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October 21, 1981

To: Members of the Executive Board

From: The Secretary

Subject: Yugoslavia - Supplementary Background Material for Use of
the CONTRACTING PARTIES to the GATT

The attached paper has been prepared by the staff to supply more recent background information on Yugoslavia in connection with the forthcoming consultation between the CONTRACTING PARTIES to the GATT and Yugoslavia. In the absence of objection from an Executive Director by noon on Tuesday, October 27, 1981, the paper will be transmitted to the CONTRACTING PARTIES for their information and use.

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INTERNATIONAL MONETARY FUND

YUGOSLAVIA

Supplementary Background Material for the GATT

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

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This supplement updates the Fund reports "Yugoslavia - Recent Economic Developments" (5/27/80) and "Yugoslavia - Supplementary Background Material for Use of the CONTRACTING PARTIES to the GATT" (3/26/81).

I. Introduction

Developments in the Yugoslav economy during 1981 have been mixed. While industrial production has tended to increase at planned rates and real domestic demand has been reduced, and overall monetary and credit targets were adhered to, the rate of inflation has averaged a considerably higher level. Externally, the deficit in the current account of the balance of payment has been contained despite the disappointing performance in exporting to convertible currency countries. For the full year 1981 real gross social product (GSP) is likely to rise by around the planned rate of 3 per cent (Table 1), the retail price index is expected to average over 45 per cent above that in 1980, and the current account deficit of the balance of payments should be kept within the planned target of US\$1.8 billion.

II. Domestic Developments

With domestic production rising at an annual rate of 3 to 4 per cent in the first half of 1981, excess domestic demand has been further reduced. After a slow start, industrial production rose at a rapid rate in the middle months of 1981 and is now expected to rise in line with the planned rate of increase of 4 per cent for the full year (Table 2). Preliminary estimates indicate that the increase in agricultural production in 1981 will be below the planned rise of 4 per cent as a result primarily of a large shortfall in the wheat harvest. Construction activity was the most depressed sector in the first half of 1981, due to the sharp reduction in real fixed investment, which is estimated to have fallen by 7 to 8 per cent compared with the same period of 1980. Real personal consumption is estimated to have fallen by

around 2 per cent, due largely to a decline in real personal incomes; real wages in the socialized sector are estimated to have fallen at an annual rate of 6 to 7 per cent in the first 8 months of the year. The only domestic demand component showing a discernible rise during 1981 has been investment in inventories.

The most disturbing developments in the domestic economy in 1981 have been in the area of prices. Following their acceleration in the second half of 1980, domestic price increases rose at an even faster rate in the initial months of 1981. The 12-monthly rate of increase of the retail price index reached a peak of 53 per cent in May 1981, while that of the industrial producer price index reached 51 per cent in June 1981 (Table 3). The sharp upsurge in prices has been due largely to factors of domestic origin. In January 1981 industrial producer prices rose by 9 per cent as many enterprises engaged in anticipatory price increases so that they could increase profit margins above the levels they expected would be implicit in the formal price agreements governing 1981. Higher rates for sales taxes together with the recording in price indices of increases that had taken place in late 1980 but which had not been reported to the authorities contributed also to the sharp rise in prices in the first quarter of 1981.

The official price targets introduced in March 1981 aimed at limiting the increase in the retail price index to 32 per cent over the 12 months to December 1981, and that in the industrial producer price index to 30 per cent. However, with domestic prices continuing to rise at excessively rapid rates in April and May the authorities enacted legislation on June 18 to limit price increases to 5 per cent and 7 per cent, respectively, for services and goods, over the remainder of the year. The agreement on implementing the price policy in March 1981 required also that republican and provincial authorities provide compensation for part of the increase in the prices of basic foodstuffs (milk, bread, meat, and poultry). The extent of these subsidies was to vary from republic to republic and would in practice be limited by their ability to finance them. The price limits appear to have helped to mitigate the rate of increase of domestic prices in recent months, with the monthly increase in the retail price index in the three months to August averaging 1.1 per cent.

Incomes policy during 1980 and 1981 has aimed at keeping the growth of personal incomes below that of gross incomes of enterprises. In the event, this aim has been achieved with personal incomes in the socialized sector rising by 35 per cent in the first six months of 1981 compared with the same period of 1980, while the corresponding increase in enterprises' incomes exceeded 45 per cent. It was also official policy to keep the rise in real personal incomes in line with the projected rise in labor productivity. This objective has not been met over the last two years due to a faster than anticipated increase in consumer prices, thus causing real personal incomes

to fall. In addition, official guidelines have required that increases in personal incomes in the noneconomic sector (banking, education, health, government, etc.) be limited to a rate of 5 percentage points below those in the economic sector. In the first six months of 1981 the estimated decline in real personal incomes in the noneconomic sector was about twice as great as that in the economic sector. Although real personal incomes are expected to show an increase in the second half of 1981, for the full year they are expected to decline. Pension and other transfers recorded real declines in line with those in real personal incomes during 1981. However, considerable increases in remittances from Yugoslav workers abroad helped boost household receipts and allowed them to limit the fall in real terms.

2. Fiscal developments

Although there have been some weaknesses in the financing of the budget of the Federation, public sector expenditures appear to have been contained over the last two years and have contributed to the stabilization effort. The public sector recorded a deficit of only Din 10.7 billion in 1980 (about 0.1 per cent of GSP) in 1980 despite a sharp rise in the deficit of the budget of the Federation. The Federal Government deficit of Din 20.3 billion in 1980 (Table 4) was well above the planned deficit of Din 6.3 billion. The excess was largely financed by issuing bonds totalling Din 13.3 billion to the commercial banks. Expenditure was 3.5 per cent greater than planned, but it was still fractionally lower as a percentage of GSP than in 1979. Revenue was 9 per cent lower than planned, with the major shortfall occurring in customs duties as a result of the abolition of the 10 per cent surcharge, and an unforeseen shift in the structure of imports toward lower taxed items.

The Federation's expenditure plans for 1981 have not been changed significantly in nominal terms from those decided in late 1980, despite the higher-than-expected price increases that have occurred so far in 1981. Accordingly, the volume of expenditure in real terms is likely to be less than planned and there should be a further decline in the ratio of expenditure to GSP to about 7 per cent, which is in line with the medium-term objective of reducing the relative size of the public sector. Revenues of the Federation are projected to increase by 50 per cent in 1981 due to sharp rises in projected receipts from general turnover and sales taxes and from contributions from the republics and provinces. During the first five months of 1981 both expenditures and revenues lagged well behind schedule. On the revenue side the main areas of concern are receipts from general turnover and sales taxes. These may well turn out lower than planned, because of a change in the structure of household consumption, induced by lower real personal income, away from luxuries that are taxed at higher rates, and toward goods such as food, which are not taxed or are taxed at low rates. It is government policy to offset any shortfall in planned revenues with lower expenditures rather than by additional borrowing. The Federal Government borrowed Din 4.6 billion from the National Bank of Yugoslavia in the first quarter of 1981; there has been no further borrowing since.

3. Money and credit

Restraint on the growth of money and credit is a central part of the stabilization program. In 1980 both money and credit grew considerably less rapidly than nominal income (Table 5). For 1981 it is the authorities' intention to keep the growth of domestic bank credit and the money supply to 22 per cent. In the first six months of 1981 the increases in domestic credit and the money supply were in line with planned limits but well below the growth of nominal GSP. The tightening of monetary conditions during 1981 has been reflected in a continuing marked rise in the income velocity of narrow money. However, part of this increase has resulted from a voluntary switch by the household sector from narrow money into other assets, especially foreign currency deposits, which are included in quasi-money. An increase in trade credits among organizations of associated labor appears to have contributed to the rise in the income velocity of money and helped ease the liquidity position of the enterprise sector.

III. Developments in the External Sector

Externally, the major aim of economic policy is to effect a marked reduction in the current account deficit of the balance of payments. This deficit was reduced from US\$3.7 billion (6 per cent of GSP) in 1979 to US\$2.3 billion (3.7 per cent of GSP) in 1980 (Table 6) due to a substantial increase in the volume of exports and a similar sharp fall in import volume (Table 7). For 1981 the official target for the current account is to contain the deficit to US\$1.8 billion or 2.7 per cent of projected GSP. The trade deficit was projected to remain virtually unchanged at US\$6 billion, with the volume of merchandise exports estimated to rise by 7 per cent and the volume of imports projected to decline by 3 per cent. A moderate increase was projected in the surplus on services account largely as a result of higher net receipts from tourism, investment works abroad and workers' remittances. Although the trade deficit was higher than planned in the first part of 1981, due largely to relatively poor performance in exporting to convertible currency countries, the current account target for the full year is expected to be attained because of higher-than-expected receipts from merchandise exports to the nonconvertible currency area, and from services' exports, particularly tourism, workers remittances, and investment works abroad.

Developments in the capital account during 1981 indicate that drawings on medium- and long-term loans will be approximately the same as in 1980. The bulk of such drawings comprise the utilization of suppliers' credits and the disbursement of financial credit obtained by the National Bank of Yugoslavia. The latest official projections call for a small reduction in short-term external indebtedness during 1981 and a build-up in external reserves. The level of gross international reserves amounted to US\$1,513 million at the end of September 1981 compared with US\$1,462 million at the end of 1980 (Table 8).

The effective exchange rate (trade weighted) for the Yugoslav dinar appreciated slightly in the first seven months of 1981 although costs and prices showed a large increase relative to those in trading partner countries. Thereafter, in August and September 1981 the dinar was depreciated considerably in a series of steps. By end-September 1981 the dinar had depreciated by around 16 per cent compared with end-July 1981 and by 12 per cent compared with a year earlier.

In April 1981 a significant liberalization of import restrictions was undertaken by shifting a large number of items from the restricted import commodity lists to the liberalized (LB) list. As a result, in terms of numbers of items, the share of liberalized items in the total rose from 60 per cent to 78 per cent. In value terms, the share of items in the LB list is estimated to have risen by about 15 percentage points to some 55 per cent. The items liberalized affected many different types of commodities including agricultural products, raw materials, and consumer goods.

In July 1981, a limitation was placed on the amount of domestic currency that could be exported or imported into Yugoslavia. Previously an amount of Din 1,500 was permitted for each trip but now such an amount is permitted on one trip only each year. This measure was motivated mainly with a view to stemming capital flight. The Fund granted temporary approval of this measure in August 1981.

Table 1. Yugoslavia: National Accounts, 1/ 1977-85

	1980 In billions of dinars; at current prices	Percentage Change					
		1977	1978	1979	1980	1981 Plan <u>2/</u>	1981-85 Plan average
Private consumption	803.0	7.0	7.0	6.0	0.3	1.5	3.0
Public consumption <u>3/</u>	136.5	7.4	5.3	7.9	1.6	-2.1	3.3
Gross fixed capital formation	536.6	11.7	13.4	4.6	-1.6	-4.8	1.6
Gross domestic expenditure	1,618.8	11.7	4.8	9.5	0.5	-0.6	2.8
Exports: goods and services	360.3	-4.4	-1.9	3.4	7.9	7.0	8.0
Imports: goods and services	456.9	12.5	-1.3	9.8	-10.4	-3.0	1.1
Gross social product	1,564.9	8.0	6.8	7.0	2.2	3.0	4.5
<u>Memorandum item:</u>							
Gross social product deflator		14.7	15.0	20.7	31.3	--	14.4

Source. Data supplied by the Yugoslav authorities.

1/ Based on material product national income accounting according to Yugoslav methodology, which excludes services rendered to individuals from the gross material product. Gross domestic product is estimated to be about 15 per cent higher than gross social product for 1980.

2/ Revised estimates.

3/ Includes material costs of general and material consumption only. In particular, it excludes personal incomes payments.

Table 2. Yugoslavia: Gross Social Product by Sector 1/

	1980 Level at current prices; in billions of dinars estimated	Percentage Change				
		1978 At constant prices <u>2/</u>	1979	1980 At constant prices <u>2/</u>	1981 <u>3/</u> Plan	1981-1985 <u>3/</u> Plan average
Manufacturing and mining	5,680	8.6	7.9	4.4	4.0	5.0
Of which.						
Energy	74	4.7	6.5	6.4	6.0	7.1
Basic metals	49	8.5	3.1	2.6	3.0	7.0
Equipment and consumer durables	147	12.5	9.7	3.5	2.6	4.6
Nonmetallic minerals and construction material	35	9.6	7.4	5.6	4.7	5.7
Chemicals	55	14.1	8.2	9.2	5.6	7.3
Other	208	5.7	8.2	3.6	4.1	4.2
Agriculture, forestry, and fishing	191.0	-4.6	5.3	-1.8	4.0	4.3
Trade and catering	362.9	9.8	6.1	3.0	3.5	4.8
Construction	166.0	11.5	9.7	4.0	-2.6	1.0
Transport and communications	136.5	10.2	4.2	4.0	4.3	5.0
Arts, crafts, and others <u>4/</u>	<u>137.6</u>	<u>6.6</u>	<u>5.2</u>	<u>4.2</u>	<u>4.0</u>	<u>5.5</u>
Total	1,562.0	6.8	7.0	3.1	3.2	4.5

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

1/ Based on material product national income accounting according to Yugoslav methodology, which excludes services rendered to individuals from the gross material product. Gross domestic product is estimated to be about 15 per cent higher than gross material product or gross social product.

2/ At constant 1975 prices.

3/ At constant 1980 prices.

4/ Includes public utility production.

Table 3. Yugoslavia: Twelve-Monthly Changes in Price Indices

(Percentage changes in 12 months to end of period)

	1977	1978	1979	1980	1981 <u>1/</u>
Producers' prices					
Industrial goods, total	9.8	8.9	15.2	39.8	51.0
Investment goods	10.5	5.1	5.3	22.2	25.0
Semifinished goods	9.4	9.8	17.8	46.7	55.8
Consumption goods	10.0	8.5	13.1	33.7	47.4
Agricultural goods, total	5.7	12.6	23.6	46.5	51.7 <u>2/</u>
Retail prices					
General index	14.0	15.7	23.9	39.2	49.0
Agricultural goods	13.3	14.0	25.8	42.2	41.6
Industrial goods	14.5	16.5	24.0	41.7	55.2
Services	15.0	14.3	24.0	24.3	30.7
Cost of living					
General index	14.1	15.8	23.0	37.3	43.4
Food	14.1	14.1	22.7	40.3	45.1
Clothing	15.1	17.6	22.2	29.1	38.1
Rent	12.7	16.1	18.7	25.7	22.8
Services <u>3/</u>	14.7	14.0	21.6	22.7	29.1

Sources: Indeks; and data supplied by the Yugoslav authorities.

1/ June 1981, compared with June 1980.

2/ April 1981, compared with April 1980.

3/ Excluding rent.

Table 4. Yugoslavia: Budget of the Federation

(In millions of dinars)

	1979	1980	1981 Revised Plan
Revenue			
Customs duties and other import fees	24,591	20,694	24,137
Contributions from republics and provinces	28,436	38,469	63,773
General turnover and sales taxes	37,700	47,400	73,377
Other taxes	169	230	230
Nontax revenues	<u>2,681</u>	<u>2,501</u>	<u>2,850</u>
Total revenue	93,577	109,354	164,367
Expenditure			
Administration	15,621	18,574	20,680
Defense	55,084	76,149	101,894
Grants to republics and provinces	10,502	14,258	16,277
Grants to funds and communities of interest	14,794	18,700	25,237
Investment	674	818	874
Other or discrepancy	<u>618</u>	<u>1,173</u>	<u>1,536</u>
Total expenditure	97,293	129,672	166,498
Surplus or deficit	-3,716	-20,318	-2,131
Financing, net domestic	<u>3,716</u>	<u>20,318</u>	<u>2,131</u>
Bond issues	--	13,344	--
National Bank credits	8,451	9,200	4,600
Repayment of bank credits	-1,678	-726	-1,979
Bond amortization	-2,857	-1,264	-205
Allocation to budgetary reserves	-200	-236	-285

Source: Data supplied by the Yugoslav authorities.

Table 5. Yugoslavia: Monetary Survey 1/

(Change in billions of U.S. dollars)

	Stock at end of period in billions of dinars				Percentage change over 12 months to end of period			
	1979 Dec.	1980 June	1980 Dec.	1981 June	1978	1979	1980	1981 June
Net foreign assets	-112.0	-209.8	-257.3	...	-138.6	-235.3	-129.7	...
Domestic credit <u>2/</u>	1,201.3	1,368.4	1,554.6	1,733.1	29.5	26.7	29.4	26.7
Money supply <u>3/</u>	375.2	399.3	461.6	506.0	25.5	19.0	23.0	25.7
Quasi-money <u>4/</u>	575.9	680.4	785.5	...	33.5	28.5	36.4	...
Other items, net	171.0	111.1	50.2	...	16.6	-5.7	-63.7	...

Source: Data supplied by the Yugoslav authorities.

1/ The definition of the banking sector covered by these estimates varies between series and years. A broad definition, including the post office savings bank and the fund for financing trade, is used for money supply in all years, and for quasi-money since 1979. A narrow definition excluding these two institutions is used for domestic credit in all years, and for quasi-money up to 1979. Net foreign assets are the same under the two definitions. Other items, net, is a residual and absorbs the (small) adjustment arising from the use of inconsistent definitions in the same year.

2/ Comprises bank loans extended in both dinars and foreign currencies.

3/ Includes government deposits and excludes items in transit.

4/ Comprises foreign exchange deposits of residents, other sight deposits, time deposits, restricted deposits, securities issued by banks, and claims on banks in respect of pooled resources.

Table 6. Yugoslavia: Balance of Payments, 1978-81

(in millions of U.S. dollars)

	1978	1979	1980	Jan - June 1980	1981 Estimate
A Goods and services and unrequited transfers					
Exports, f.o.b.	-1,283	-3,661	-1,291	-2,240	-1,848
Imports, c.i.f.	5,809	6,794	8,978	4,104	4,726
	-10,439	-14,019	-15,064	-7,358	-8,262
Trade balance	-4,630	-7,225	-6,086	-3,254	-3,536
Services and unrequited transfers					
<u>Credits</u>					
Workers' and emigrants' remittances	2,950	3,391	4,050	1,820	2,250
Travel	1,130	1,183	1,645	430	530
Transportation	1,200	1,405	1,669	796	860
Interest	170	188	197	66	139
Other	810	1,312	1,761	547	755
Total	6,260	7,482	9,322	3,659	4,534
<u>Debits</u>					
Workers' and emigrants' remittances	-1,280	-1,683	-2,511	-1,381	-1,285
Travel	-128	-155	-130	-45	-60
Transportation	-590	-674	-817	-380	-422
Interest	-495	-821	-1,281	-470	-691
Other	-420	-585	-768	-369	-388
Total	-2,913	-3,918	-5,527	-2,645	-2,846
Services and unrequited transfers (net)	3,347	3,564	3,795	1,014	1,688
B Long-term capital					
Long-term loans (received)					
Drawings	2,800	2,438	3,474	1,085	1,770
Repayment	-1,300	-1,304	-1,446	-728	-962
Long-term loans (extended)	-106	-125	-221	-167	-130
Total	1,394	1,009	1,807	190	678
C Total (A through B)	111	-2,652	-484	-2,050	-1,170
D Bilateral balances	-65	742	354	265	-70
E Short-term capital including errors and omissions	-25	277	-150	930	989
F Total (A through E)	21	-1,633	-280	-855	-251
G Allocation of SDRs	--	37	37	37	38
H Compensatory borrowing	350	250	71	100	50
I Total (A through H)	371	-1,346	-172	-718	-163
J Reserve movements					
Use of Fund credit	-21	218	304	348	215
SDRs	-7	-34	41	-46	-8
Reserve position in the Fund	-81	81	--	--	--
Gold	-5	-4	-5	-5	--
Official foreign exchange (increase -)	-257	1,085	-168	421	-44
Total	-371	1,346	172	718	163

Sources National Bank of Yugoslavia, and staff estimates

1/ Data on capital account converted on statistical exchange rate basis

Table 7. Yugoslavia: Foreign Trade Indicators
(Percentage change over previous year, in terms of US\$)

	1976	1977	1978	1979	1980
Exports					
Value	16.7	8.0	11.9	16.9	32.1
Volume <u>1/</u>	15.2	-2.7	2.7	1.6	11.0
Price	4.0	11.0	9.0	15.0	19.0
Imports					
Value	-7.4	32.5	6.6	34.3	7.4
Volume <u>1/</u>	-10.1	16.6	1.5	12.9	-10.5
Price	3.0	13.6	5.0	19.0	20.0
Terms of trade	1.0	-2.6	3.8	-4.3	-1.0

Sources: Data supplied by the Yugoslav authorities; IMF, International Financial Statistics; and staff calculations.

1/ Derived from value data converted at current exchange rates and price indices reported to IFS.

Table 8. Yugoslavia: External Reserves

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

		National Bank of Yugoslavia Official Reserves				Foreign Assets of Deposit Banks	
		Reserve Position in the Fund	SDRs	Gold	Foreign Exchange	Total	Total
1975		--	34	60	777	871	350
1976		--	10	59	1,980	2,049	658
1977		--	13	64	2,031	2,108	666
1978	I	--	12	66	2,184	2,263	714
	II	77	12	66	2,000	2,155	820
	III	79	24	66	2,283	2,453	869
	IV	81	20	69	2,288	2,457	783
1979	I	78	52	71	1,845	2,046	727
	II	--	76	71	1,711	1,858	664
	III	--	72	71	1,654	1,797	942
	IV	--	54	73	1,203	1,330	638
1980	I	--	74	75	762	911	424
	II	--	100	78	782	960	843
	III	--	79	78	802	959	1,273
	IV	--	13	78	1,371	1,462	1,102
1981	I	--	22	78	1,408	1,508	1,130
	II	--	21	78	1,415	1,514	...
	August	--	42	78	1,352	1,472	...
	September	--	42	78	1,393	1,513	...

Sources: IMF, International Financial Statistics; and National Bank of Yugoslavia.