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Statement by Mr. Polak on Yugoslavia
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I would like to express the appreciation of the Yugoslav authorities, as well as my own appreciation, for the staff paper reviewing the developments under Yugoslavia's stand-by arrangement that is now nearly two years old. The staff's paper discusses with perception the difficulties that Yugoslavia has encountered in the management of its economy. The paper also explores frankly the causes of these difficulties and suggests remedies. The Yugoslav authorities are grateful for the contribution that the Fund staff has again made in its analysis of the economic situation of the country and they agree with the staff that only a full realization of the problems that have emerged can lead to the adoption of constructive and lasting corrections. Like the staff, they have been disappointed by certain aspects of the performance of the economy and they concur with the staff where it has pointed out failures of policy that have manifested themselves so far this year.

One of the important weaknesses of policy was the excessive rise in real personal income in late 1981 and in the first half of 1982. This rise was both a cause and an effect of renewed surges of inflationary pressures. Indeed, one of the central difficulties of policy in Yugoslavia in recent years has been for the Government to get sufficient grip on the practices of the country's collective enterprises with regard both to the setting of prices and to the distribution of wages. The successive rules promulgated to deal with these interrelated aspects of an inflationary spiral have not so far been sufficiently successful to control this spiraling process.

Excessive growth of real income of consumers has led to excessive demand for consumption goods. Moreover, other components of the domestic demand for output also did not perform with the moderation that had been expected. Public consumption grew more rapidly than had been planned and the cut that was realized in investment activity was only about half as large as planned. As a consequence of these various forms of excessive demand, imports tended to increase and exports to decline. This started the operation of a causal chain (which was moreover intensified by external factors): the decline in exports reduced the availability of foreign exchange which then forced a decline in imports of raw materials, which in turn restrained output and thereby the availability of goods for export.

There is at present a full realization in the Government that these unplanned and undesired developments cannot be allowed to continue and that quite radical changes in policy are needed to bring aggregate demand in line with what the economy can supply--after making allowance for the first priority of improving the current account of the balance of payments. It is recognized that the attainment of this latter objective in a setting of very slow growth in Yugoslavia's markets will involve much greater sacrifices by the population than those that have been absorbed in the last two or three years.

Accordingly, a broad range of measures has been taken since the middle of this year, designed to achieve a slowdown in domestic demand so as to make possible an increase in export and hence the increase in imports necessary to expand output. To back up this general policy, measures have been taken to bring about a deceleration in the increase in personal income as well as a decline in public consumption. Moreover legislation introduced in July limits the availability of financial resources for investment, increases the share of any investment that has to be financed from the savings of the enterprise itself, bans the use of bank credit to pay for cost overruns of investment, etc. As a result, fixed investment in the third quarter of the year declined by nearly 10 per cent in real terms. As regards public consumption, communities and other public bodies have been obliged, during the last five months of this year, to spend no more than 85 per cent of their revenues, the remainder being blocked in a special account.

It is the view of the Yugoslav authorities that the deceleration in the rate of inflation should primarily result from a fall in domestic demand. However, given the pressure on prices arising from the change in the exchange rate, the Federal Executive Council has also imposed price control on all goods and services.

In addition to the approach based on a contraction of demand, the authorities also adopted a number of measures that were designed to assist directly to bring about an improvement in the balance of payments. The most important of these measures was the decision, taken last month, to devalue the dinar by 20 per cent, after a depreciation by about 19 per cent brought about by the crawling peg adopted at the beginning of the year. The new devaluation should offset the disparity that had existed against European currencies and should make Yugoslavia's exports to Western European countries fully competitive.

Other measures were taken to improve balance of payments performance with respect to invisibles. Special mention may be made in this context of a recent decree that imposes (with some limited exceptions) the obligation on citizens traveling abroad to maintain an interest free bank deposit for a period of one year. The amount of the deposit is Din 5,000 (about US\$80) for the first trip in one year and then increases by Din 2,000 for each subsequent trip. New measures have also been taken to restrict the import of Yugoslav bank notes and to avoid the private conversion (i.e. outside of banks) of foreign exchange brought in by tourists.

In the field of energy, a number of additional measures have been announced to reduce consumption and encourage conservation.

I have already referred to the difficult international trading climate in which Yugoslavia is making its effort toward fundamental adjustment. Superimposed on these difficulties are the unfavorable credit conditions in international financial markets. During 1982, Yugoslavia has been subjected to an outflow of capital and to extreme difficulties in negotiating new credits. These conditions have put heavy pressure on the

country's slim reserves, which were roughly halved in the first six months of 1982 and now stand at a very low level. The situation has been worsened by the credit difficulties that one important and a few small commercial banks have brought upon themselves and which have had an unfavorable effect on Yugoslavia's credit status. Shortage of foreign exchange has been the most direct cause of the decline in output during the first half of this year but this decline has been brought to a halt in the third quarter, thus fortifying the basis for a better performance with respect to exports.

The foreign exchange shortage has been one of the reasons for the introduction of the financial measures referred to above, as well as for the introduction of the limitation of US\$250 in currency to be withdrawn from foreign currency accounts. Any additional withdrawals can only be made by checks payable outside the country. The extremely tight foreign liquidity position is a major preoccupation of the authorities, who are actively engaged in negotiating additional bank financing, admittedly under highly adverse circumstances. The staff is correct in pointing out (p. 14) that the first half of 1983 will commence with very low levels of reserves and stocks of imported goods and a minimal amount of financial credits in the pipeline.

Many of the measures advocated by the staff in the final paragraph of its paper have in the meantime been taken. I should mention in particular measures to control the development of incomes and to restrain consumption, as well as the recent devaluation to ensure that the economy is fully competitive. Beyond this, the authorities are fully prepared to adopt new and even more severe measures should these prove necessary to bring their adjusted efforts to a successful conclusion.