arrangement.

6. Quarterly ceilings on net domestic assets of the banking system

As shown in Table 12, net domestic assets for the first half of the year were well below the prescribed limits.

7. Limits on the growth in total public sector revenue

The permissible increase in public sector revenue for the first half of 1984 was 46.6 percent (85 percent of the increase in the retail price index in the period October 1983-March 1984 compared with the same period one year earlier). However, public sector revenue exceeded the limit by Din 19.4 billion or 3.8 percentage points. On the basis of EBS/84/185, 8/28/84 the Executive Board decided on August 31, 1984 (on a lapse of time basis) to grant a waiver for the breach of this performance criterion in view of the measures already taken by the authorities to bring the growth of revenue back on track.

8. Minimum increase in the public sector's net assets with the banking system

As shown in Table 12, net assets of the public sector with the banking system exceeded the floor by a significant margin at the end of June. The increase in such assets during the first half of the year exceeded that stipulated for the year as a whole.

9. Ceiling on a new external borrowing

As shown in table 12, new external borrowing for the first seven months of 1984 was well within the limits stipulated in the program.

10. Phased increase in the external reserves of the banking system

As shown in table 12 external reserves exceeded the minimum required at the end of June by more than US$300 million.

11. Other performance criteria

There was no intensification of trade and payments restrictions during the first half of the year. Yugoslavia maintains only one restriction subject to Article VIII relating to the availability of foreign exchange for travel. This restriction takes the form of a limitation on the export and import of dinars for travel of Din 1,500 per person for the first trip and Din 200 per person for each subsequent trip within one year. A decision by the National Bank of Yugoslavia to raise these limits to Din 2,500 and Din 500, respectively, will take effect in October, 1984. The Yugoslav authorities feel that this remains necessary for the time being in order to reduce illegal currency transactions.

Finally, in accordance with Decision No. 7678-(84/62) (April 20, 1984) paragraph 4.f of the stand-by arrangement is amended to bar any purchases under the arrangement while Yugoslavia has any overdue financial obligations to the Fund. Yugoslavia has always been current on its repurchase obligations; this modification is made solely to bring the stand-by arrangement into conformity with this decision.

12. Undertakings

In addition to the performance criteria mentioned above, the stand-by arrangement also comprised understandings on limiting personal income payments by loss-making and illiquid enterprises and on reductions in export subsidies. The reductions in export subsidies were planned to begin only at the end of September. The staff was assured that the necessary preparation for effecting this was under way. The legislation required to limit personal income payments by loss-making and illiquid enterprises was passed in April. For the country as a whole, the permissible increase in personal income payments by loss-making enterprises in the first half of 1984 was 30.9 percent and the actual increase was 24.7 percent. However, in three of the regions actual payments exceeded the limits by small amounts (2-3 percentage points). As agreed, the limitation on income payments by illiquid enterprises went into effect on July 1.

As described in Section IV, the staff conducted a study of the foreign exchange allocation system during the first half of the year, with the assistance of consultants from the World Bank and a commercial bank.

VI. Staff Appraisal

Developments in most sectors of the Yugoslav economy during the first seven months of 1984 have generally been as anticipated under the program. Moreover, with the exception of the process chosen to lift the price freeze and some delay in implementing revenue-reducing measures in the public sector--for both of which waivers were granted--policies have generally been implemented as expected under the stand-by arrangement. All performance criteria other than those relating to the factors noted above have been observed. In certain areas, notably related to personal income payments, measures adopted by the authorities have been more stringent than those foreseen in the program. Notwithstanding these promising developments, the current situation is not without its concerns, especially as regards the near term prospects for inflation.

A major aim of the current program is to consolidate the improvement in the external current account in convertible currencies that began in 1983 and, at the same time, to reverse the sharp deterioration which had occurred in the short term capital account (including errors and omissions). Progress is evident on both fronts. A surplus was recorded on the current account with the convertible currency area during January-July 1984 and, during the same period, net outflows on short-term capital account and under errors and omissions were negligible. In contrast to an expected seasonal decline, international reserves increased by US$130 million over this period. Movements in the total balance of payments (i.e., including accounts with the nonconvertible area) show similar trends.

The improvement in the external accounts has occurred with no further compression of imports. The increase in industrial production of more than 5 percent in the first seven months of 1984 compared with the same period one year earlier seems partly attributable to the improved availability of raw materials and intermediate goods imports. Global export performance has been somewhat below expectations, but this has reflected special factors. Adjusting for such factors, export performance is roughly as forecast, with especially large gains made in shipments to the industrial countries. While data for June and preliminary figures for August show a worrisome tendency for these export trends to weaken, it is too early to determine whether this represents anything other than a temporary deviation.

While the pickup in activity in partner countries is partly responsible for the improved export performance--as is some continued, albeit small, diversion of exports from the nonconvertible area--exchange rate policy appears to have played a major role. As intended under the program, the real appreciation of the dinar which occurred in late 1983 and early 1984 has been reversed. By the end of June, the targeted real depreciation of the dinar of 25 percent from its level in early 1983 was achieved and has since been maintained by frequent adjustments in the nominal exchange rate. Developments thus far appear to support the rationale for this adjustment in the real level of the dinar. Nevertheless, exchange rate policy will have to be kept under review both to ensure the sufficiency of the adjustment in light of the faltering of exports in recent months and the uncertainty over the special factors affecting export performance and to avoid any unnecessary inflationary pressure arising from this source.

A major element of this year's program, partly directed to a reversal of outflows in the balance of payments, has been a sharp increase in interest rates paid on bank deposits. Rates on three month deposits were raised from 12 percent to 30 percent on May 1 and to 34 percent on July 1. The adjustment formula incorporated into the program calls for a further increase to 47 percent on October 1. Interest rates on longer-term deposits are from 5 to 8 percentage points higher. While interest rates are still negative in real terms, the increases in nominal rates appear to be having the desired effect. While much of the reversal in short term capital flows and errors and omissions in the balance of payments is attributable to special factors, some of the change appears to have been influenced by interest rate policy. Domestically, the anticipated shift in the structure of bank deposits is beginning to appear; real dinar deposits of households have increased, for example, as their foreign currency deposits have declined.

The impact of interest rate policy on financial savings is difficult to judge because of the practice of crediting interest to deposit accounts only at the end of the year. Intra-year monetary movements are also clouded by this practice. The staff has made rough adjustments to the published series for deposits and money on the basis of preliminary estimates of interest payable on deposit balances provided by the authorities. On the basis of these data, credit and monetary policy can be seen to have been carried out generally in line with the program.

Fundamental to the success of many elements of the current program was a presumption of a high degree of price flexibility. The interest rate and exchange rate adjustments, among others, are tied directly to movements in price indices. In early May, the authorities lifted the price freeze which had been imposed at the turn of the year but at the same time instituted a 30 day prior-notice requirement on certain prices which it had been understood would be fully liberalized. The authorities explained that their motivation in this regard was to avoid a sudden surge in prices immediately upon relaxation of the freeze. This seems to have been the effect, with prices recording only modest increases in May and June but accelerating to 8.8 percent (for industrial producer prices) in July. Inflation fell back significantly in August but could increase again in September or October as the 30 day requirement was finally lifted on September 1 and as scheduled changes in certain administered prices are reflected in the indices.

A relatively high level of inflation was anticipated in the program and, notwithstanding the staff's reservations on the delayed process by which the freeze was lifted, developments to date are generally in accord with those expectations. In this light, and in view of the modest revisions to projections in the real and external sectors of the economy, the monetary program initially established was judged during this mid-term review to be appropriate for the remainder of the year. Monetary growth had lagged behind the program estimates for the first six months of the year; but so had inflation as a result of the price freeze and the process chosen to relax it. Under the program, broad money can expand at a maximum rate of about 35 percent during the second half of the year. This rate is deemed appropriate to restrain price increases beyond those inevitably associated with the relaxation of the price freeze.

The authorities' concern over inflation is reflected in the measures recently adopted or currently being discussed to assure some control over price developments. While the authorities indicated that no action under these arrangements would be taken against producers or retailers dealing in products with "liberalized" prices, this tendency toward administrative price control is a matter of some concern. To the extent that speculative stocking is taking place--and there is a good deal of evidence that this is the case--the staff recommended an acceleration of the adjustment in nominal interest rates above that called for by the formula incorporated into the program to induce release of these stocks. In this connection, it is important as well not to diminish the attractiveness of high bank deposit rates, especially to enterprises, through restrictive administrative impediments.

Under the program, measures were taken to limit the growth of public sector revenue. Combined with a minimum increase in net claims of the public sector on the banking system, these measures were aimed at reducing public expenditures. At the same time, however, the measures were meant to ensure a release of resources, especially to the enterprise sector. While expenditure has been controlled as intended, there has been some delay in implementing reductions in tax and contribution rates entailing a consequent delay in the unburdening of the enterprise sector. A full review of the revenue projections is to be made in September and the staff advised action at the earliest possible date to set revenue growth on the appropriate path if it was found to be excessive. The limits placed on transfers from the Joint Reserve Funds--payments from which can have the impact of delaying adjustment in loss-making enterprises--have been met and the accumulation of large balances in these funds should now permit a reduction in enterprise contributions, further encouraging adjustment in favor of the external sector.

The limits placed on payments of personal income by loss-making and illiquid enterprises were generally observed in the first half of 1984, notwithstanding some delay in securing approval for the necessary legislation. Evidence on the impact of these measures at this point is, at best, sketchy. Reportedly, the number of enterprises in arrears to other work organizations has declined and the growth of interenterprise credit has slowed. However, judgments on the effectiveness of these measures in encouraging mobility of resources or in altering the structure of production must await more detailed data.

Real personal incomes in the socialized sector fell in the first half of 1984, following four consecutive years of decline. One counterpart of this was an increase in the share of income retained by enterprises, a welcome development in light of the need to increase domestic savings. The sharp decline in wage income in the socialized sector over the past four years needs to be seen against the background of a far more modest decline in real disposable household income. The latter pattern is reflected as well in the modest declines in real consumer spending with little change in the savings ratio. These trends are thought to have continued into 1984. The already substantial declines in real income suggest that the scope for adjustment through this mechanism may be reaching its limit, making even more imperative full implementation of those elements of the program aimed at an improved allocation of resources and increased production.

As provided for in the letter of intent, two studies of the foreign exchange allocation system have been conducted, one by the authorities and one by the staff. Both studies concentrated on the operational problems which had arisen in the present system and possible solutions to them.

In the interim between presentation of the staff's tentative conclusions in June and discussions on the basis of the two reports in early September, the authorities took several measures to correct certain inconsistencies in the system; other measures were under discussion at the time of the mid-term review with implementation expected before the end of September. All of the major problems identified are addressed by these measures. While differing somewhat regarding the specific solutions chosen, the staff could generally support the measures proposed or already adopted. The authorities indicated that modification of the system would be a virtually continuous exercise, with quarterly reports on its operation required to be submitted by the Federal Secretariat for Finance.

The staff has not at this stage endorsed the present system. Rather, the system is seen as, at best, an expedient solution for managing foreign exchange through the recent period of severe scarcity. Nevertheless, since the system appeared to have the potential to foster the development of a limited foreign exchange market which could serve as a transitional mechanism to a more liberal market system at a later date, efforts have been concentrated on identifying and correcting the problems which have prevented the system from operating as envisaged. The staff stressed the need to have a fully workable system in place before foreign exchange entitlements are established for 1985. The minimal evidence that the system is working will be the emergence of foreign exchange transactions to satisfy the entitlements to purchase foreign exchange in the market. That is the base upon which further transition mechanisms can be forged within the current system to move toward the authorities' aim of a convertible dinar. If a market does not emerge on the basis of the measures recently adopted or now envisaged, a fundamental review of the system would be necessary.

In light of the foregoing, the following draft decision is proposed for adoption by the Executive Board:

1. Yugoslavia has consulted with the Fund in accordance with paragraph 24 of the stand-by arrangement for Yugoslavia (EBS/84/65, Supplement 1, April 19, 1984), and the letters from the Governor of the National Bank of Yugoslavia and the Federal Secretary for Finance, annexed to the stand-by arrangement, dated March 20, 1984 and May 25, 1984, in order to reach understandings with the Fund regarding policies and measures which Yugoslavia will pursue through April 17, 1985.

2. The Fund finds that the contemplated review is completed, and that no additional understandings are necessary regarding circumstances in which purchases may be made by Yugoslavia under the stand-by arrangement.

3. The approval under Decision No. 7635-(84/27), 2/17/84 of Yugoslavia's restriction on the availability of foreign exchange for tourist travel is extended until the completion of the next Article IV consultation with Yugoslavia or until April 30, 1985, whichever is earlier.

4. Paragraph 4.f of the stand-by arrangement for Yugoslavia (EBS/84/65, Supplement 1) shall be amended to read as follows:

"During the entire period of this stand-by arrangement, while Yugoslavia has any overdue financial obligation to the Fund, or if Yugoslavia..."

Table 1. Yugoslavia: Selected Economic and Financial Indicators, 1981-84

	1981	1982		1983			1984		
	Actual	Program	Actual	Original program EBS/83/46	Revised program EBS/83/141	Actual	Program	Revised staff forecast	Latest available data 11/
	(Annual percentage changes, unless otherwise specified)								
National income, prices, and costs:									
GSP at constant prices	2	2 1/2	--	-2 1/2	-2 1/2	-1 1/2	1/2	1/2	--
Final domestic demand	-4 1/2	-2	-2	-4	-4	-3 1/2	-1/2	-3	-3 1/2
GSP deflator	40 1/2	20	34 1/2	31	35	40	60	65	...
Retail prices 1/	39	15	31	30	36	58 1/2	50	60	60
External sector (convertible currency area)									
Export volume	-7	12	-7	8	6	13 1/2	9 1/2	9	9
Import volume	-15	1	-16	-9	-7	-11	5 1/2	2	-1/2
Terms of trade (deterioration-)	-1 1/2	--	6	--	--	--	--	-1 1/2	1
Nominal effective exchange rate (depreciation-) 2/	-23	3/	-30	...	...	-46 1/2	...	...	-21
Real effective exchange rate (depreciation-) 2/	-2	3/	-15	-24	-30	-25 1/2	1	1	1
Federal government									
Total revenue	51	24	21	24	23	31 1/2	43	43	52
Total expenditure	29	21	18 1/2	25	24 1/2	32	43	42	53
Money and credit									
Net domestic assets 1/ 4/	23	16 1/2	17	11 3/4	11 1/2	10 3/4	17 1/2	17 1/2	7
Money (M1) 1/	27	17	26 1/2	12	11	20	25	25	32
Broad money (M2) 1/	31	...	32	...	31	37 1/2	50	50	32 1/2
Velocity (GSP relative to M1)	12	2	4	14 1/2	18	12	28 1/2	31	...
Interest rate (annual rate, one year savings deposit)	9	5/	6/	18 7/	8/	18 9/	10/	10/	39
	(In percent of GSP)								
Public sector expenditure	35	35	33 1/2	34	34	32 1/2	29 1/2	26	...
Federal government expenditure	7 1/2	7	6 1/2	7	7	6 1/2	6	5 1/2	...
Federal government deficit	--	--	--	--	--	--	--	--	...
Gross fixed investment	31	28	29	28	25	25 1/2	24	23	...
Money (M1); end of period	26 1/2	26	25	24	21	22	17	16 1/2	...
Convertible current account balance	-3	-1	-2 1/2	-1	-1 1/2	1/2	1	1	...
External convertible currency debt; end of period	29	...	32	...	...	44	...	46	...
	(Other ratios and data)								
External debt service ratio, convertible currencies, in percent of exports of goods and services (remittances net)	31	30	34	41	42	40	42	43	...
Of which:									
Interest payments, in percent of exports	16	15 1/2	18	16 1/2	17	15	15 1/2	16	...
Gross official reserves (weeks of convertible merchandise imports)	13	13	10	14	9	10	13	14	...
Overall balance of payments with convertible currency area (in millions of U.S. dollars)	-435	-592	-1,575	207	-499	-465	500	500	166

Sources: Data provided by the Yugoslav authorities; and staff estimates.

1/ Twelve-monthly change to end of period.

2/ End of year over end of preceding year; Yugoslav official currency basket.

3/ The nominal exchange rate was to be adjusted in line with the differential between Yugoslav cost and price inflation and that in trading partner countries.

4/ Stand-by definition; for 1981 and 1982, refers to domestic credit.

5/ The interest rate on bank deposits of households of one year's maturity was increased to 11 percent in March 1982. Interest rates were to be reviewed against the background of price developments and prospects in mid-1982.

6/ The interest rate on one-year saving deposits was increased further to 13 percent on October 1, 1982.

7/ The interest rate on one-year deposits of households was raised to 18 percent in February.

8/ The interest rate on one-year deposits of households was to be raised to 24 percent before the end of 1983.

9/ The interest rate increase to 24 percent was not implemented.

10/ Interest rate is to be increased in five steps beginning May 1, 1984 to reach positive real levels by April 1, 1985.

11/ Based on GSP and monetary data through the first half of 1984; the interest rate as of July 1, 1984; retail prices and exchange rate data through August 1984; other external data and fiscal data through July 1984.

Table 2. Yugoslavia: Social Product Accounts 1/

	1983		1981	1982	1983	1984		
	In billions of dinars	Percent of total				Official forecast		Staff forecast
						Plan	Revised	
			In 1982 prices; percent change					
Private consumption	2,100.0	51.5	-1.0	-0.1	-0.6	0.7	--	-1.0
Public consumption	351.9	8.6	-2.9	1.0	1.0	-1.1	1.0	1.0
Gross fixed investment	1,035.4	25.4	-9.8	-5.7	-10.2	-10.7	-8.0	-8.0
Final domestic demand	3,487.3	85.5	-4.3	-1.9	-3.6	-2.8	-2.3	-2.9
Stockbuilding 2/	576.3	14.1	3.0	-0.1	0.6	1.3	2.1	2.1
Total domestic demand	4,063.6	99.6	-1.1	-1.7	-2.6	-1.1	0.2	-0.3
Exports of goods and nonfactor services	1,251.0	30.7	-0.1	-11.0	-0.6	12.6	6.1	6.7
Of which: goods	(923.0)	(22.6)	(4.5)	(-8.9)	(-0.1)	(...)	(8.4)	(7.7)
Imports of goods and nonfactor services	1,241.6	30.4	-12.2	-13.4	-5.5	2.9	1.8	3.7
Of which: goods	(1,131.6)	(27.7)	(-12.2)	(-13.9)	(-4.7)	(...)	(0.4)	(2.6)
Foreign balance 2/	9.4	0.2	3.9	0.9	1.2	2.4	1.3	0.9
Gross social product, demand-side estimate	4,073.0	99.9	2.7	-0.9	-1.4	1.4	1.5	0.6
Statistical discrepancy 2/	10.5	0.3	-1.3	1.6	0.1	0.7	1.0	--
GSP, production estimate	4,083.5	100.1	1.4	0.7	-1.3	2.0	2.5	0.6
GSP (average estimate) 1/	4,078.3	100.0	2.1	-0.1	-1.4	1.7	2.0	0.6

Sources: Data provided by the Yugoslav authorities; and staff estimates.

1/ GSP estimated by staff as the arithmetic average of demand and production estimates; official estimates and forecasts are based on production data.
2/ Change in percent of preceding year's GSP at constant prices.

Table 3. Yugoslavia: Income and Outlays of the Household Sector

	1980	1981	1982	1983	1980	1981	1982	1983
	In billions of dinars				Percentage change			
Personal income from employment (gross)	966.7	1,326.5	1,733.4	2,295.3	25.7	37.2	30.7	32.4
Income from collective consumption funds	32.5	34.1	45.5	58.4	41.3	4.9	33.4	28.4
Net interest income 1/	21.9	29.3	43.8	85.8	31.1	33.8	49.5	95.9
Social security, related transfers	158.5	209.1	284.5	377.5	24.6	31.9	36.1	32.7
Transfers from abroad	110.8	187.9	244.7	363.6	68.1	69.6	30.2	48.6
Other transfers and receipts	8.8	12.9	18.0	23.9	25.7	46.6	39.5	32.8
Total household income	1,299.2	1,799.8	2,369.9	3,204.5	28.8	38.5	31.7	35.2
Taxes, contributions, etc.	281.9	330.0	432.0	566.1	25.4	17.1	30.9	31.0
Disposable household income	1,017.3	1,469.8	1,937.9	2,638.4	29.8	44.5	31.8	36.1
Consumption	878.2	1,218.7	1,607.3	2,230.2	31.1	38.8	31.9	38.8
Expenditure on gross social product 2/	818.8	1,143.3	1,510.7	2,100.0	31.6	39.6	32.1	39.0
Expenditure on nonproductive services	59.4	75.4	96.6	130.2	24.5	26.9	28.1	34.8
Saving	139.1	251.1	330.6	408.2	22.1	80.5	31.7	23.5
Housing, other fixed investment	71.8	101.3	135.6	161.4	26.2	41.1	33.9	19.0
Financial saving	67.3	149.8	195.0	246.8	18.7	122.6	30.2	26.6
Memorandum items								
Household saving ratio (in percent)	(13.7)	(17.1)	(17.1)	(15.5)				
Cost of living index					30.3	40.7	31.7	40.5
Real personal income from employment					-3.5	-2.5	-0.8	-5.8
Real disposable income					-0.4	2.7	0.1	-3.1
Valuation gain in foreign currency deposit accounts 3/	59.8	61.9	142.7	392.6				

Sources: Federal Statistical Office, Statistical Yearbook; and data provided by the Yugoslav authorities.

1/ Excluding income from revaluation of foreign currency deposits in banks, owing to exchange rate changes.
2/ Private consumption in Table 2.
3/ Estimated on the basis of changes in the Din/DM exchange rate in the course of each year.

Table 4. Yugoslavia: Domestic Price Developments

	Weights in 1982	1981	1982	1983	1984 Jan.-August	1981 Dec.	1982 Dec.	1983 Dec.	1984 Mar.	1984 June	1984 August
	In percent	Percentage change from one year earlier									
Industrial producer prices	100.0	44.7	25.0	32.0	56.4	37.4	24.7	55.0	55.4	50.4	61.0
Investment goods	10.1	25.0	15.8	22.1	38.4	18.7	17.9	29.9	34.6	35.0	46.8
Intermediate goods	54.0	47.1	27.1	33.9	61.5	40.8	26.2	61.4	62.5	53.8	66.6
Consumer goods	35.9	42.9	24.8	31.7	53.3	38.3	24.6	52.2	49.8	49.0	55.5
Retail prices	100.0	46.0	29.5	39.1	57.0	39.3	30.7	58.4	55.9	56.7	59.9
Of which:											
Agricultural products	5.1	39.2	43.8	44.1	42.3	36.0	44.7	54.0	38.6	44.8	41.0
Manufactures	79.7	49.4	28.6	39.3	62.0	41.5	30.0	59.9	61.2	61.1	66.2
Services	9.0	29.2	20.3	29.7	40.7	27.0	19.7	50.0	41.6	33.0	42.4
Cost of living	100.0	40.7	31.7	40.9	54.6	36.2	32.7	60.1	53.0	54.3	56.3
Of which:											
Food	42.9	42.9	38.8	44.9	51.3	38.0	40.1	63.2	49.5	50.7	50.2
Clothing	12.5	37.5	35.2	40.6	61.2	37.6	36.1	51.7	56.6	65.6	67.5
Rent	2.7	29.9	18.0	34.4	34.1	34.6	18.1	45.6	44.0	22.1	35.8
GSP deflator	...	40.4	34.4	40.2							

Sources: Federal Statistical Office, Indeks; and data provided by the Yugoslav authorities.

Table 5. Yugoslavia: Export Unit Values Relative to Domestic Producer Prices, by Commodity Group

Industrial Branch	Percent of Total Exports in 1981	1975	1981	1982	1983
		(1981 = 100)			
Coal	0.3	40.0	100.0	127.5	166.6
Processed coal products	0.1	63.1	100.0	121.0	164.2
Petroleum products	1.4	67.7	100.0	102.8	121.4
Ferrous metals	2.4	125.2	100.0	107.6	119.4
Nonferrous metal ores	0.2	77.5	100.0	115.5	146.9
Nonferrous basic metals	1.9	69.7	100.0	104.8	148.2
Alloys of nonferrous metals	1.9	87.6	100.0	121.3	221.9
Nonmetallic minerals	0.1	122.3	100.0	111.4	150.5
Mineral manufactures	1.8	71.2	100.0	118.6	168.6
Fabricated metal products	6.6	63.4	100.0	124.8	184.6
Nonelectrical machinery	7.4	47.9	100.0	124.8	223.3
Transport equipment	7.3	62.6	100.0	144.7	216.2
Electrical machinery	9.5	60.1	100.0	142.3	229.4
Basic chemicals	6.3	68.1	100.0	100.3	120.6
Processed chemicals	7.4	84.0	100.0	113.1	200.6
Construction materials	0.5	82.3	100.0	122.9	134.8
Lumber products	2.9	93.0	100.0	146.9	230.5
Wood manufactures	5.0	67.4	100.0	166.0	235.6
Paper	1.8	87.6	100.0	112.6	154.5
Yarns, fabrics	2.9	68.7	100.0	115.9	163.1
Textile products	6.9	47.6	100.0	130.4	186.5
Leather, fur	0.3	85.7	100.0	104.1	127.7
Leather products	6.6	43.4	100.0	116.1	142.3
Rubber products	1.7	58.9	100.0	122.9	151.3
Food products	5.4	87.3	100.0	108.8	132.9
Beverages	1.0	91.8	100.0	148.1	206.4
Animal feeds	--	129.3	100.0	106.8	102.0
Tobacco products	1.2	97.9	100.0	113.3	142.0
Total industrial exports 1/	95.5	68.5	100.0	123.2	172.3

Sources: Federal Statistical Office, Statistical Yearbook and Saopstenje; and IMF, International Financial Statistics.

1/ This relative price index was 190.9 in December 1983, 187.9 in June 1984; it averaged 43.7 in the period 1961-65, 59.9 in 1966-70, and 68.6 in 1971-75.

Table 6. Yugoslavia: Nominal and Real Net Personal Income Per Worker in the Socialized Sector

		Net Personal Income Per Worker				Cost of Living	Real Net Personal Income Per Worker			
		Socialized sector		Of which: Productive sector			Socialized sector		Of which: Productive sector	
		Dinars per month	Percent change 1/	Dinars per month	Percent change 1/	1981=100	1981=100	Percent change 1/	1981=100	Percent change 1/
1979		6,113	20.5	5,928	20.7	54.7	113.4	--	111.9	0.1
1980		7,368	20.5	7,167	20.9	71.3	105.0	-7.4	104.0	-7.1
1981		9,846	33.6	9,675	35.0	100.0	100.0	-4.8	100.0	-3,8
1982		12,542	27.4	12,329	27.4	131.6	96.8	-3.2	96.9	-3.1
1983		15,858	26.4	15,638	26.8	185.4	86.9	-10.3	87.2	-10.0
1984	Jan.-May	19,778	39.5	19,549	40.0	251.2	80.0	-9.0	80.4	-8.7
1981	December	11,590	34.0	11,277	35.4	111.6	105.5	-1.4	104.4	-0.4
1982	December	14,284	23.2	13,900	23.3	148.2	97.9	-7.2	97.0	-7.2
1983	June	15,336	23.0	15,091	23.3	179.6	86.7	-10.0	86.8	-9.8
	December	19,463	36.3	18,900	36.0	237.1	83.4	-14.8	82.4	-15.0
1984	1st qtr.	19,098	39.3	18,889	39.8	246.3	78.8	-11.0	79.3	-10.7
	April	20,316	38.2	20,008	38.1	253.7	81.3	-7.7	82.9	-7.7
	May	21,290	41.1	21,082	42.2	263.0	82.2	-5.4	82.9	-4.9

Sources: Federal Statistical Office, Indeks; and data provided by the Yugoslav authorities.

1/ Change from corresponding period of preceding year.

Table 7. Yugoslavia: Budget of the Federation

(In billions of dinars)

	1980	1981	1982	1983		1984	
				Year	Jan.-July	Budget	Jan.-July
Revenue							
Customs duties and other import fees	20.7	26.2	28.3	44.6	20.2	83.8	34.8
Contributions from republics and provinces	38.5	63.8	80.4	97.4	50.6	130.6	73.4
General turnover and sales taxes	47.4	71.3	85.2	112.0	50.0	150.1	77.5
Other taxes	0.2	0.2	0.3	0.5	0.3	0.8	0.4
Nontax revenue	2.5	3.3	4.8	7.6	4.0	8.7	4.4
Total revenue	109.4	164.8	199.0	262.1	125.1	374.0	190.5
(Percent change)	(16.9)	(50.7)	(20.8)	(31.7)	(...)	(42.7)	(52.3)
Expenditure							
Administration	18.6	21.9	26.0	33.2	19.0	41.6	26.2
Defense	76.1	99.8	118.2	154.6	66.5	233.9	109.9
Grants to republics and provinces	14.3	16.6	20.8	24.8	13.5	29.7	18.8
Grants to funds and communities of interest	18.7	24.8	29.8	43.7	25.1	60.0	35.0
Investment	0.8	0.9	0.4	1.3	0.6	1.8	0.9
Other or discrepancy	1.2	3.7	1.5	2.6	0.8	2.8	0.9
Total expenditure	129.7	167.1	196.7	260.2	125.5	369.8	191.7
(Percent change)	(33.3)	(28.8)	(17.7)	(32.3)	(...)	(42.1)	(52.7)
Surplus or deficit	-20.3	-2.3	2.3	1.9	-0.4	4.2	-1.2
(As a percentage of GSP)	(-1.3)	(-0.1)	(0.1)	(--)	(...)	(0.1)	(...)

Source: Data supplied by the Yugoslav authorities.

Table 8. Yugoslavia: Public Sector Revenue

	Revenue for General Consumption							
	Budgets							
	Federation	Republics, provinces	Local governments	Community of Interest for Foreign Economic Relations 1/	Other	Total 2/	Revenue for Collective Consumption 3/	Public Sector Revenue
	(In billions of dinars)							
1979	58.9	68.5	35.8	24.9	3.4	191.5	233.8	425.3
1980	66.9	89.4	44.5	27.7	2.7	231.2	292.0	523.2
1981	95.2	129.3	57.1	33.6	5.6	320.8	386.6	707.4
1982	117.0	151.8	73.6	40.6	8.9	391.8	499.8	891.7
1983	161.2	197.3	87.5	75.0	8.6	529.6	643.0	1,172.6
1984								
January-March	52.9	59.4	23.4	29.0	3.0	167.8	196.3	364.1
January-June	108.3	123.1	53.0	52.5	5.4	342.2	415.6	757.8
January-July	129.1	146.4	63.2	60.6	7.1	406.2	493.2	899.4
	(Percentage change from year earlier)							
1980	13.6	30.6	24.3	11.2	-21.6	20.7	24.9	23.0
1981	42.3	44.6	28.3	21.3	107.4	38.7	32.4	35.2
1982	22.9	17.4	28.9	20.9	58.5	22.1	29.3	26.0
1983	37.7	30.0	18.9	84.5	-2.8	35.2	28.6	31.5
1984								
January-March	54.2	49.4	38.5	155.8	-19.0	58.2	47.8	52.4
January-June	57.7	46.6	40.6	106.2	-26.0	53.4	48.1	50.4
January-July	54.2	42.7	39.1	99.4	-29.0	49.4	47.9	48.6

Sources: Social Accounting Service, Statistical Bulletin and Saopstenje.

1/ Revenue comprises customs duties and other taxes on imports, earmarked for payments to export producers.
2/ Equal to total revenue of sociopolitical communities, for government administration, defense, the judiciary, etc.
3/ Revenue of communities of interest for collective consumption (health, education, culture, social welfare, etc.).

Table 9. Yugoslavia: Monetary Survey

(In billions of dinars)

	1980	1981	1982	1983				1984	
	Dec.	Dec.	Dec.	March	June	Sept.	Dec.	March	June
Money supply (M1)	461.6	584.3	739.8	747.3	764.4	833.6	888.6	943.8	1,007.0
Quasi-money	768.7	1,030.0	1,386.7	1,568.5	1,677.7	1,808.0	2,038.7	2,144.8	2,233.7
Of which:									
Foreign exchange deposits	(318.7)	(466.6)	(671.7)	(821.7)	(917.5)	(1,069.5)	(1,250.6)	(1,286.6)	(1,356.9)
Broad money (M2)	1,230.3	1,614.3	2,126.5	2,315.8	2,442.1	2,641.6	2,927.3	3,088.6	3,240.7
Net foreign assets	-254.3	-375.1	-587.9	-688.6	-856.6	-1,003.8	-1,197.3	-1,223.8	-1,473.8
Net domestic assets	1,484.8	1,989.4	2,714.4	3,004.4	3,298.7	3,645.4	4,124.6	4,312.4	4,714.5
Other items, net	-83.5	61.6	345.2	486.0	645.6	814.1	948.6 1/	976.0	1,107.5
Domestic credit	1,568.3	1,927.8	2,369.2	2,518.4	2,653.1	2,831.3	3,176.0 1/	3,336.4	3,607.0
	(Percentage change from previous year)								
Memorandum items:									
M1	23.0	26.6	26.6	25.9	24.0	25.4	20.1	26.3	31.7
M2	33.6	26.6	31.7	35.2	37.7	40.9	37.7	33.4	32.7

Source: National Bank of Yugoslavia.

1/ The definition of domestic credit was changed at the end of 1983, the main change being that some short-term foreign exchange credits which had previously been included in "other items, net" were moved to domestic credit. Figures for domestic credit and for "other items, net" are therefore not comparable with figures before December 1983.

Table 10. Yugoslavia: Actual and Projected
Net Domestic Assets of the Banking System

(In billions of dinars)

	1983 Dec. 3/	1984 June	1984 June	1984 Sept.	1984 Dec.
	Actual		Agreed program		
1. Net foreign liabilities 1/	1,198	1,208	1,252	1,252	1,252
2. Broad money (M2) 1/ 2/	2,740	2,874	2,990	3,158	3,381
Of which:					
Foreign exchange deposits 1/	(1,251)	(1,213)	(1,251)	(1,251)	(1,251)
3. Net domestic assets (1+2) 1/	3,938	4,082	4,242	4,410	4,633
4. Other items, net 1/	948	805		948	948
	948				
5. Domestic credit (3-4) 1/	2,990	3,277	3,294	3,462	3,685
6. Foreign exchange credits 1/	762	833	804	825	846
7. Dinar credits, total (5-6)	2,228	2,444	2,490	2,637	2,839
8. Net credit to the public sector	-57	-103	-60	-85	-97
9. Dinar credits to the nonpublic sector (7-8)	2,285	2,547	2,500	2,722	2,936
	(Percentage change from previous year)				
Memorandum items:					
M2 1/ 2/	...	9.4	13.8	20.2	23.4
Net domestic assets 1/	...	6.9	11.1	16.5	17.5

Sources: National Bank of Yugoslavia; and staff estimates.

1/ Adjusted for exchange rate changes.
2/ The definition of M2 in the program excludes public sector deposits, thus differing from the Yugoslav definition shown in Table 9.
3/ Minor revisions have been made to the figures for net foreign liabilities and net domestic assets. The definition of domestic credit was changed at the end of 1983 (see Table 9). The program for 1984 has been adjusted to take the latter change into account.

Table 11. Yugoslavia: Selected Interest Rates

(In percent per annum)

	1978	1979	1980	1981	1982		1983		1984	
					June	Oct.	Feb.	July	May	July
Central Bank interest rates										
Official discount rate and liquidity credits 1/	6	6	6	6	12	14	22	30	30	34
Selective credits 2/	1-6	1-6	1-6	1-6	4-8	4-9	8-12	18-22	18-22	21-25
Commercial bank interest rates										
Deposit rates										
Sight deposits of OALs 3/	--	--	--	--	1	1	4	4	4	4
Dinar deposits of households										
Sight	7.5	7.5	7.5	7.5	7.5	7.5	7.5	7.5	7.5	7.5
3 months	...	...	...	...	...	...	12	12	30	34
6 months	...	...	...	...	...	...	15	15	...	...
Long term 4/	9-10	9-10	9-10	9-10	11-15	13-20	18-28	18-28	35-38	39-42
Foreign currency deposits of households 5/										
Sight	7.5	7.5	7.5	7.5	7.5	7.5	7.5	7.5	7.5	7.5
Long term 4/	9-10	9-10	9-10	9-10	9-10	9-12.5	9-12.5	9-12.5	9-12.5	9-12.5
Lending rates										
Short-term credits	7.5-11.5	8.5-11.5	9-12	9-12	9-16	9-21	32	30-38	30-55 6/	...
Long-term credits	7.5-11	7.5-11	7-12	7-12	9-18	11-21	30-32	30-38	30-50 6/	...

Source: National Bank of Yugoslavia.

1/ The rate on liquidity credits was 8 percent for the period 1978-81.
2/ Credits for exports, agriculture, and imports.
3/ Organizations of Associated Labor.
4/ Lower rate for 1-year deposit; higher rate for 3-year deposit. From May 1984, higher rate for dinar deposits with 2-year maturity.
5/ No interest is paid on foreign exchange deposits of OALs.
6/ Typical rates for non-selective credits. Average weighted rate charged for such credits during the period May 1 - June 30, 1984 was 38 percent.

Table 12. Yugoslavia: Quantitative Performance Criteria, 1984

	Credit Ceilings			
	Net domestic assets of the banking system		Net asset position of the public sector with the banking system	
	Limit	Actual	Floor	Actual
	(In billions of dinars)			
1984				
January-June 1/	4,117	4,035	...	...
June 2/	4,239	4,082	60	103
July-September 1/	4,378	...	...	...
September 2/	4,410	...	85	...
October-December 1/	4,570	...	...	...
December 2/	4,633	...	97	...

	External Reserves of the Banking System 2/	
	Limit	Actual
	(In millions of U.S. dollars)	
1984		
June	1,500	1,819
September	1,800	...
December	2,122	...

	Disbursements of Loans in 1984	
	Limit	Actual 3/
	(In billions of U.S. dollars)	
With original maturities of more than 1 year and up to and including 12 years	3.5	1.1
With original maturities of more than 1 year and up to and including 5 years	1.8	0.4
Short-term credits with an original maturity of up to and including 1 year	0.5	--

Sources: Yugoslav authorities; and IMF staff.
1/ Average of end-of month data.
2/ End month data.
3/ January-July 1984.

Table 13. Yugoslavia: Global Balance of Payments, 1981-84

(In millions of U.S. dollars)

	1981	1982	1983	1983 January-July	1984 January-July	1984 Est.
Exports, f.o.b.	10,205	9,923	9,914	5,269	5,555	10,500
Percentage change in volumes	4.7	-6.2	--	...	4.5	7.7
Percentage change in unit values	8.6	3.7	--	...	-0.9	-1.7
Imports, c.i.f.	14,528	12,810	12,154	6,279	6,344	12,300
Percentage change in volumes	-12.6	-10.0	-5.1	...	1.4	2.6
Percentage changes in unit values	10.4	-2.2	--	...	-0.4	-1.4
Trade balance	-4,323	-2,887	-2,240	-1,010	-789	-1,800
Nonfactor services, credit	4,845	3,672	3,502	1,700	1,670	3,570
Nonfactor services, debit	1,954	1,357	1,161	663	712	1,330
Nonfactor services, net	2,891	2,315	2,341	1,037	958	2,240
Balance on exports of goods and nonfactor services	-1,432	-572	101	95	169	440
Workers' remittances (net)	2,107	1,679	1,705	810	873	1,655
Interest payments, net	-1,621	-1,731	-1,532	-905	-968	-1,765
Current account balance	-946	-624	274	-68	74	330
Medium- and long-term capital, net	548	-187	952	480	-118	240
Short-term capital, including errors and omissions	740	41	-1,935	-1,120	197	-20
Bilateral balance (surplus -)	-776	-805	244	275	13	-50
Overall balance	-434	-1,575	-465	-433	166	500
Use of Fund resources	672	563	410	285	-36	10
Change in reserves	-238	1,012	55	148	-130	510

Sources: Data provided by the Yugoslav authorities; and staff estimates.

Table 14. Yugoslavia: Balance of Payments with the Convertible Currency Area, 1981-84 1/

(In millions of U.S. dollars)

	1981	1982	1983	1983 Jan-July	1984 Jan-July	1984 Proj.	1984 Prog.
Exports, f.o.b.	5,720	5,526	6,271	3,271	3,652	6,700	7,000
Volume (percentage change) 2/	-6.9	-6.8	13.5	...	8.7	9.0	9.4
Unit value (percentage change)	8.6	3.7	--	...	2.7	-2.0	2.0
Imports, c.i.f.	10,600	9,069	8,069	4,130	4,163	8,200	8,700
Volume (percentage change) 2/	-15.2	-16.3	-11.0	...	-0.6	2.1	5.7
Unit value (percentage change)	10.4	-2.2	--	...	1.4	-0.5	2.0
Trade balance	-4,480	-3,543	-1,798	-859	-511	-1,500	-1,700
Services (net)	3,059	1,941	2,097	709	785	2,000	2,200
Workers' remittances	2,077	1,663	1,599	804	857	1,630	1,550
Tourism	1,195	704	875	328	424	1,000	1,000
Interest payments	-1,590	-1,692	-1,489	-872	-937	-1,700	-1,650
Other	1,377	1,266	1,112	449	441	1,070	1,300
Current balance	-1,821	-1,602	299	-150	274	500	500
Medium- and long-term capital (net)	583	-126	911	419	-93	250	250
Loans received (net)	818	51	1,068	478	-53	390	450
Drawings	(2,513)	(1,815)	(3,628)	(976)	(567)	(3,310)	(3,195)
Repayments (-)	(-1,695)	(-1,764)	(-2,560)	(-498)	(-620)	(-2,920)	(-2,745)
Loans extended, net (-)	-235	-177	-157	-59	-40	-140	-200
Short-term capital through the banking system	167	-506	-670	-115	-10	--	--
Other short-term capital, errors and omissions	636 3/	659	-1,005	-587	-5	-250	-250
Overall balance	-435	-1,575	-465	-433	166	500	500
Use of Fund credit	672	563	410	285	-36	10	10
Purchases	760	608	590	346	104	290	293
Repurchases	88	45	180	61	140	280	283
Reserve movements (increase -)	-237	1,012	55	148	-130	-510	-510
Memorandum item:							
Trade flows estimated at current exchange rates 4/							
Exports	...	5,689	6,195	3,409	3,623	6,649	...
Imports	...	9,423	7,957	4,320	4,122	8,122	...
Trade balance	...	-3,734	-1,762	-911	-499	-1,473	...

Sources: Data provided by the Yugoslav authorities; and staff estimates.

1/ Based on statistical exchange rates of currencies to the U.S. dollar which may result in significant over- or underestimation of balance of payments flows, depending on currency composition and actual movement of currencies against the dollar. Rough staff estimates of trade flows at current exchange rates are included as memorandum items.

2/ Official estimates of volume and unit values are only calculated for total trade flows. Staff estimates of volume changes for trade with the convertible currency area are based on official unit values for total trade for 1981-83. The independent 1984 estimates are based on partner country data.

3/ Including allocation of SDRs of US$38 million in 1980 and 1981.

4/ Staff estimates from the movements of eight currencies (accounting for 90 percent of trade) against the accounting exchange rate, weighted by their share in export and import payments.

Table 15. Yugoslavia: Balance of Payments with the Nonconvertible Currency Area, 1981-84

(In millions of U.S. dollars)

	1981	1982	1983 Prel.	1983 January-July	1984 January-July	1984 Est. 1/
Current account	875	956	-25	82	-200	-170
Exports, f.o.b.	4,485	4,397	3,643	1,998	1,903	3,800
Imports, c.i.f.	-3,928	-3,706	-4,085	-2,149	-2,181	-4,100
Trade balance	557	691	-442	-151	-278	-300
Services (net)	318	265	417	233	78	130
Long-term capital	-35	-33	41	61	-25	-10
Long-term loans received (net)	-20	-8	40	58	-20	-10
Drawings	(218)	(216)	(203)	(152)	(90)	(240)
Repayments (-)	(-238)	(-224)	(-163)	(-94)	(-110)	(-250)
Loans extended, net (-)	-15	-25	1	3	-5	--
Short-term capital (net)	--	--	23	--	--	--
Errors and omissions	-64	-118	-283	-418	212	230
Total	776	805	-244	-275	-13	50
Bilateral balance (surplus -)	-776	-805	244	275	13	-50

Sources: Data provided by the Yugoslav authorities; and staff estimates.

1/ Staff estimate.

Table 16. Yugoslavia: External Debt Disbursed and Outstanding

(In millions of U.S. dollars; end of period)

	1979	1980	1981	1982	1983 1/
Repayable in convertible currency	13,680	17,608	18,337	18,488	19,002
Medium- and long-term	12,812	15,558	16,025	16,678	17,860
Public and publicly guaranteed	3,530	4,697	5,957	6,380	8,683
IMF	456	760	1,252	1,754	2,364
IBRD	1,143	1,359	1,483	1,576	1,719
Other	1,931	2,578	3,222	3,050	4,600 2/
Private	9,282	10,861	10,068	10,298	9,177
Commercial banks	5,120	6,110	6,350	6,040	4,865
Other	4,162	4,751	3,718	4,258	4,312 2/
Short-term	868	2,050	2,312	1,810	1,142
Repayable in bilateral currencies	1,490	1,542	1,531	1,528	1,514
Total debt	15,170	19,150	19,868	20,016	20,516

Sources: Data provided by the Yugoslav authorities.

1/ Preliminary official estimates calculated at statistical exchange rates in effect during 1983. According to staff estimates, total outstanding debt at the end of 1983 repayable in convertible currencies amounted to US$18,572 when converted at end-1983 exchange rates.

2/ Staff estimates.

Table 17. Yugoslavia: External Reserves

(In millions of U.S. dollars; end of period)

	National Bank of Yugoslavia: Official Reserves					Foreign Assets of Deposit Banks	Total
	Reserve position in the Fund	SDRs	Gold 1/	Foreign exchange	Total		
1976	--	10	62	1,980	2,052	658	2,710
1977	--	13	64	2,031	2,108	666	2,774
1978	81	20	69	2,288	2,457	783	3,245
1979	--	54	73	1,203	1,330	638	1,968
1980	--	13	78	1,371	1,462	1,102	2,567
1981							
I	--	22	78	1,408	1,508	1,130	2,638
II	--	21	78	1,415	1,504	987	2,501
III	--	33	78	1,435	1,546	1,044	2,590
IV	--	84	78	1,540	1,702	985	2,687
1982							
I	--	37	78	1,038	1,157	821	1,978
II	--	25	78	819	925	851	1,776
III	--	--	78	846	927	760	1,687
IV	3	--	78	771	850	825	1,675
1983							
I	--	--	78	769	843	828	1,671
II	--	--	78	858	936 2/	808	1,744 2/
III	--	--	78	975	1,053 2/	644	1,697 2/
IV	55	--	78	922	1,055	567	1,622
1984							
January	--	12	78	830	920	566	1,488
February	--	--	78	862	940	577	1,517
March	--	--	78	937	1,015	600	1,615
April	--	--	78	905	983	634	1,617
May	--	--	78	917	995	648	1,643
June	--	--	78	995	1,073	746	1,819
July	--	--	78	932	1,010	740	1,750
August 20	--	--	78	1,044	1,122	763	1,885

Source: Data provided by the Yugoslav authorities.

1/ Valued at US$42.22 per ounce.
2/ Including BIS credits.

Yugoslavia - Fund Relations

End-August 1984

I. Membership status

(a) Yugoslavia is an original member of the Fund.
(b) Status - Article XIV.

A. Financial Relations

II. General Department

(a) Quota: SDR 613 million.

(b) Total Fund holdings of dinars: SDR 2,507.1 million, or 409.0 percent of quota.

(c) Fund credit: SDR 1,894.1 million, or 309.0 percent of quota. Of which:
SDR 1,859.5 million, or 303.3 percent of quota under tranche policies; and SDR 34.6 million, or 5.7 percent of quota under special facilities.

(d) Reserve tranche position: none.

(e) Current Operational Budget (maximum use of currency): none.

(f) Lending to the Fund: none.

III. Current stand-by arrangement and special facilities

(a) Current stand-by arrangement: 1-year stand-by approved on April 18, 1984.

(b) In May 1979 Yugoslavia was granted a stand-by arrangement covering the first credit tranche, i.e., SDR 69.25 million, which was used in full.

On June 6, 1980 the Executive Board approved a stand-by arrangement effective through December 31, 1981 for an amount of SDR 339.325 million (122.5 percent of the quota then in effect) of which SDR 200 million was purchased. This arrangement was replaced by a three-year stand-by arrangement approved by the Executive Board on January 30, 1981 for an amount of SDR 1,662 million (400 percent of the quota then in effect). Yugoslavia purchased the full amount available under this arrangement.

Cumulative purchases under these arrangements amounted to SDR 1,931.25 million, equivalent to 315.05 percent of the present quota.

(c) Special facilities: none in the past three years.

IV. SDR Department

(a) Net cumulative allocation: SDR 155.16 million.

(b) Holdings: SDR 0.23 million, or 0.1 percent of net cumulative allocations.

(c) Current designation plan: not included.

V. Administered Accounts

(a) Trust Fund loans: none.

(b) SFF Subsidy Account: none.

VI. Overdue obligations to the Fund

None.

B. Nonfinancial Relations

VIII. Exchange rate arrangement

The currency of Yugoslavia is the Yugoslav dinar. The authorities do not maintain the exchange rate of the dinar within announced margins and, therefore, all transactions, with the exception of those effected under the procedures set forth for certain countries with which Yugoslavia has bilateral payments arrangements, take place at a fluctuating exchange rate. However, the authorities intervene in the foreign exchange markets, when necessary, to ensure orderly conditions or to smooth out fluctuations in exchange rates. The buying and selling rates for the U.S. dollar in the foreign exchange market in Belgrade on August 31, 1984 were Din 165.470 and Din 165.944 per U.S. dollar, respectively. Rates are quoted for certain other currencies.

Yugoslavia maintains a restriction under Article VIII on the availability of foreign exchange for travel. This restriction has been approved by the Fund's Executive Board until the 1984 Article IV consultation, or October 31, 1984, whichever is earlier.

IX. Last consultation

The staff report for the 1982 Article IV Consultation and Review of Stand-by Arrangement with Yugoslavia (EBS/83/46, 2/24/83) was considered by the Executive Board at EBM/83/47 (3/11/83). The Executive Board's decision on the 1982 consultation with Yugoslavia (Decision No. 7362-(83/47), adopted March 11, 1983) was as follows:

1. The Fund takes this decision in relation to Yugoslavia's exchange measures subject to Article VIII, Sections 2 and 3, and in concluding the 1982 Article XIV consultation with Yugoslavia in the light of the 1982 Article IV consultation with Yugoslavia under Decision No. 5392-(77/63) adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. Yugoslavia continues to maintain the restriction on the availability of foreign exchange for travel as described in EBS/83/46 (2/24/83). In the circumstances of Yugoslavia, the Fund grants approval for the retention of this exchange restriction until the completion of the next Article IV consultation or February 28, 1984, whichever is earlier. The Fund notes the existence of external payments arrears and the intention of the authorities to eliminate them at an early date. In the circumstances, the Fund grants approval of maintenance of external payments arrears until August 14, 1983.

The Executive Board's decision on the stand-by arrangement with Yugoslavia, Decision No. 7671-(84/60), was adopted on April 18, 1984.

The Executive Board's decision on a waiver and modification of performance criteria prior to the first purchase under the stand-by arrangement, Decision No. 7717-(84/87), was adopted on June 6, 1984.

The Executive Board's decision on a waiver of performance criterion prior to the second purchase under the stand-by arrangement, Decision No. 7793-(84/131), was adopted on a lapse-of-time basis on August 31, 1984.

Table 1. Yugoslavia: Fund Position During Period of Arrangement

	Outstanding at the Beginning of Arrangement March 31, 1984	1984 April-June	1984 July-Sept.	1984 Oct.-Dec.	1985 Jan.-April
		(In millions of SDRs)			
Transactions under tranche policies (net) 1/	--	52.71	51.44	28.46	28.54
Purchases		100.00	90.00	90.00	90.00
Ordinary resources	--	50.00	45.00	45.00	45.00
Enlarged access resources		50.00	45.00	45.00	45.00
Repurchases	--	47.29	38.56	61.54	61.46
Ordinary resources	--	31.69	30.19	37.35	44.50
Enlarged access resources		15.60	8.37	24.19	16.96
Transactions under special facilities (net) 2/	--	-34.63	-17.31	-17.31	-17.31
Purchases		--	--	--	--
Repurchases	--	34.63	17.31	17.31	17.31
Total Fund credit outstanding (end of period)	1,922.50	1,940.58	1,974.71	1,985.86	1,997.09
Under tranche policies 1/	1,835.94	1,888.65	1,940.09	1,968.55	1,997.09
Under special facilities	86.56	51.93	34.62	17.31	--
		(As percent of quota)			
Total Fund credit outstanding (end of period)	313.6	316.6	322.1	323.9	325.8
Under tranche policies 1/	299.5	308.1	316.5	321.1	325.8
Special facilities 2/	14.1	8.5	5.6	2.8	--

Source: International Monetary Fund.

1/ Ordinary and enlarged access resources.
2/ Compensatory financing facility.

Yugoslavia - World Bank Lending

I.	Structural adjustment loan	
	Amount approved:	US$275 million
	Appraisal mission: February 28-March 18, 1983	
	Approval: June 28, 1983	
	A. First tranche (US$175 million)	
	Disbursements through December 31, 1983	US$ 31 million
	Disbursements, January 1-August 31, 1984	US$135 million
	B. Second tranche (US$100 million)	
	Released: August 23, 1984	
	Commitments through August 31, 1984	US$55 million
	Disbursements through August 31, 1984	None
II.	Other lending	
	Disbursements	
	January 1-December 31, 1983	US$260 million
	January 1-August 31, 1984	US$136 million
	New commitments, July 1, 1983-June 30, 1984, by purpose	(US$ millions)
	Electric power transmission project	120
	Hydroelectric power generation project	60
	Railway project	110
	Fertilizer imports	90
	Lines of credit to two Yugoslav banks	70
	Total	450
III.	Position of World Bank, including the SAL, August 31, 1984	(US$ millions)
	Total amount disbursed and outstanding	1,986
	Undisbursed loans	1,080
	Total	3,066

Status of Arrangements Connected with the Joint Financing Packages for Yugoslavia, 1983 and 1984

I. 1983 Arrangements

1. Commercial banks

Preliminary agreement was reached on March 25, 1983 between the Yugoslav authorities and the International Coordinating Committee (ICC) of foreign commercial banks on the terms and conditions of financial arrangements encompassing the refinancing of medium- and long-term nonguaranteed maturities due to commercial banks (US$950 million), the provision of new money (US$600 million), and a short term facilities arrangement (US$800 million). 1/ Under the agreement, in the case of the medium-term loans, certain Yugoslav banks and the National Bank of Yugoslavia (NBY) would be joint borrowers with the Socialist Federal Republic of Yugoslavia (SFRY) as guarantor. Under the short-term facilities, the NBY would be the guarantor of individual agreements between Yugoslav banks and their foreign counterparts. In the event, final agreement was not reached until the end of September 1983, due in part to a number of technical difficulties; the first installment of the US$600 million in new money was not made until the end of October, though the whole of it was disbursed by early December. Under the short-term facilities, US$215 million of nontrade-related short-term obligations were extended for two years falling due on January 17, 1985. Trade credits and interbank deposits of US$580 million were to be repaid when due but would become immediately available on a revolving basis under a "continuing credit facility (CCF)" until January 17, 1985. Outstanding credits under the CCF as of that date would become payable as they mature and the CCF would be reduced correspondingly. At mid-1984 some US$300 million was outstanding under the CCF.

2. Intergovernmental arrangement

At a meeting in Berne in January 1983, representatives of the governments of 15 western countries agreed to a package of financial support for Yugoslavia. The pledges of financial support totalled US$1.3 billion. The bulk of this was in the form of supplier credits tied to exports from the lending countries but there was also some refinancing totalling US$300 million and new financial credits totalling

1/ For a detailed description of the 1983 packages, see EBS/83/141, July 8, 1983.

US$170 million. 1/ Bilateral negotiations between individual governments and Yugoslavia on the terms and conditions of supplier credits were drawn out, partly because of administrative delays but also because of difficulties in reaching agreement on the type of supplier credits (medium-term credits for raw materials and intermediate goods) sought by Yugoslavia. Most bilateral arrangements were concluded before the end of 1983 and the remaining were finalized at the beginning of 1984. Some US$340 million was disbursed in 1983 and at the end of July 1984 a total of US$480 million had been committed. US$300 million is expected to be disbursed in 1984 leaving some US$150 million effectively unused. The supplier credits were extended via particular Yugoslav associated banks, each of which is in charge of relations with specified countries. These banks will in turn on-lend the credits on a revolving basis to Yugoslav enterprises which are judged as having the best prospects for quickly earning foreign exchange as a result of the imported goods being financed. Whereas the maturity for repayment of the supplier credits will be 3-5 years, the enterprises will be expected to repay their foreign currency debt to the Yugoslav banks within 6-12 months so that the foreign exchange may be onlent to other interested Yugoslav enterprises. When the credit is rolled over it will no longer be tied to specific transactions but the bank remains responsible for the original commitment.

3. World Bank Structural Adjustment Loan

The Board of Directors of the World Bank agreed to the provision of a Structural Adjustment Loan amounting to US$275 million to Udruzena Beogradska Banka on June 28, 1983 with the SFRY as guarantor. The proceeds of this loan are to be onlent on a revolving basis for export-oriented production. Only about US$30 million of the first tranche (US$175 million) was disbursed in 1983 (Appendix III). Access was liberalized in the beginning of 1984 so that imports of raw materials of more general interest to the economy could be financed and by August 1984 virtually all of this first tranche had been utilized. The second tranche has been recently released and is expected to be fully disbursed before the end of the year.

1/ All the new financial credits were disbursed in 1983. Although agreement had been reached in principle on the refinancing arrangements, an arrangement with one country valued at US$111 million is not yet finalized due to a legal dispute between the Yugoslav and the foreign partner in the project concerned. In the balance of payments table this has nevertheless been included as both an outflow and a financing item for 1983.

II. 1984 Arrangements

1. Commercial banks

Commercial banks agreed in December 1983 to a three month standstill on medium- and long-term maturities falling due between January 1 and March 31, 1984 and, in principle, to reschedule 100 percent of nonguaranteed debt falling due in 1984 contingent on Fund approval of the present program. In part because of delays in negotiating this program, the standstill had to be extended until June 18. Signing of the final agreement between the ICC and the Yugoslav authorities took place on May 16, 1984, and the first of a series of monthly refinancing and consolidating loans was made on June 18, 1984. A total of US$1,250 million, or slightly more than originally estimated, is being refinanced, essentially in the same way as for the 1983 refinancing operation. The maturity and the grace period, however, were extended by one year with the first of seven semiannual installments being due on April 18, 1988, and the final on April 18, 1991.

2. Intergovernmental arrangement

At a meeting in Geneva in November 1983 the participants to the Berne arrangement agreed in principle to participate in a financial arrangement for 1984. For this purpose two subgroups were established, Group A to consider the possibility of refinancing maturities falling due in 1984 due to or guaranteed by governments; and Group B to consider whether a formal pledging of new credits was warranted for 1984. The two subgroups reported to the umbrella group in Geneva on March 24, 1984. It was agreed in principle to refinance 100 percent of maturities on debt contracted before December 2, 1982 1/ and due in 1984, estimated on the basis of data provided by the creditor governments at US$740 million. Repayment would be made in six semiannual installments starting December 31, 1988 and ending June 30, 1991. The meeting in Geneva also confirmed that Governments stood ready to carry over into 1984 the unused portion of the 1983 Berne package, to maintain the existing level of short-term credits and, subject in some cases to final assessment or bilateral negotiations, to remain on cover on new medium-term credits. Governments did not formally pledge new credits but they endorsed the Fund staff estimate contained in the program that some US$700 million of supplier credits from all sources would be made available in 1984. On the basis of the pace of disbursements during the first seven months of the year supplier credits may fall somewhat short of this target; they are presently estimated at an annualized rate of some US$600 million.

1/ The Berne arrangement covered credits granted from December 3, 1982.

After the approval of the current program by the Fund's Executive Board, the 16 governments 1/ met again in Paris on May 22 to finalize the work of subgroup A on the refinancing of maturities due in 1984 and to sign the agreed minute. Bilateral negotiations are presently under way. Agreements have been signed with three countries and agreement in principle has been reached with several others. The Yugoslav authorities expect this process to be completed before the end of the year, or ahead of the deadline of January 31, 1985.

1/ Kuwait has joined the original group participating in the Berne agreement.

Table 1. Yugoslavia: Financial Flows vis-à-vis the Convertible Currency Area, 1983-84

(In millions of U.S. dollars)

	1983 Est.	1984 Revised Proj.	1984 Prog.
Sources of funds	4,517	4,100	3,988
Current account surplus	299	500	500
Government packages	816	1,040	1,240
Berne	816	300	390
Refinancing and financial credits	(476)	(--)	(43)
Supplier credits	(340)	(300)	(347)
Geneva	...	740	850
Refinancing	(...)	(740)	(700)
Supplier credits	(...)	(--)	(150)
Commercial bank package	1,550	1,250	1,200
Refinancing	950	1,250	1,100
New money	600	--	100
Rollover of commercial bank loan outside package	...	200	...
IBRD	280	495	505
IMF	590	290	293
Other, mainly suppliers' credits	982	325	250
Uses of Funds	4,517	4,100	3,988
Amortization of medium- and long-term loans	2,560	2,920	2,745
Loans extended, net	157	140	200
Short-term debt, net	670	--	--
Other short-term capital flows, errors and omissions	1,005	250	250
Repayments to the IMF	180	280	283
Increase in reserves	-55	510	510

Sources: Data provided by the Yugoslav authorities; and staff estimates.

Medium-Term Scenarios for External Debt and the Balance of Payments

The Yugoslav authorities are in the process of drawing up their plans for external financial flows through 1990. At the time of the discussions with the staff for the mid-term review, they were in a position to indicate only their preliminary plans for the medium-term and their strategy for financing the likely balance of payments gap over the next few years. In general terms, the staff understands that the authorities expect that an important contribution to the financing of debt repayment will come from the accumulation of substantial surpluses on the current account and that an important aim will be to achieve a substantial reduction in the debt service ratio through a reduction in outstanding debt over this period. To ascertain the implications of such a policy for the balance of payments a small computational model has been used to update the scenarios presented in EBS/84/65 (3/23/84). The calculations should be viewed only as illustrative since they depend crucially on the underlying assumptions which, over the medium-term, are inevitably somewhat arbitrary.

The three scenarios have a number of assumptions in common. Export and import prices and interest rates (in terms of U.S. dollars) are consistent with those assumed for the Fund's most recent medium-term World Economic Outlook exercise. Export and import prices are assumed to increase by 5 percent in 1985, 4.5 percent in 1986, and by 4 percent in the 1987-90 period. The average interest rate on total medium- and long-term debt is assumed to decline gradually from 10.3 percent in 1984 to 8.6 percent in 1990 in line with a 3 percentage point decline in LIBOR (60 percent of Yugoslavia's debt is contracted at floating interest rates).

Scenario I assumes high export volumes, with the growth in export volume declining from 9 percent in 1984 to 7 percent per annum in 1987-90. This would be consistent with continued, albeit declining, rate of increase in market shares. Scenarios II and III contain more cautious estimates of export volume, with growth declining to 4 percent per annum in the period 1988-90. On the basis of the interest rate assumptions, debt service payments on external debt outstanding at the end of 1983, are given. Also, the special financing arrangements from governments and commercial banks for 1984 are incorporated and specific assumptions are made for financing from multinational development banks, normal supplier credits, export financing, and short-term capital movements. On the basis of net borrowing and reserve targets, the model can be used to solve for the residual level of required gross borrowing from commercial sources, debt service payments and the permissible growth of merchandise imports. Debt service projections are based on the assumptions that regular supplier credits carry a maturity of 5 years with 2-years' grace; those under the Berne agreement carry an average maturity of four years with no grace. Refinancing by governments and banks, as well as new money from banks, is assumed to carry a maturity of seven years with a four year grace period.

Table 1. Yugoslavia: Medium-Term External Debt and Payments Scenarios, 1983-90

(In millions of U.S. dollars)

	1983	1984	1985	1986	1987	1988	1989	1990
Scenario 1								
Current account balance	299	500	900	1,200	1,400	1,260	1,100	900
Gross medium- and long-term borrowing	3,628	3,310	2,689	2,451	2,168	2,407	2,554	2,550
Of which: Additional borrowing on commercial terms	600	--	1,509	1,146	868	1,057	1,154	1,100
Amortization of medium- and long-term debt outstanding at end-1983	2,560	2,920	2,495	2,704	2,372	1,816	1,100 1/	600 1/
Amortization of new borrowing	--	--	300	166	342	934	1,726	2,237
Interest payments	1,662	1,900	2,039	1,903	1,745	1,588	1,449	1,334
Total debt outstanding at year end	19,000	19,400	18,850	18,050	17,100	16,290	15,640	15,190
Debt service ratio (percent of foreign exchange earnings)	39.7	43.2	38.8	34.9	30.1	27.2	24.0	20.4
Ratio of total debt to GSP	44.0	46.3	41.2	35.6	30.5	25.9	22.2	19.2
Export volume growth (annual percentage change)	13.6	10.5	8.0	7.5	7.0	7.0	7.0	7.0
Import volume growth (annual percentage change)	-11.0	2.1	4.0	7.0	7.6	10.0	9.4	9.1
Scenario 2								
Current account balance	299	500	900	1,200	1,400	1,260	1,100	900
Gross medium- and long-term borrowing	3,628	3,310	2,689	2,451	2,168	2,407	2,554	2,550
Of which: Additional borrowing on commercial terms	600	--	1,509	1,146	868	1,057	1,154	1,100
Amortization of medium- and long-term debt outstanding at end-1983	2,560	2,920	2,495	2,704	2,372	1,816	1,100 1/	600 1/
Amortization of new borrowing	--	--	300	166	341	934	1,726	2,237
Interest payments	1,662	1,900	2,039	1,903	1,745	1,588	1,449	1,333
Total debt outstanding at year-end	19,000	19,400	18,850	18,050	17,100	16,290	15,640	15,190
Debt service ratio (percent of foreign exchange earnings)	39.7	43.2	39.2	36.1	31.7	29.4	26.7	23.2
Ratio of total debt to GSP	44.0	46.3	41.6	36.6	31.9	27.6	24.1	21.4
Export volume growth (annual percentage change)	13.6	8.9	6.0	5.0	4.5	4.0	4.0	4.0
Import volume growth (annual percentage change)	-11.0	2.1	2.4	4.2	4.8	6.9	6.4	6.2
Scenario 3								
Current account balance	299	500	700	500	450	450	400	350
Gross medium- and long-term borrowing	3,628	3,310	2,889	3,151	3,118	3,216	3,311	3,358
Of which: Additional borrowing on commercial terms	600	--	1,709	1,846	1,818	1,867	1,911	1,908
Amortization of medium- and long-term debt outstanding at end-1983	2,560	2,920	2,495	2,704	2,372	1,816	1,100 1/	600 1/
Amortization of new borrowing	--	--	300	166	341	934	1,783	2,494
Interest payments	1,662	1,900	2,050	1,959	1,879	1,799	1,720	1,647
Total debt outstanding at year end	19,000	19,400	19,050	18,950	18,950	18,950	19,000	19,100
Debt service ratio (percent of foreign exchange earnings)	39.7	43.2	39.2	36.4	32.6	30.7	28.5	26.3
Ratio of total debt to GSP	44.0	46.3	41.5	36.8	33.6	31.0	28.7	26.6
Export volume growth (annual percentage change)	13.6	8.9	6.0	5.0	4.5	4.0	4.0	4.0
Import volume growth (annual percentage change)	-11.0	2.1	4.6	8.9	5.9	4.2	4.6	4.5
Memorandum items:								
Repurchases from the IMF	184	282	338	381	405	467	378	163
Charges payable to the IMF	162	215	225	192	146	95	45	14
Amortization payments on refinancing packages	--	--	--	530	530	1,010	868	604
1983 package 2/	--	--	--	530	530	530	264	--
1984 package	--	--	--	--	--	480	604	604

Sources: Data provided by the Yugoslav authorities; and Fund staff estimates.

1/ The preliminary official data only include data through 1988; 1989 and 1990 are rough staff estimates.
2/ Including US$600 million in new money from banks in 1983, but excluding financial credits and suppliers' credits under the Berne arrangement

Legal and Administrative Framework of the 1977 Law on Foreign Exchange Operations

1. Introduction

Since 1982, the Yugoslav authorities have introduced a number of significant modifications to the foreign exchange allocation system in order to facilitate a more efficient use of foreign exchange resources. A principal objective has been to restore the functioning of the foreign exchange market--which has been dormant since late 1979--as the development of such a market is seen as a necessary step in the evolutionary process toward the ultimate objective of a fully convertible dinar. To ascertain the extent to which the modifications in the system have brought about the desired results, the current stand-by arrangement called for separate studies of the foreign exchange allocation system to be carried out by the Yugoslav authorities and by the Fund, with the assistance of consultants inside and outside of Yugoslavia. This appendix summarizes the report of the Fund mission. 1/

The legal basis for the foreign exchange allocation system remains the Law on Foreign Exchange Operations and Foreign Credit Relations, which was enacted in 1977. The first part of the appendix therefore provides a brief discussion of the legal and administrative framework established by this law, 2/ as well as of the operation of the foreign exchange allocation system during the period 1978-82. The major part of the study then focusses on the substantial changes in the system which were introduced between December 1982 and early 1984 and describes the current operation of the system, identifying some of the major problems which have arisen. Measures recently taken or under discussion by the authorities are described in the main text of this paper.

In order to bring the foreign trade and payments system into closer accord with the principle of self-management embodied in both the 1974 Constitution and the 1976 Law on Associated Labor, three laws were passed by the Federal Assembly in March 1977, the main provisions of which took effect on January 1, 1978:

1/ For the purposes of the study, two staff missions visited Yugoslavia during the periods May 5-12 and June 18-29, 1984; on both missions there was a representative from the World Bank, and on the second a consultant from the CBD panel. In addition to meetings in Belgrade with federal authorities and Yugoslav-wide institutions, discussions were held in Croatia, Macedonia, Serbia and Slovenia with representatives of republican governments, Communities of Interest for Foreign Economic Relations, Chambers of Economy, academicians, enterprises and commercial banks.

2/ For a detailed description of the law, see SM/78/246, October 5, 1978, Yugoslavia - Exchange and Trade System.

(i) Law on Trade in Goods and Services with Foreign Countries, which established the institutional framework for the formulation and implementation of import and export policies;

(ii) Law on the Conduct of Business Activities Abroad, which defined the scope of overseas activities abroad by Yugoslav enterprises and set forth their basic rights and obligations; and

(iii) The Law on Foreign Exchange Operations and Foreign Credit Relations.

This last law introduced major changes in the legal and administrative framework governing the foreign exchange system. Despite important modifications introduced in both 1983 and 1984, the framework established by this law continues to govern the foreign exchange system to the present day. The underlying principle of the new law was the assertion that "Foreign exchange realized by basic organizations of associated labor shall belong to these organizations." Surrender requirements were therefore eliminated, 1/ and basic organizations of associated labor (BOALs) which earned foreign exchange through their independent performance were free to use their foreign exchange earnings for imports, deposit them in foreign exchange accounts with authorized banks or to sell them on the foreign exchange market. In cases where foreign exchange earnings were realized through the joint efforts of more than one BOAL, the law declared that such earnings belonged jointly to all BOALs "which have taken part in its realization through co-production, financial or other kinds of economic cooperation" (Article 67). The arrangements for sharing foreign exchange receipts were to be incorporated in self-management agreements concluded by the various BOALs; in general, each BOAL was to receive foreign exchange "according to the contribution made to the realization of the foreign exchange by workers in these organizations with their past and present labor." In addition, the law also allowed the transfer of foreign exchange from a net earner to a net user by "pooling" of

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1/ On the basis of the Law on Foreign Exchange Dealings enacted by the Federal Assembly on June 28, 1972, surrender requirements had previously been established for each industry or sector. In most cases, 20 percent of foreign exchange earnings could be retained by an enterprise, while the remaining 80 percent were surrendered to the National Bank of Yugoslavia.

foreign exchange for the purpose of undertaking joint production at joint risk (Article 68). 1/

The Law on Foreign Exchange Operations provided for the establishment in each of the republics and autonomous provinces of a self-managing community of interest for foreign economic relations (CIFER), and for their association at the federal level in the Yugoslav CIFER; membership was obligatory for all economic agents who transacted business with foreign countries or otherwise disposed of foreign exchange. These communities of interest were given a central role in the implementation of policies regarding the allocation of the right to use foreign exchange. Enterprises with insufficient foreign exchange earnings were to acquire rights to purchase foreign exchange from the market on the basis of self-management agreements concluded within the framework of the regional 2/ CIFERs (Article 69). In the case of unforeseen shortfalls in foreign exchange inflows to a particular republic or autonomous province, the regional CIFER would generally be given the responsibility for adopting corrective measures, which could involve restrictions on the otherwise free use of foreign exchange earned by enterprises within the region.

Under the foreign trade and payments system established by the 1977 legislation, the Federal Assembly was to formulate annually a decision on Yugoslav foreign exchange policy, of which the projections of the

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1/ The scope and procedures for sharing foreign exchange under Article 67, and "pooling" foreign exchange under Article 68, were not clearly delineated in the law, and accordingly, have been subject to considerable debate within Yugoslavia. In principle, Article 67 pertained to sharing of foreign exchange earned on the basis of past labor, while Article 68 arrangements dealt with the pooling among enterprises of foreign exchange already earned, for the purpose of creating future production and joint income. In practice, however, Article 68 has been used primarily for the transfer of foreign exchange between enterprises having mutually dependent relationships which could not be defined as clearly as for Article 67 transactions. For example, in the case of joint production of refrigerators by two enterprises--in which one supplied the motor and the second supplied the rest of the refrigerator and made the actual export transaction--the two enterprises would be likely to conclude an Article 67 self-management agreement under which each would receive a specified proportion of total export receipts. In cases where the contribution of each enterprise could be quantified only imprecisely--e.g., the contribution of the chemical industry to the wood processing industry--arrangements for sharing foreign exchange receipts would generally be concluded under the terms of Article 68. While strictly illegal in terms of the law, Article 68 arrangements have also been used on occasion to effect direct sales of foreign exchange between enterprises.

2/ The term "regions" will on occasion be used as a shortened expression for "republics and autonomous provinces".

balance of payments were a major component. The overall balance was the sum of mutually agreed balances of payments of the individual republics and autonomous provinces, approved by the relevant republican or provincial authorities. The projections were arrived at through an interactive process, taking into account the projections of annual foreign trade and foreign exchange flows of basic and other OALS, as well as the foreign exchange expenditures and revenues of the Federal Government.

The Law on Foreign Exchange Operations also defined the scope and operations of the foreign exchange market. Sales and purchases of foreign exchange were to take place through authorized banks and exchange dealers. Authorized banks were to buy and sell foreign exchange among themselves, either bilaterally or at interbank meetings attended by the National Bank of Yugoslavia (NBY), which would intervene in the market in order to maintain general liquidity in international payments and to maintain the exchange rate of the dinar in conformity with established policy. Foreign exchange earned by BOALs--directly and through sharing with organizations which had exported the final product--could be held in accounts with authorized banks or sold on the foreign exchange market. Conversely, as noted above, enterprises which earned insufficient foreign exchange to pay for their imports were entitled to purchase foreign exchange on the foreign exchange market on the basis of self-management agreements within the regional CIFERs.

2. Operation of the system, 1978-82

During the first part of this period, the foreign exchange market was to a large extent supplied from foreign borrowing. Foreign exchange borrowed abroad was sold to the NBY for dinars, and the NBY would in turn sell foreign exchange to enterprises which needed it for debt or import payments. Beginning in 1979, however, the increasing scarcity of foreign exchange--reflecting the deterioration in the overall balance of payments--put increasing strain on the functioning of the foreign exchange system. At the end of 1979, the National Bank began to restrict considerably its sales of foreign exchange to authorized banks. As banks and enterprises became increasingly aware that they could no longer depend on the National Bank to supply them with foreign exchange, they became reluctant to sell their holdings into the market. As a result, there was a dramatic reduction in the size of thedomestic foreign exchange market 1/ and its effective replacement by numerous bilateral transactions among individual enterprises. Foreign exchange was reportedly transferred from surplus to deficit enterprises outside the framework of the foreign exchange market, and at effective rates of exchange substantially higher than the official rate. While

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1/ Transactions between authorized banks in the inter-bank foreign exchange market declined by 85 percent between 1979 and 1982, while sales of foreign exchange by authorized banks to the NBY virtually ceased (falling from US$356 million in 1979 to US$16 million in 1982).

direct sales of foreign exchange between enterprises were prohibited, in many cases such transactions were apparently disguised under the terms of "pooling" of foreign exchange resources allowed under Article 68.

In view of the decentralized administrative and legal structure established by the Law on Foreign Exchange Operations, corrective measures adopted by regional CIFERs during this period in response to foreign exchange shortages differed considerably among the various republics and autonomous provinces. Under the terms of the 1977 foreign exchange law, these measures were designed to facilitate circulation of foreign exchange only within a particular republic or autonomous province, as there was no mechanism at the federal level to induce flows of foreign exchange between surplus and deficit republics and provinces. 1/ Inter-regional flows of foreign exchange were instead supposed to take place on a voluntary basis through sales on the foreign exchange markets by exporters and through interbank transactions; as noted above however, foreign exchange transactions in the inter-bank foreign exchange market fell to a very low level during this period.

The growing foreign exchange crisis led to severe debt servicing problems for a number of Yugoslav firms and banks in 1982. Partly in response to this development, in May 1982 the Federal Assembly enacted a Law on the Terms and Procedures for the Disposition and Use of Foreign Exchange for External Payments and on External Borrowing in 1982. This temporary measure decreed that social legal entities could effect foreign payments only after discharging certain specified obligations with regard to servicing the international debt of Yugoslavia. Regulations and self-management agreements subsequently adopted to implement the provisions of the law reintroduced a formal surrender requirement from export earnings, equal to 58.8 percent of total foreign exchange receipts: 20.9 percent for the needs of the republics and autonomous provinces, 15.9 percent for the National Bank, 17 percent for payments of priority imports (e.g., petroleum), and 5 percent for the needs of the Federal Government.

3. 1983: Revised administrative and legal framework

The changes to the foreign exchange system implemented in May 1982 had been introduced only on a temporary basis. The first substantive changes in the legal framework governing the foreign exchange allocation system occurred with the adoption in December 1982 of the Law Amending and Supplementing the Law on Foreign Exchange Operations. The amended

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1/ Article 35 of the law authorized the Federal Executive Council to provide general guidelines for regulating the corrective measures taken by individual republics and autonomous provinces; such guidelines were issued, however, only for 1978. In all other years, corrective measures--in some cases including surrender requirements to regional authorities--were left entirely to the discretion of the regional authorities.

law, which took effect on January 1, 1983, made permanent a number of the temporary provisions adopted in May 1982 and added a number of new regulations. The amendments were designed to limit foreign exchange outflows to the projected level of inflows, stimulate exports, provide for a more efficient use of foreign exchange by eliminating hoarding, and give priority to debt repayments. There was a considerable strengthening of the federal entities at the expense of the regional ones, as the earlier emphasis on regional balance of payments of the individual republics and autonomous provinces was in principle replaced by a more centralized focus on the combined balance of payments of the Yugoslav federation. In particular, the procedure whereby the allocation of foreign exchange rights were determined within the republican/provincial CIFERs was replaced by a system in which such allocations were to be carried out on a national level.

While retaining the basic principle that foreign exchange belonged to those economic agents which had contributed to its realization, the amended system placed greater emphasis on the principle (Article 5 in the original law) that "Foreign exchange realized by basic and other organizations of associated labor shall be the result of the labor of workers in the basic organization of associated labor *and of the labor of the entire society*." 1/ The surrender requirement of a portion of foreign exchange earnings to the NBY, implemented on a temporary basis in May 1982, was made a permanent element of the system. Specifically, the amended law authorized an act of the Federal Assembly which would establish a fixed portion of foreign exchange receipts to be utilized for federal needs: (i) for payments to foreign countries by federal agencies and organizations; (ii) for supplementing the foreign exchange reserves of the National Bank; and (iii) for repayment of credit obtained by the National Bank in its own name and on its own account.

Under the amended system, a portion of foreign exchange receipts not surrendered directly to the National Bank would be "withheld" by the enterprise which earned the foreign exchange. In order to further promote exports, enterprises were required to agree among themselves to form groups (or "activities") which would jointly determine the disposition of the "withheld" portion of foreign exchange earnings according to certain *uniform criteria* to be adopted by the Yugoslav CIFER, in cooperation with the Yugoslav Chamber of Economy; any remaining foreign exchange receipts would then have to be sold on the unified foreign exchange market. The establishment of uniform criteria for allocating foreign exchange represented a sharp break with the system as it had existed prior to 1983; not only had there been no formal surrender requirement until mid-1982, but the criteria which had previously been used for allocating foreign exchange had frequently differed among the various republics and autonomous provinces.

1/ Italics added.

"Activities" were to be formed on a national rather than a regional level, and the number and composition of such groups was to be decided by the individual enterprises under the supervision of the Yugoslav Chamber of Economy. It was expected that these groups of enterprises would be vertically integrated--i.e., comprising all enterprises contributing to the final export product--in order to maximize the incentives for exporting at higher stages of production. For each group, the amount of foreign exchange earnings (including those realized through self-management agreements with enterprises in other groups in the case of collective production for exports) which could be retained for the purpose of servicing external debt would be determined as a function of the ratio of total debt servicing obligations falling due in 1983 to total foreign exchange receipts in 1982. For imports of raw materials and spare parts, the basic allocation of foreign exchange was set at 80 percent of the ratio of average actual imports (excluding equipment) to exports in 1981-82; an additional allowance was provided in cases where earnings from exports to the convertible currency area exceeded 20 percent of total income.

The amended foreign exchange law gave considerably greater responsibility to the banking system in terms of allocating foreign exchange and assuring the servicing of external debt. Enterprises were required to maintain their foreign exchange accounts in a single authorized bank. In addition, commercial banks were to be responsible for verifying that any foreign borrowing by enterprises would be for uses which would generate a sufficient flow of convertible currency earnings to meet future debt servicing obligations. The legal framework governing repayment of external debt was further strengthened in July 1983 by the adoption of the Law on Payments in Convertible Foreign Exchange. This law (known also as the "Law of Circles") required all economic units in Yugoslavia to pool their resources as necessary to service Yugoslav external debt: (i) if an individual enterprise had insufficient foreign exchange to meet its external debt obligations, then all enterprises associated with the debtor enterprise would be called upon to supply the necessary foreign exchange; (ii) if this were not sufficient, then foreign exchange would be provided by all members of the basic or associated bank to which the debtor enterprise belonged; (iii) at the next level, foreign exchange would be provided by all authorized banks located in the republic or autonomous province of the debtor enterprise; (iv) if obligations remained after the above steps had been taken, additional foreign exchange would be provided by all social and legal persons in Yugoslavia through an obligatory allocation of a portion of their foreign exchange receipts; and finally, if all the above measures failed to provide the necessary foreign exchange, the National Bank would be authorized to instruct all other banks in Yugoslavia to pay the obligation in question. Foreign exchange provided under this law only is in the form of a loan, so that the debtor enterprise bears the exchange risks. The debtor enterprise is also required to provide to the lender the dinar counterpart of the foreign exchange made available to it, interest free, for the duration of the loan.

4. 1983: Operation of the system

It was initially intended that the economic groups (or "activities") into which enterprises were to voluntarily associate themselves would be in place by the end of June 1983, and that the foreign exchange market would at that time begin to play an important role in circulating foreign exchange from surplus to deficit users of foreign exchange. As a result of administrative delays--due at least in part to the lack of precise understanding as to what such "activities" were to encompass--by the end of 1983 only eight groups had been formed. Foreign exchange allocations during most of 1983 were therefore governed by ad hoc arrangements within the regional CIFERs and on the basis of interim arrangements which had been established by the Uniform Criteria. The foreign exchange market remained inoperative, and transactions between enterprises outside the market--often at a considerable premium--were reported to have been widespread. Nevertheless, application of the Law of Circles had ensured the timely repayment of all fixed and guaranteed debt obligations. 1/

5. 1984: Further revisions in the legal and administrative framework

In December 1983, the Federal Assembly enacted a second series of amendments to the Law on Foreign Exchange Operations. The amendments gave high priority to the objectives of achieving a more rapid circulation of foreign exchange and a more efficient use of foreign exchange reserves for the promotion of export production.

The key provision of the amended system was that all foreign exchange receipts were to circulate through the unified foreign exchange market. The complicated system of surrender requirements in 1983--both direct surrender and mandatory allocations from "withheld" foreign exchange receipts--was replaced by a uniform surrender requirement; the major part of this would go to the National Bank of Yugoslavia, and the remainder would be transferred to the account of a republic/province. A second portion of foreign exchange receipts, corresponding to the socially verified reproduction needs (SVRN) of an individual enterprise would be retained by the foreign exchange earner in order to finance its debt service and authorized import payments. The remaining portion of

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1/ This was generally achieved within the republican "circles", i.e., from the foreign exchange resources of the debtor enterprise itself, associated enterprises, the debtor enterprise's bank, or other banks in the republic. In several cases, it was necessary for the NBY to intervene with a short-term loan because a bank had been temporarily illiquid and there had been insufficient time to mobilize the foreign exchange resources of other banks in the republics. Recourse has not been made to the federation-wide circle since August 1983, when banks in some republics were designated to repay debts of banks in other republics in order to eliminate outstanding arrears on fixed and guaranteed obligations.

foreign exchange receipts--i.e., those not surrendered to the NBY (and republics/provinces) or designated as constituting an enterprise's SVRN--would have to be sold to an authorized bank within two days of receipt. 1/ Conversely, enterprises whose retained earnings of foreign exchange were insufficient to meet their socially verified reproduction needs were entitled to purchase the difference on the unified foreign exchange market.

For the purpose of promoting export growth by fostering a closer linkage among enterprises, enterprises were to formulate their SVRNs within the framework of either:

(i) one of more general associations within the Yugoslav Chamber of Economy;

(ii) special forms of association constituting large commercial conglomerates.

These associations replaced the somewhat ill-defined "groups" or "activities" which the 1983 system had sought to encourage. By the end of April 1984, all enterprises had chosen the form of association to which to belong; in addition to the 22 general associations already defined within the Yugoslav Chamber of Economy, 12 special forms of association--consisting of large commercial conglomerates--were approved by the Yugoslav CIFER.

Uniform Criteria enacted by the Yugoslav CIFER stipulated that the total amount of foreign exchange receipts (SVRNs) to be shared among the members of an association would be calculated along the same lines as had been defined in the 1983 Uniform Criteria, i.e., according to (i) the ratio of debt service obligations accruing during the course of the year (including outstanding obligations as of the end of 1983) to total exports in 1983; and (ii) the average ratio of imports (excluding imports of equipment) in 1982-83 to exports in those two years. The sum of SVRNs for all associations was to be calculated so as to be consistent with the balance of payments projections for the year as a whole. This would be achieved by applying a uniform adjustment factor to the import/export ratios described above.

While the total SVRN of each form of association was calculated on the basis of the formula contained in the Uniform Criteria described above, there was no requirement that the allocation of the total among the members of the association be done in a uniform fashion. In principle, the association's total SVRN was to be divided among the enterprises on the basis of mutually adjusted production and export

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1/ Under the amended system, "pooling" of foreign exchange receipts under Article 68 could be undertaken only with the foreign exchange available to an enterprise within its own SVRN. This represented a substantial reduction in scope for pooling of foreign exchange earnings.

plans, in such a manner as to achieve the largest possible export production of the association as a whole. In most associations, however, agreement on this basis had not been possible, and individual SVRNs had been determined instead by applying the formula contained in the Uniform Criteria directly to the trade and debt data of individual enterprises.

In a decision adopted by the Federal Assembly, the portion of foreign exchange channeled to the NBY was established at 44.1 percent of export earnings. The amendments to the foreign exchange law, adopted in December 1983, specified that these funds were to be used:

(a) to satisfy the needs of the Federation;

(b) to increase the international reserves of the NBY;

(c) to repay credits taken by the NBY in its own name and on its own behalf;

(d) to pay for part of the imports of special importance for supplying the population;

(e) to import fuels and inputs needed for the search for fuels

(f) to make compensation under Article 22 to enterprises which were forbidden to export; and

(g) to pay Yugoslav pensions to beneficiaries living abroad.

Within the 44.1 percent, there was no fixed allocation of foreign exchange for the purposes enumerated above, as had been the case in 1983. Actual allocations would instead depend on the foreign exchange inflow, and on the priorities established by the Federal Executive Council as they might evolve over time. An additional amount--which could not exceed 10 percent of projected export earnings--was allocated to republics and autonomous provinces. 1/ Thus, exporters were in principle required to surrender 54.1 percent of all export receipts.

6. 1984: Operation of the system

The essential elements of the system were in place by the end of the first quarter. The part of the market supplied by the 54.1 percent surrendered to the National Bank of Yugoslavia and to the republics and provinces was functioning relatively well--and indeed had been in operation since the beginning of the year. Foreign exchange was

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1/ Each republic/province would receive (up to) 10 percent of the foreign exchange earned by enterprises within its borders, including the portion of foreign exchange earned by enterprises under Article 67 and 68 arrangements with enterprises in other republics/provinces.

generally made available on a timely basis for the imports of the planned quantities of essential raw materials to supply the domestic market and for energy raw materials. Although, as noted below, the foreign exchange inflow to the NBY was affected to some extent by an increase in the value of exports exempted from the general surrender requirements, this appears to have been offset by the increase in the share surrendered from 37.7 percent in the second half of 1983 to 44.1 percent in 1984.

The surrender of 10 percent of export receipts to republics and autonomous provinces was also in place and being implemented as planned. However, representatives of one republic indicated that the amount available to that republic was smaller than expected, as the surrender requirement had been applied to a smaller-than-expected share of total exports. Moreover, the share surrendered to republics and autonomous provinces had been reduced from 15 percent in 1983 to 10 percent in 1984.

While certain aspects of the system were in place and functioning as anticipated, the "narrow" foreign exchange market--in which enterprises with SVRNs in excess of 45.9 percent of their projected export earnings were to purchase foreign exchange--was functioning to only a very limited extent. None of the enterprises with which the staff had contacts had been able to purchase substantial quantities of foreign exchange in this market, although they were entitled to do so. The nonfunctioning of this "narrow" market was also evidenced by the continuing low level of inter-bank operations, both bilaterally and within the inter-bank meeting; virtually the only transactions in the inter-bank meeting had been sales by the NBY from the proceeds of the 44.1 percent surrendered directly to it, for the various purposes enumerated above.

The nonfunctioning of the foreign exchange market was to a large extent explained by the fact that the total value of entitlements to purchase in the market had been overestimated--in relation to the projected supply--when the system had been established at the beginning of the year. This was in turn due principally to two factors: (i) the increasing prevalence of trade conducted under various forms of one-to-one trading arrangements, from which export proceeds were largely exempt from surrender requirements; and (ii) the failure to reduce entitlements to foreign exchange (SVRNs) in cases where commodity credits used by enterprises were not repayable until a subsequent year.

a. One-to-one trade

As noted earlier, SVRNs for individual enterprises were determined in such a manner as to be consistent with the projected foreign exchange inflow to Yugoslavia in 1984. In making these estimations, it was implicitly assumed that all Yugoslav exports were cash transactions and hence would be subject to (i) the 54.1 percent surrender requirement to the NBY and to the republics/provinces; and (ii) the obligatory sale to the foreign exchange market of the portion of retained foreign exchange receipts (i.e., 45.9 percent of the total) which exceeded an individual enterprise's SVRN. However, the Decision on a Common Foreign Exchange Policy for 1984, adopted by the Federal Assembly in December 1983, partially exempted a number of "special forms" of trading arrangements from these requirements, including: (i) border trade; (ii) barter arrangements; (iii) compensation (counter) trade; and (iv) long-term cooperation agreements. The first two categories of "one-to-one" trade were completely exempted from the surrender requirements; for compensation trade, the excess of export earnings over associated import payments was to be subject to a 100 percent surrender requirement, while for long-term cooperation agreements, the regular surrender requirements applied to the excess of exports over imports.

As a result of these exemptions, enterprises which participated in one-to-one trading arrangements were effectively able to reduce the proportion of their foreign exchange receipts which had to be surrendered to the National Bank and to the "narrow" foreign exchange market. According to some estimates, the share of all trade not subject to the surrender requirements had increased from 10-15 percent in 1981-82 to more than 40 percent in the first half of 1984. The increasing prevalence of one-to-one trading arrangements was thus a major factor in creating a situation in which the supply of foreign exchange to the market was considerably less than had been anticipated.

b. Use of commodity credits

When enterprises' entitlements to foreign exchange were established at the beginning of 1984, the projected use of foreign commodity credits was taken into account as one of the major sources of foreign exchange. It therefore follows that use of such credits by an enterprise on a net basis--i.e., for which repayment was not required in the current year--should have led to a commensurate reduction in the borrowing enterprise's SVRN. If this adjustment were not made, the enterprise would have effectively increased its entitlement to import at the expense of other enterprises which had rights to purchase foreign exchange from the market as part of their SVRNs. Under the system established in early 1984, however, no provision was made for such adjustments to borrowing enterprises' SVRNs. This failure to adjust SVRNs for use of net commodity credits was, in quantitative terms, perhaps the single most important factor underlying the observed scarcity of foreign exchange in the market.

7. Other problems in implementation of the system

Largely reflecting the two factors cited above, the "narrow" foreign exchange market remained dormant during the first half of 1984. In theory, the foreign exchange allocation system implemented in 1984 had an automatic adjustment mechanism to handle such cases in which the supply of foreign exchange to the "narrow" market was less than projected. In these circumstances, the Yugoslav CIFER was authorized to effect, on a quarterly basis, uniform reductions in enterprises' entitlements to purchase foreign exchange from the market, in order to restore equality between entitlements and the supply of foreign exchange to the market. It was apparent from the discussions, however, that this adjustment procedure was by no means automatic, but was instead subject to intense discussion and negotiation within Yugoslavia.

A somewhat different problem in the operation of the system arose from the fact that the scope and terms of the rescheduling of debt due to commercial banks and governments had not been known at the time the SVRNs were initially calculated. The calculations therefore included amortization payments of those debts which were subsequently refinanced and for which the enterprise therefore did not need to acquire foreign exchange. Unlike the two factors cited earlier--i.e., one-to-one trade and the treatment of commodity credits--this situation should not, in principle, have created any global overentitlement to foreign exchange. Instead, it would have increased the SVRNs of some OALS above, and reduced the SVRNs of other OALs below, the levels that would have resulted had the rescheduling been taken into account.

In general, despite the success in meeting foreign debt obligations, it was apparent that the foreign exchange system continued to suffer from a lack of confidence in the availability of foreign exchange in the market. This lack of confidence was readily understandable in view of the circumstances prevailing during the first half of 1984, notably the failure to correctly calculate entitlements to foreign exchange. Development of confidence in the operation of the foreign exchange market also appears to have been particularly hampered by the fact that the present system contains no provision for intervention by the NBY, even in cases in which an enterprise with a legally established entitlement to purchase in the market is unable to exercise that entitlement because of an insufficient supply of foreign exchange among the commercial banks. Had the system been calculated correctly--i.e., if entitlements had corresponded to actual foreign exchange inflows--such intervention would, in principle, only be necessary to cover timing differences between exports and imports; 1/ the foreign exchange provided by the NBY in this manner would then automatically revert to the NBY through sales of surplus foreign exchange in the inter-bank market when the export proceeds were repatriated.

1/ Problems of timing have been accentuated by the incentive for enterprises to import as early in the year as possible, in order to forestall the possibility that foreign exchange entitlements might be reduced later in the year. To counteract this incentive, commercial banks have been given the responsibility for ensuring that enterprises do not depart from their normal seasonal pattern of imports.