

**FOR
AGENDA**

EBS/71/35
Correction 1

CONFIDENTIAL

February 18, 1971

To: Members of the Executive Board
From: The Secretary
Subject: Yugoslavia - Request for Stand-By Arrangement

The following correction has been made in EBS/71/35. A corrected page is attached.

Page 16, paragraph no. 8, third sentence, should read:

"The increase in budgetary and extrabudgetary expenditures for 1971 cannot exceed in total by more than 10.8 per cent, total expenditures in 1970."

Att: (1)

capital inflow, the decline in net foreign assets of the monetary sector will approach \$100 million. The gross gold and convertible foreign exchange holdings of the banking system are currently less than \$300 million; and a continued decline in these reserves could not be permitted for long.

4. During the course of 1970, measures were taken to reduce excess demand. Monetary policy was tightened by a number of successive measures. Temporary ceilings on short-term credit of banks were imposed from May to July. Reserve requirements were raised from 30 to 32 per cent in July and August. In addition, the over-all rediscount ceiling was lowered, the minimum liquidity ratio of banks was raised, and the conditions for central bank borrowing by banks were more restrictively interpreted. In July, an import surcharge of 5 per cent was introduced. In the fiscal field, turnover taxes on a number of products were increased in April, and part of the increased revenue was blocked. However, these measures were not sufficient to halt the deterioration in the economic situation. In particular, imports continued at a very high level and the weakness in the balance of payments remained. Therefore, in the final months of 1970, the Government embarked on a stabilization program.

5. The program is being designed to halt the present inflationary trends and to eliminate the over-all deficit in the balance of payments, while allowing a rate of growth in the economy that will absorb the increase in the labor force. The stabilization effort consists of two stages. In the first, which is currently in effect, some measures have been taken, that are intended to have an immediate effect on the major symptoms of the current imbalance. These measures are essentially of a temporary character. In the second stage, which will be introduced during the first half of 1971, more fundamental adjustments will be made in the field of incomes, monetary and fiscal policy, as an integral part of the new five-year plan, 1971-75. In the external field, the Government is aiming at a level of gold and convertible currency reserves (including the Fund position and SDRs) of the National Bank that is not less at the end of the year than at the end of 1970.

6. The temporary measures referred to in the previous paragraph include the following. There is currently a freeze on all prices. Conditions governing consumer credits have been tightened. At the end of December 1970 outstanding short-term credits of the business banks are to be not more than 1.5 per cent greater than at the end of October 1970 and not more than one per cent higher than the October figure at the end of January 1971. During the first quarter of 1971, the increase in money supply will be limited to 2 per cent of the total at the end of December 1970. In the fiscal field, expenditure increases in all budgets and in all extrabudgetary funds in the first quarter of 1971 cannot exceed their level in the first quarter of 1970 by more than 10.8 per cent. Measures directly influencing foreign transactions include a prior deposit scheme for imports, increases in interest rates on deposits in foreign currency, and postponements in the allocation of import authorizations.

7. The Government believes that these measures will improve the economic position of Yugoslavia, particularly as regards the balance of payments. However, it considers that there are some problems that can be solved only by longer-term policies. It is, therefore, as mentioned above, in the process of instituting a series of more basic measures. Among them, it is proposed that a law will be passed that will govern the determination of personal incomes. The law will cover all personal incomes. It will involve compulsory negotiations between economic organizations, the Chambers of the economy, the trade unions, and the Government. The principles governing these negotiations will take account of productivity changes and differences between regions. Provision will be made for disciplining, by means of additional taxation, economic organizations that do not follow decisions made regarding permissible increases in personal incomes. As an immediate measure, the Government decided that minimum depreciation rates will be substantially increased. This will reduce the funds of economic organizations legally available for income distribution under the system of self-management. The Government firmly believes that, when instituted, these new policies will prove effective in preventing excessive increases in labor costs.

8. As mentioned above, steps have already been taken to reduce the growth of fiscal expenditure in the first quarter of 1971. The Government believes that it is essential that this restraint be continued and for the year as a whole fiscal policy will be significantly more restrictive than in 1970. The increase in budgetary and extrabudgetary expenditures for 1971 cannot exceed in total by more than 10.8 per cent, total expenditures in 1970. This will mean very little growth in real terms for about 30 per cent of total domestic expenditures. The law requires all budgets to be in balance, and in 1971 the Government also expects the extrabudgetary funds as a whole to be in balance. Budget surpluses which had been blocked in 1970 will not be released during 1971 except for a few very special categories of use. Any increases in revenue in 1971 over 1970 in excess of 10.8 per cent will also be blocked, and the use of special reserve funds will be further restricted.

9. The Government is in the process of deciding upon the division of fiscal responsibility between the Federation on the one hand, and the Republics and local authorities on the other. By placing more direct responsibility in the latter group, in terms of undertaking expenditures and being obliged to finance them, the Government believes that more effective fiscal discipline will follow.

10. The Government believes that, to ensure the success of the program, it will be necessary to pursue a tight monetary policy throughout 1971. A decision has been made to limit the growth of the money supply during the first quarter of 1971 to 2 per cent. This is equivalent to an annual rate of increase of around 10 per cent, which is less than the expected increase in nominal social product and which is believed to be appropriate for 1971 as a whole. An increase during 1971 of not more than Din 7.5 billion in domestic credit of the banking system as currently