

EBS/81/5
Correction 2

CONFIDENTIAL

January 27, 1981

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

The following corrections have been made in EBS/81/5
(1/16/81):

Page 15, 1st full para., line 4: for "26 per cent" read "28 per cent"

Page 33, Column 1980, Revised, line 10: for "19,334" read "14,334"

Column 1981, line 16: for "-1,687" read "489"
line 17: for "163,320" read "165,592"

Corrected pages are attached.

Att: (2)

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commenced, except if totally self-financed by the public body concerned. The public sector as a whole is expected to be in approximate financial balance in 1981.

Data is now available only for the budget of the Federation, which in recent years has been virtually the sole source of the public sector deficit (Table 15). Preliminary estimates indicate that total expenditures of the Federation are to increase by 28 per cent in 1981. Outlays for defense, which are expected to comprise about 62 per cent of the total are projected to rise by 34 per cent, while nondefense expenditures are targeted to rise by less than 16 per cent and to decline substantially in real terms. Total revenues are budgeted to rise by 52 per cent. Custom revenues are expected to rise by 80 per cent largely as a result of the accrual of a higher proportion of these revenues to the Federation; the percentage is to rise from 42 per cent in 1980 to 68 per cent in 1981 at the expense of institutions in the republics concerned with foreign economic relations. Receipts from general turnover and sales taxes are budgeted to increase by 56 per cent in 1981 owing primarily to an expected rise in sales and turnover tax rates. The deficit is expected to amount to Din 1.1 billion compared with Din 21.1 billion in 1980, which was equivalent to about 1.3 per cent of GSP. As described above, borrowing from the National Bank will be reduced from Din 9.2 billion in 1980 to Din 4.6 billion, of which Din 3.0 billion will be used to amortize bonds held by the commercial banks.

c. Incomes and prices policies

Real personal incomes in the socialized sector are to rise on average by 1.3-1.5 per cent in 1981, in line with the projected increase in labor productivity. Enterprises will be expected to continue the differentiated incomes policies pursued in 1980, i.e., workers in noneconomic sectors (e.g., communal services, banking, and finance) will receive below average increases, while workers in arduous occupations will receive relatively higher increases. Measures will be taken to improve the standard of living of the lower income households through higher allowances for children and educational expenses.

The authorities expect that the stability of real domestic demand and the low increase in real personal incomes will have a dampening effect on domestic prices in 1981. In addition, the need for administered price increases should be substantially less. Furthermore, neither the depreciation of the effective exchange rate of the dinar nor the increase in dollar prices of Yugoslav imports is expected to be as great in 1981 as in 1980.

4. Exchange rate, foreign borrowing, and reserve policies

In 1981 the authorities will continue to aim at maintaining external competitiveness through any necessary adjustments in the exchange rate of the Yugoslav dinar in accordance with relative price and cost movements and the evolution of the current account. In spite of the forecast decline in the current account deficit in 1981, gross medium- and long-term loan receipts are projected to be at approximately the same level as in 1980, of

which at least US\$800 million in financial credits is expected to be obtained by the National Bank of Yugoslavia. Yugoslavia expects further increases in its net liabilities under bilateral payment agreements (with non-Fund members) and compensatory foreign borrowing by the commercial banks. The above receipts, together with the proposed use of Fund resources, would permit the repayment of some short-term credit and a modest increase in the level of gross official reserves, which the authorities believe is essential. The resultant level of official reserves of US\$1.8 billion would be equivalent to the very low level of about one month's supply of imports of goods and services from the convertible currency area. Consistent with these borrowing plans and the expected pattern of developments in the current account of the balance of payments, the authorities have established quarterly targets for the net convertible foreign assets of the National Bank (excluding the medium- and long-term liabilities mentioned below) less compensatory borrowing by the commercial banks and semi-annual targets for the net increase in medium- and long-term borrowing in convertible currencies, including that by the National Bank but excluding compensatory borrowing by the commercial banks. These limits, which are shown in Table 31, are incorporated in the proposed stand-by arrangement as performance criteria.

V. Staff Appraisal

The economic performance of Yugoslavia deteriorated sharply in the period 1977-79, culminating in the emergence of a current account deficit in the balance of payments in 1979 of US\$3.7 billion, equal to 6 per cent of GSP. A variety of factors contributed to the deterioration. Some were external and outside the authorities' control. Others, including excess domestic demand and an unsatisfactory pattern of production and investment, resulted in part from inadequate policies. The solutions to the economic imbalances required strong and pervasive economic actions. They also required a mixture of short-term demand management policies and longer-term policies to bring about structural changes, particularly those affecting the balance of payments directly or indirectly. Although a stabilization program based largely on demand management policies was begun in 1979, little success was evident in that year. Also, although structurally oriented policies were instituted to some extent during the 1976-80 Plan period, their effects were slow to eventuate. At the end of 1979 the authorities recognized that a much greater effort was needed both in the 1980 Annual Plan and in the period of the 1981-85 Plan.

The 1980 stabilization program had very considerable success. Policies were firmly implemented in all areas and in the main achieved their intended results, in part because there was widespread cooperation from all levels of government and enterprises. In particular, there was a major improvement in the balance of payments, with the current account deficit declining by about US\$1.5 billion to US\$2.2 billion. The fact that domestic demand grew more slowly than did total output, was aided in part by commendable restraint in nominal wage increases, which led to a substantial decline in real wage rates and a strengthening of enterprise finances. Furthermore, the first signs of structural improvement began to appear.

Table 15. Yugoslavia: Budget of the Federation

(In millions of dinars)

	1977	1978	1979	1980		1981 Plan
				Original	Revised	
Revenue						
Customs duties and other import fees	39,755	23,333	24,591	30,591	19,540	35,437
Contributions from republics and provinces	38,996	20,827	28,436	36,914	38,469	52,562
General turnover and sales taxes	--	26,273	37,700	48,859	47,120	73,377
Exchange profits	80	--	--	--	--	--
Other taxes	96	121	169	155	304	230
Nontax revenues	1,085	2,047	2,681	2,568	2,701	2,850
Total revenue	80,012	72,601	93,577	119,088	108,234	164,456
Expenditure						
Administration	10,908	13,066	15,621	17,491	17,626	21,380
Defense	38,131	42,595	55,084	73,598	76,276	101,894
Grants to republics and provinces	6,139	7,028	10,502	13,834	14,334	16,277
Grants to funds and communities of interest	10,410	12,441	14,794	18,519	19,197	25,237
Intervention in the economy	22,257	1,415	--	--	--	--
Foreign trade	(19,809)	(1,277)	(--)	(--)	(--)	(--)
Agriculture	(2,448)	(138)	(--)	(--)	(--)	(--)
Investment	547	551	674	765	765	215
Other or discrepancy	590	790	618	1,122	1,122	489
Total expenditure	88,982	77,886	97,293	125,329	129,320	165,592
Surplus or deficit	-8,970	-5,285	-3,716	-6,271	-21,086	-1,136
Financing, net domestic 1/	8,970	5,285	3,716	6,271	21,086	1,136
Bond issues	3,980	--	--	--	14,844	--
Bank credits, net 2/	13,000	...	--	--	--	--
Of which:						
National Bank	(11,200)	(9,487)	(8,451)	(9,200)	(9,200)	(4,600)
Repayment of bank credits 2/	-562	-847	-1,678	-1,373	-1,373	-2,974
Bond amortization	-3,621	-3,055	-2,857	-1,390	-1,350	-205
Allocation to budgetary reserves	-284	-300	-200	-236	-236	-285
Additions to deposits and cash balances	-1,700	--	--	--	--	--
Other or residual	-2,405	--	--	--	--	--

Sources: Data supplied by the Yugoslav authorities; budget documents published in Sluzbeni List; and National Bank of Yugoslavia, Annual Report, 1977 and Quarterly Bulletins.

1/ Foreign loans are no longer used to finance the federal budget deficit. Repayment of most previously contracted foreign loans is now the responsibility of the organizations of associated labor, which were the actual beneficiaries of the loans.

2/ For the 1977 outturn, data on repayment of bank credits are included in net bank credits. For the following years, they are not included.

Table 16. Yugoslavia: Public Sector Operations
by Level of Government

(In billions of dinars)

	1976	1977	1978	1979 ^{1/}
Federal budget				
Revenues	64.9	80.0	72.6	93.6
Expenditures	75.5	89.0	77.8	97.3
Of which:				
Transfers to other budgets	(5.4)	(6.1)	(7.0)	(10.5)
Transfers to funds and communities of interest	(9.6)	(10.4)	(13.8)	(15.2)
Surplus or deficit	-10.6	-9.0	-5.2	-3.7
Budgets of republics and autonomous provinces				
Revenues	21.0	25.5	37.5	50.2
Of which:				
Grants from other governmental units	(5.2)	(6.1)	(7.0)	(10.5)
Expenditures	21.9	25.3	37.1	50.1
Of which:				
Transfers to other governmental units ^{2/}	(1.7)	(2.5)	(3.0)	(4.9)
Surplus or deficit	-0.9	0.2	0.4	0.1
Budgets of communes and cities				
Revenues	20.2	22.7	30.9	39.8
Of which:				
Grants from other governmental units	(1.7)	(--)	(3.0)	(3.3)
Expenditures	20.5	26.8	31.5	38.5
Of which:				
Transfers to other governmental units	(0.3)	(--)	(--)	(...)
Surplus or deficit	-0.3	-4.1	-0.6	1.3
Social security funds ^{3/}				
Revenues	85.2	105.8	135.8	165.3
Of which:				
Grants from federal budget	(7.8)	(7.1)	(12.4)	(15.2)
Grants from other budgets	(--)	(2.5)	(--)	(...)
Expenditures	89.0	105.3	136.0	162.4
Surplus or deficit	-3.8	0.5	-0.2	2.9
Funds and interest communities ^{4/}				
Revenues	67.1 ^{5/}	89.7	131.3	152.4
Of which:				
Grants from federal budget	(1.8)	(3.3)	(1.4)	(1.6) ^{6/}
Expenditures	63.4	84.5	130.7	152.1
Surplus or deficit	3.7	5.2	0.6	0.3
Consolidated public sector ^{7/}				
Revenues	241.4	304.7	384.3	470.7
Expenditures	253.3	311.9	389.3	469.8
Surplus or deficit	-11.9	-7.2	-5.0	0.9
Financing				
External, net	-1.5	-0.1	-0.1	--
Domestic, net	13.4	7.3	5.1	-0.9

Sources: Data supplied by the Yugoslav authorities; Sluzbeni List; National Bank of Yugoslavia, Annual Reports and Quarterly Bulletins; and IMF, Government Finance Statistics Yearbook.

^{1/} Preliminary.

^{2/} Not including agreed contributions to the federal budget.

^{3/} Including communities for child protection and health, pension, and invalid insurance.

^{4/} Excluding social security funds above and the fund for the development of the underdeveloped regions. Data on these funds and interest communities are estimated by treating them as a residual using data on the consolidated public sector, grants and transfers, and on expenditures and revenues of other levels of government.

^{5/} Due to rounding errors, revenues were adjusted upward by Din 0.5 billion.

^{6/} From the republics and autonomous provinces.

^{7/} Exclusive of grants and transfers among governmental units.