FOR AGENDA

EBS/90/35
Supplement 1

CONFIDENTIAL

March 2, 1990

To: Members of the Executive Board

From: The Secretary

Subject: Yugoslavia - Request for Stand-By Arrangement

Attached for consideration by the Executive Directors is a paper on Yugoslavia's request for a stand-by arrangement equivalent to SDR 460 million. The letter from the Yugoslav authorities, together with a memorandum of economic policies, was circulated as EBS/90/35 on February 23, 1990. A draft decision appears on page 26.

Mr. van Houten (ext. 8850), Mr. Weerasinghe (ext. 8873), or Mr. Lahiri (ext. 8864) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

YUGOSLAVIA

Request for Stand-By Arrangement

Prepared by the European and Exchange and Trade Relations Departments

(In consultation with the Fiscal Affairs, Legal, and Treasurer's Departments)

Approved by Manuel Guitián and Eduard Brau

March 2, 1990

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I. Introduction

Following several preliminary staff visits, negotiations on the program in support of which Yugoslavia is requesting a stand-by arrangement were held in Belgrade during October 23-November 3, December 5-19, 1989 and February 7-9, 1990. 1/ The negotiations were concluded at headquarters in the period February 17-19, 1990. The staff met with Prime Minister Marković; with several members of the Federal Executive Council, including Mr. Marendić, Federal Secretary of Development, and Mr. Zekan, Federal Secretary of Finance; Mr. Vlatković, Governor of the National Bank of Yugoslavia; and with senior officials of the Federal Secretariats of Finance, Development, Labor and Foreign Economic Relations, the National Bank of Yugoslavia, the Social Accounting Office, and the Federal Bureau of Prices. Mr. van Houten also met with Mr. Drnovćek, President of Yugoslavia. Mr. Posthumus, Executive Director for Yugoslavia, attended a number of meetings during the December discussions. The Managing Director met with Mr. Marković in Washington on October 13, 1989.

In the letter and accompanying Economic Policy Memorandum dated February 23, 1990 (EBS/90/35), Yugoslavia requests an 18-month stand-by arrangement in an amount equivalent to SDR 460 million (75 percent of quota). It is proposed that purchases be made available in seven equal tranches of SDR 65.7 million each, financed from ordinary and borrowed resources. Taking into account scheduled repurchases, the outstanding use of Fund credit would rise from SDR 522 million (85 percent of quota) at end-January 1990, to SDR 646 million (105 percent of quota) at end-August 1991 (Appendix II). Accordingly, a waiver of the limitation in Article V, Section 3(b)(iii) of the Articles of Agreement will be required.

On September 12, 1989, the Executive Board suspended the decision approving enhanced surveillance for Yugoslavia adopted on March 12, 1986 (EBM/86/45) until the next Article IV consultation or Fund approval of a stand-by arrangement for Yugoslavia, whichever came first (EBM/89/123, 9/12/89). The authorities have now notified the Fund that upon the approval of their request for a stand-by arrangement, the enhanced surveillance for Yugoslavia will be canceled.

At the time of the 1989 Article IV consultation with Yugoslavia, Executive Directors expressed strong support for the efforts to introduce wide-ranging economic reforms and institutional changes in Yugoslavia (EBM/89/123). However, they were seriously concerned about

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1/ The staff team consisted of Messrs. van Houten (Head), Carter, Lahiri, Weerasinghe (all EUR), Mr. Thomsen (ETR), with Ms. Khattak (secretary, ETR) for the October-November discussions, and Mrs. Monsma (secretary, EXR) in December. The February mission consisted of Messrs. van Houten (Head), Weerasinghe (both EUR), and Mr. Thomsen (ETR).

the high level of inflation, and urged the authorities to give the highest priority to bringing it under control promptly. They stressed the need for a major tightening of monetary and fiscal policy as well as effective guidance over wages. Directors agreed that tighter budget constraints in the enterprise and banking sectors were key conditions to regain control over inflation. In that regard, the reform and clarification of ownership of enterprises and banks was thought to be essential.

World Bank loans disbursed and outstanding amounted to US$1.8 billion at end-December 1989. A structural adjustment loan (SAL) of US$275 million was disbursed in 1983 (Appendix IV) and a second SAL in an amount of US$300 million is expected to be approved shortly to support the Government's structural reforms, inter alia, in the areas of trade and price liberalization and the strengthening of financial discipline and accountability. A financial sector adjustment loan in an amount of US$250 million to support the rehabilitation of the banking sector is also under discussion.

II. Recent Developments 1/

The last stand-by arrangement for Yugoslavia expired on June 28, 1989. This arrangement was designed to address the external and domestic imbalances which had intensified during 1987 and early 1988. Foreign exchange reserves had been nearly depleted and debt servicing difficulties had emerged. Inflation had accelerated while economic activity declined. Major factors which had contributed to the imbalances were a stop-go pattern of wage formation, a general lack of financial discipline and accountability, strongly negative real interest rates, and an inefficient foreign exchange system.

The program's main objectives were to avert a balance of payments crisis, strengthen the external sector, and bring down inflation. It called for the dismantling of the administrative foreign exchange allocation system, a depreciation of the currency, a large increase in interest rates to positive real levels, and a major debt rescheduling. The import regime was to be liberalized and most domestic price controls were to be removed. To secure and protect the projected strengthening of the balance of payments, the program relied on the maintenance of the newly established exchange rate and interest rate levels in real terms. After an initial increase associated with the devaluation and price liberalization, inflation was programmed to decline. Ceilings on bank credit, wages and public spending, calculated on the basis of the targeted path of inflation, provided the nominal anchors for the program.

1/ For a detailed discussion of developments prior to mid-1989, see the Staff Report for the 1989 Article IV Consultation (SM/89/181, 8/17/89) and the accompanying report on Recent Economic Developments (SM/89/188, 8/28/89).

In the event, the program averted an external payment crisis and redressed the external situation; gross reserves increased from US$1.8 billion at the end of 1987 to US$3.3 billion at the end of 1988. However, the program failed to control inflation, which accelerated from 167 percent in the 12 months ending December 1987, to 251 percent in 1988. Failure to stick to the nominal ceilings on credit and wages soon veered the program off track and only the first two disbursements under the arrangement were made. Efforts to revive the program in the context of a scheduled review were unsuccessful.

1. The nature of the inflation process

Since the early 1980s, many factors have contributed to the generation and perpetuation of inflation in Yugoslavia and ultimately to its acceleration to very high levels. Cost factors, including periodic depreciation of the currency and bouts of wage increases, acting in an environment of weak financial discipline of enterprises with ill-defined ownership, led to a ratcheting up of prices that were validated through an accommodating monetary policy. As inflation rose to higher levels, inertial and expectational factors became more pronounced.

Institutional rigidities contributed further to the inflationary outturn. In particular, the National Bank was assigned multiple, often conflicting, objectives and was given virtually no authority to take monetary management decisions. The process of money creation was subject to strong pressures stemming from the requirement that the National Bank provide subsidized selective credits and absorb the losses resulting from the revaluation of foreign currency deposits. In addition, the operating losses of many large nonviable socially owned enterprises were habitually financed by bank credit and ultimately by monetary expansion by the National Bank.

At the time the previous stand-by arrangement went into effect, the underlying rate of inflation was repressed by the existence of price controls. The combination of a 20 percent depreciation, increases in administered prices and the removal of price controls in May 1988, led to substantial upward pressure on the price level. An accommodating monetary stance, in part due to the monetary effects of the stronger-than-expected external performance and the large share of foreign currency deposits in total broad money, validated these pressures and raised inflationary expectations. Moreover, the authorities abandoned the policy of controlling credit through limits on bank credit without taking steps to improve reserve money management. Finally, the history of "on-off" price controls had taught producers to hike prices in "off" periods as a precaution against a return to controls in the future.

In the last quarter of 1988, incomes policy was eased considerably, and starting in January 1989, control over wages was abandoned. Real monthly wages, net of taxes, which had declined by about 14 percent in the nine months ending September 1988, increased by over 46 percent in the subsequent 12 months. This wage cost push set off a new round of inflation. By September 1989, the inflationary spiral had climbed to hyperinflationary levels with price rises averaging 50 percent per month in the last four months of 1989 (Chart 1).

2. Output and employment

Developments in the domestic economy in 1989 were only marginally better than in the 1987-88 period when output declined on average by more than 2 percent per annum (Table 1). Output growth in 1989 is estimated at about 1 percent, mainly on the strength of an improvement in agricultural production following droughts in 1987 and 1988, and some upturn in industrial activity. Contrary to 1988, when it had contributed significantly to growth, the foreign balance was not a source of growth in 1989 (Chart 2). The substantial wage increases during the year were associated with a reduction in labor unrest and labor productivity reportedly rose, halting the downward trend observed in recent years. However, employment continued to stagnate and unemployment increased.

The easing of demand and incomes policies in 1989 arrested the decline in domestic demand in real terms observed in 1987-88. Gross fixed capital formation increased and the depletion of stocks, which had been very rapid in 1988, was reversed. Public material consumption declined further in real terms, but private consumption stabilized. In relation to 1988, domestic savings in 1989 rose somewhat relative to the gross social product, reflecting higher real wages and higher positive real interest rates, but they did not fully cover the higher rate of gross capital formation so that the foreign balance was lower in relation to GSP.

Operating losses of enterprises in 1989 exceeded total net earnings of profitable organizations for the third consecutive year (Table 3). Owing to changes in accounting rules in both 1988 and 1989, an accurate year-to-year comparison is not possible; nonetheless, the persistence of net losses provides a strong indication of serious financial imbalances in the enterprise sector and the weakness of budget constraints.

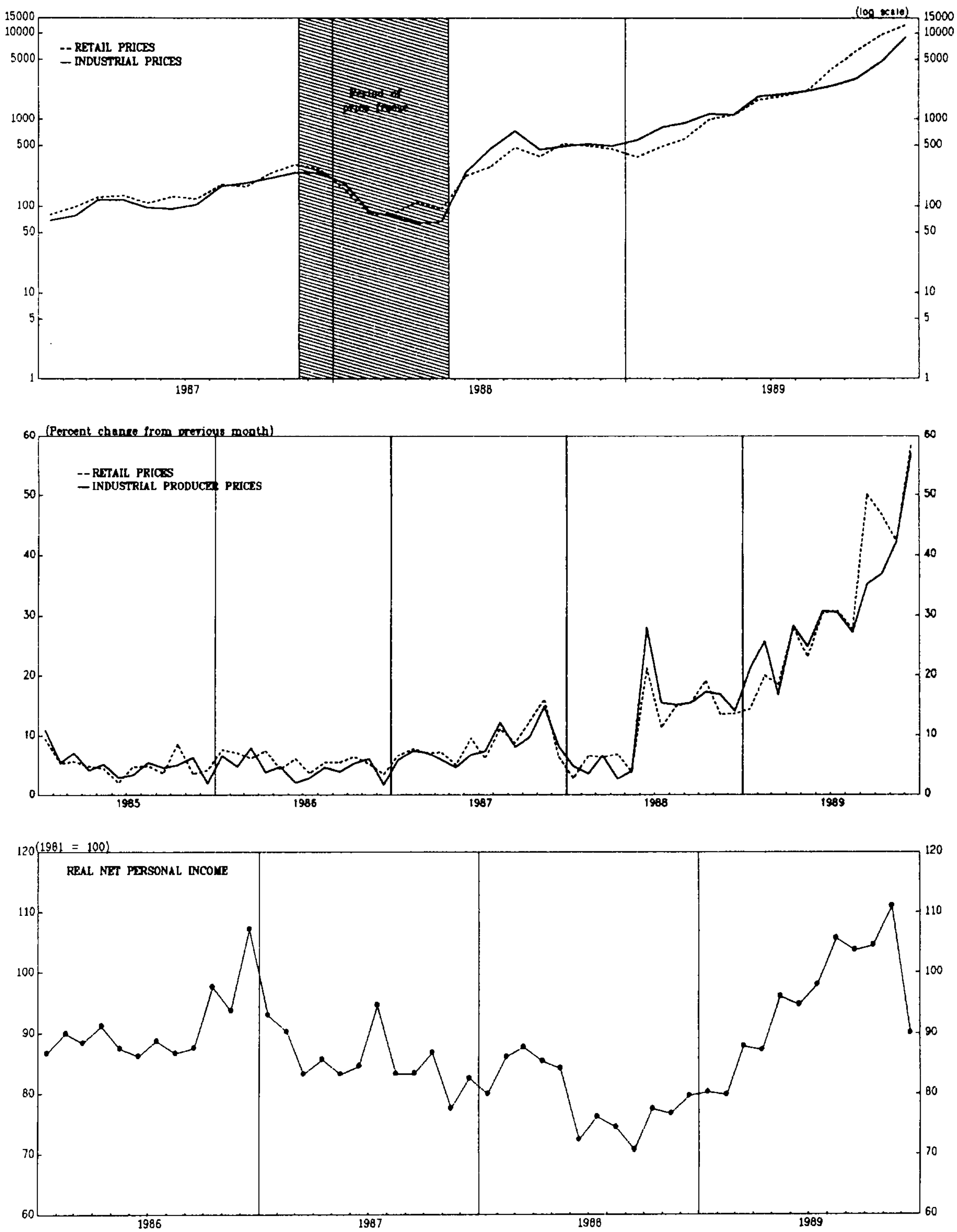
3. Domestic policies

a. Monetary policy

Monetary policy in 1989 continued to be highly accommodating (Chart 3). As already mentioned, late in 1988 the authorities abandoned the policy of controlling total bank credit through credit ceilings on individual banks, but did not strengthen the NBY's control over reserve money expansion. As a result, in the absence of offsetting policies by the NBY, the large overall external surplus contributed to a rapid increase in domestic liquidity, especially after mid-1989 when the inflow of foreign exchange rose sharply owing in part to seasonal factors. Also, there was a significant rise in dinar credit by the NBY in the last quarter of 1989 which compounded the monetary expansion generated by the external sector surplus.

CHART 1

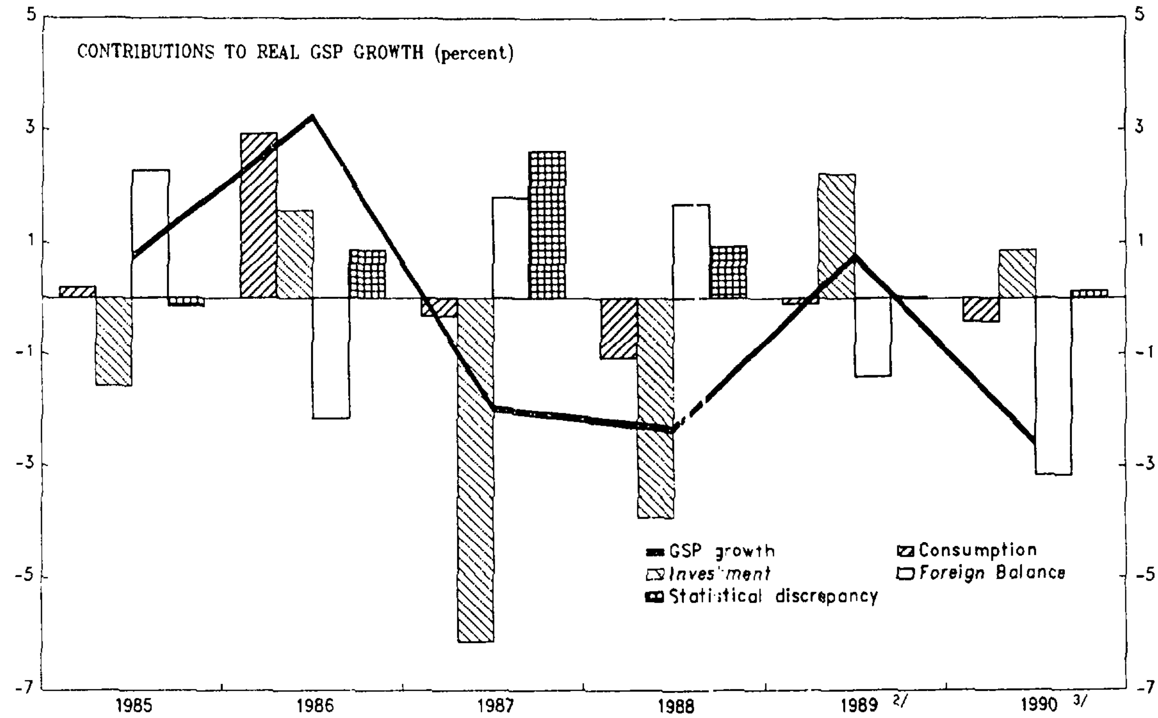
YUGOSLAVIA
WAGES AND PRICES

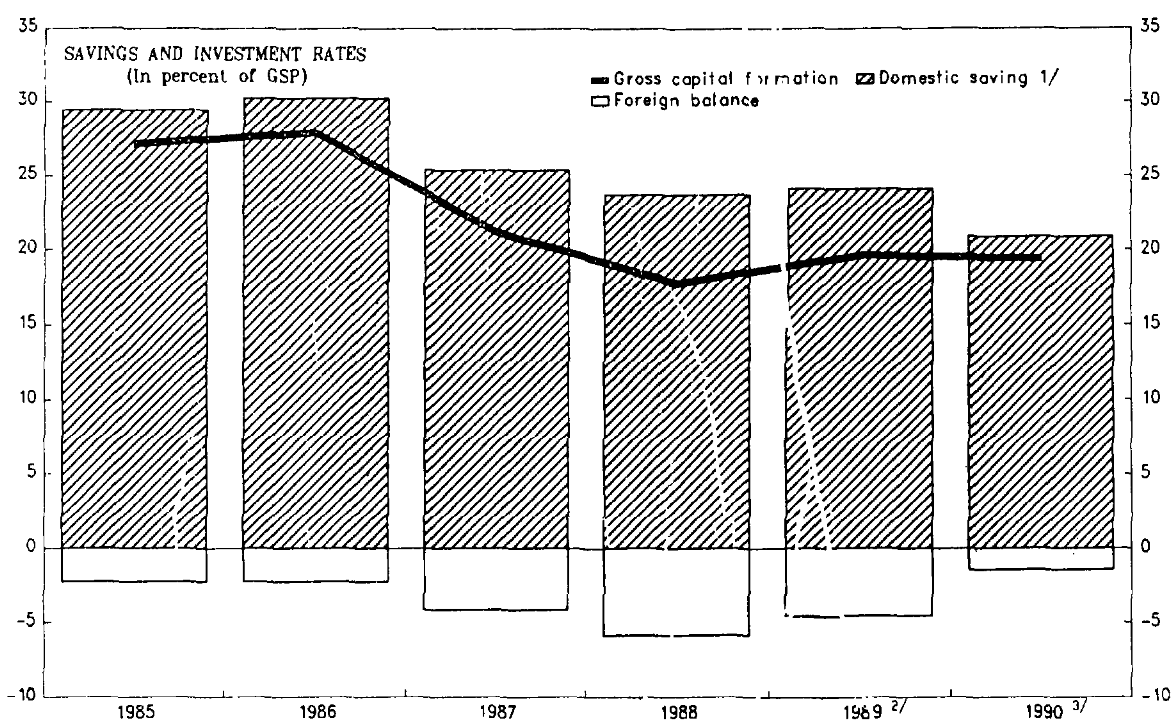


Sources: Data provided by Yugoslav authorities; and staff estimates.

CHART 2

YUGOSLAVIA
SELECTED NATIONAL ACCOUNT INDICATORS





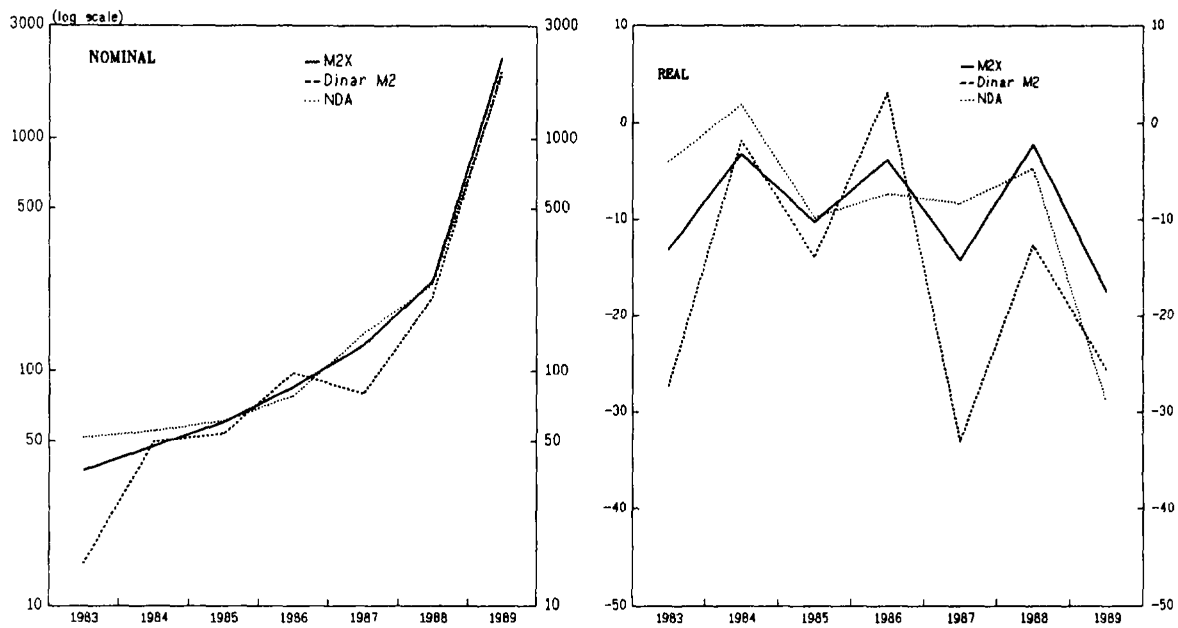
Sources: Data provided by Yugoslav authorities; and staff estimates.

1/ Calculated as the sum of gross fixed investment, stock-building, and net foreign balance in the national accounts.
2/ Estimate.
3/ Program.

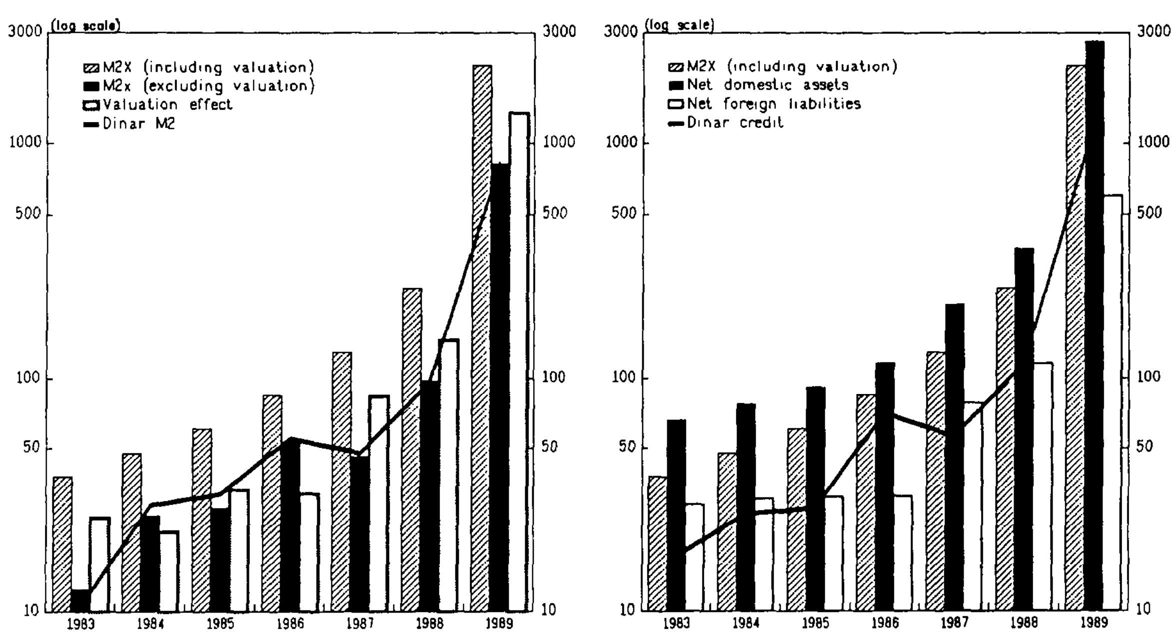
CHART 3

YUGOSLAVIA: MONETARY INDICATORS

I. NOMINAL AND REAL GROWTH IN MONETARY AGGREGATES 1/



II. SOURCES OF MONETARY GROWTH 2/



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

1/ Annual change, in percent.
2/ In percent of M2X outstanding at the beginning of each year.

The rate of inflation consistently outpaced the expansion of monetary variables throughout most of the year (Table 4). In the 12 months through December 1989, the velocity of dinar broad money is estimated to have risen by 29 percent compared with 16 percent during 1988, and that of total broad money (including foreign currency deposits) increased by 19 percent compared with a 1 percent change in 1988. The rapid nominal depreciation of the dinar resulted in a correspondingly rapid increase in the dinar value of foreign currency deposits. As the returns on dinar deposits, on average, were much less attractive, the share of foreign currency deposits in total broad money increased further from 58 percent at the end of 1988 to an estimated 62 percent at the close of 1989.

Deposits of three months and over were linked to the rate of inflation in the current month, while other term deposits were indexed to the previous month's inflation. The acceleration of inflation to very high levels led to considerable variability of deposit interest rates both in nominal and real terms. Changes in the discount rate also gave rise to conflicting signals. Starting in July 1989, the discount rate, which previously had been maintained in line with inflation in the preceding month, was fixed in nominal terms in a misguided effort to hold down the cost of borrowing. This policy was abandoned in November when the discount rate was doubled to catch up with the spiraling rate of inflation.

The continued weakness of monetary management in 1989 can be attributed in part to institutional factors. Even after the enactment of a new law on the National Bank in July 1989, which considerably strengthened the authority of the NBY to conduct monetary policy, monetary management continued to be burdened by nonmonetary objectives. Subsidies were channeled to agriculture through selective credits at a fraction of the discount rate; credit to the Federation was made available on demand; and the NBY continued to cover foreign exchange losses on the foreign currency deposits of households redeposited by banks at the National Bank.

b. <u>Fiscal policy</u>

Fiscal revenues in the first half of 1989 declined in real terms by 19 percent because of the adverse effects of inflation on tax collection and changes in the import duty drawback scheme. As a consequence, notwithstanding sharp cuts in spending, considerable pressure arose on cash payments. The Federal Government was able to relieve some of the pressure by resorting to short-term NBY advances, while other public entities reduced accumulated cash balances and built up payment arrears. Several revenue measures were initiated in the second half of 1989 to improve the fiscal situation. The Federal Government raised the turnover tax rate, increased duties and fees on imports, and reduced the period for payment of tax obligations. Other public entities also increased rates of taxes and contributions. For the year as a whole, public sector consumption spending was reduced by several percentage points in relation to GSP (Chart 4). On a cash basis, adjusted for inflation, the public sector ended 1989 with a surplus of 1.5 percent of GSP (Table 6). 1/

In 1989, as in previous years, the full extent of fiscal pressures has been masked because several operations of a fiscal nature have been carried by other sectors of the economy. The NBY, as was mentioned already, provided subsidies to agriculture and covered the exchange losses on foreign currency deposits as well as on certain foreign loans. Public sector entities, through the incurrence of payment arrears that went unregistered in the cash accounts, shifted the burden of financing to the enterprises. Also, the losses of nonviable socially owned enterprises were financed in part by involuntary loans or contributions from profitable enterprises, and by credits from banks founded and managed in many cases by the lossmakers themselves. The existence of sizable nonperforming assets gave rise to illiquidity problems in banks that were resolved through NBY credit expansion.

The magnitude of these semi-fiscal operations is difficult to measure, in part because the fiscal character of specific operations is not always transparent, and also because information is inadequate or incomplete. Available data would suggest that in 1989, such operations may have amounted to as much as 6 percent of GSP, of which approximately 2 percentage points would represent the fiscal burden carried directly by the NBY. This deficit both contributed to, and was fed by, inflation because of various indexation rules.

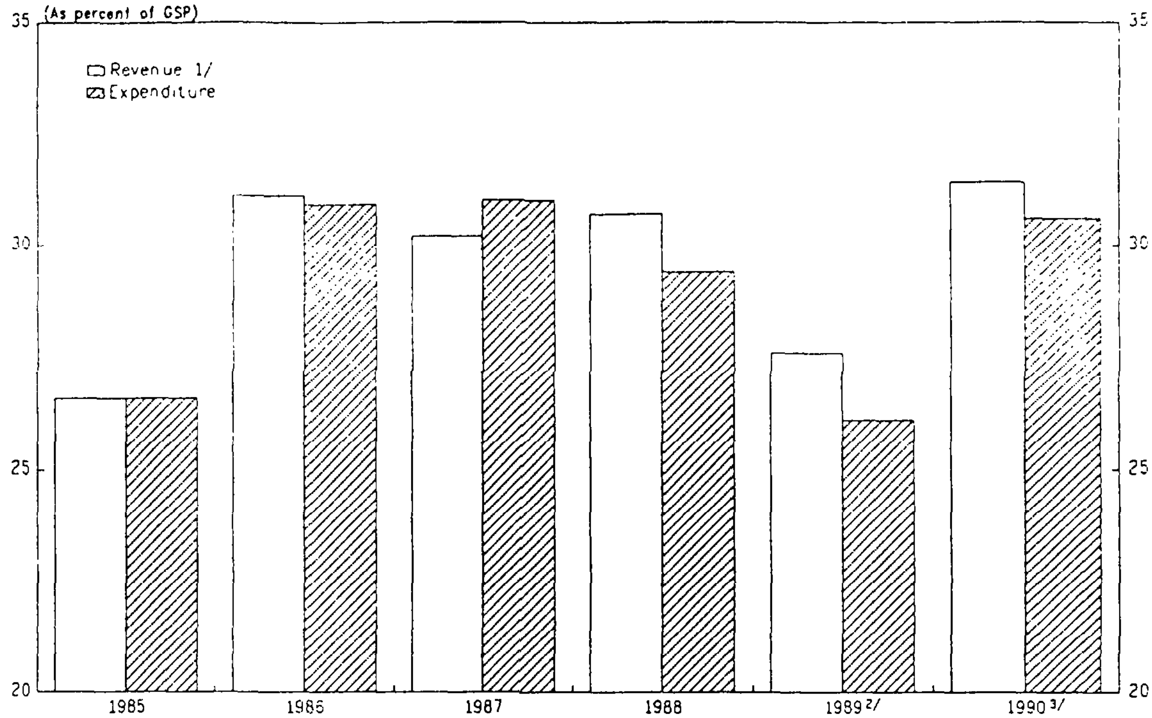
4. External sector policies

The external sector continued to perform strongly in 1989 (Chart 5). The convertible current account recorded a surplus of US$2 billion, notwithstanding an increase in import volumes of 15 percent in response to import liberalization. Export volumes rose by about 7 percent and earnings from tourism increased further. The capital account was virtually balanced, reflecting the 1988 agreement with commercial banks that had rescheduled the entire stock of commercial debt with no principal payments falling due before 1994. Also, following the expiration of the 1988 agreement in June 1989 and pending a new agreement with Paris Club creditors, Yugoslavia proceeded with a standstill on principal payments. As unspecified short-term capital movements, including errors and omissions, increased sharply to a

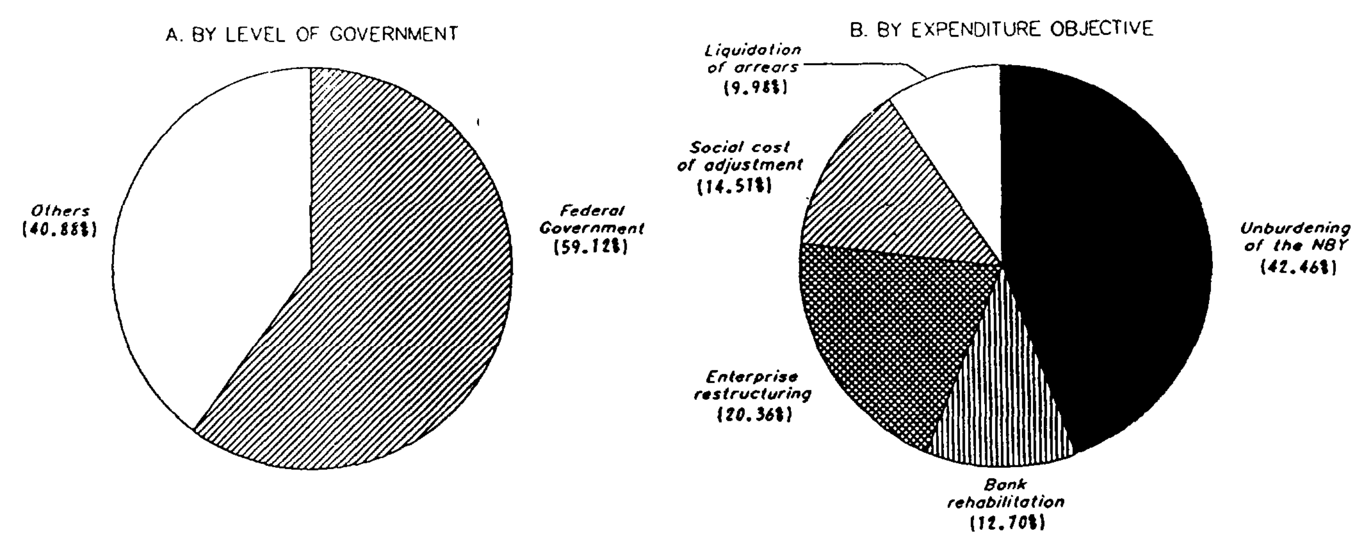
1/ Prior to the consolidation of all outstanding public sector debt in 1990, the Yugoslav public sector reported a net creditor position vis-à-vis the banking system with the accumulated surplus growing from year to year. In a high inflation environment the figures on cash surplus, if not corrected for the real loss of value of the stock since the beginning of the year, can be highly misleading. The figures on surplus reported in this paper have been corrected for such real erosion.

CHART 4
YUGOSLAVIA
PUBLIC SECTOR DEVELOPMENTS

REVENUE AND EXPENDITURE: NARROW DEFINITION



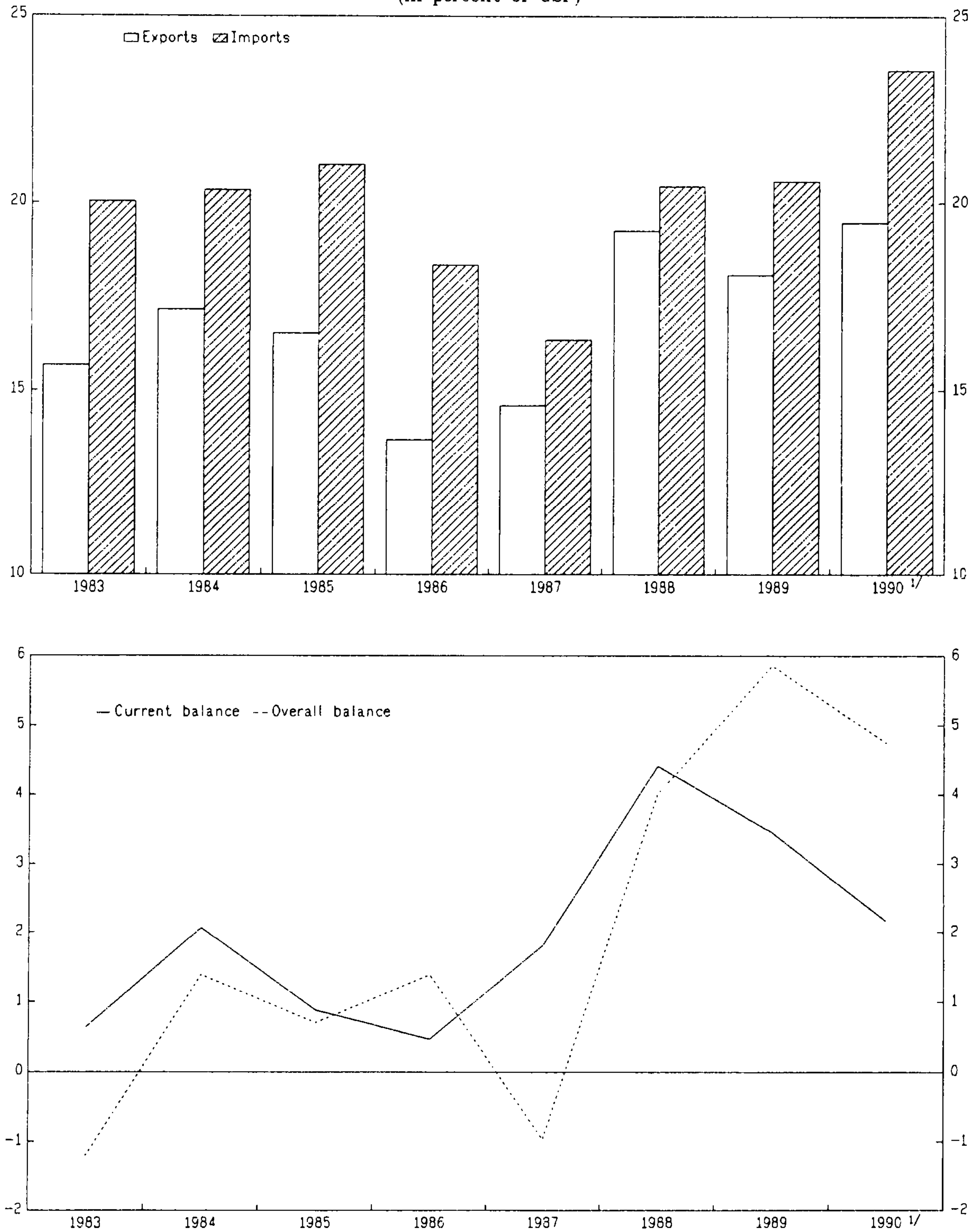
NONTRADITIONAL FISCAL EFFORT IN 1990: STRUCTURE



Sources: Data provided by Yugoslav authorities; and staff estimates.
1/ Revenue adjusted for inflation induced loss of net assets with banks.
2/ Estimate.
3/ Program.

CHART 5

YUGOSLAVIA
BALANCE OF PAYMENTS DEVELOPMENTS
CONVERTIBLE CURRENCY AREA
(In percent of GSP)



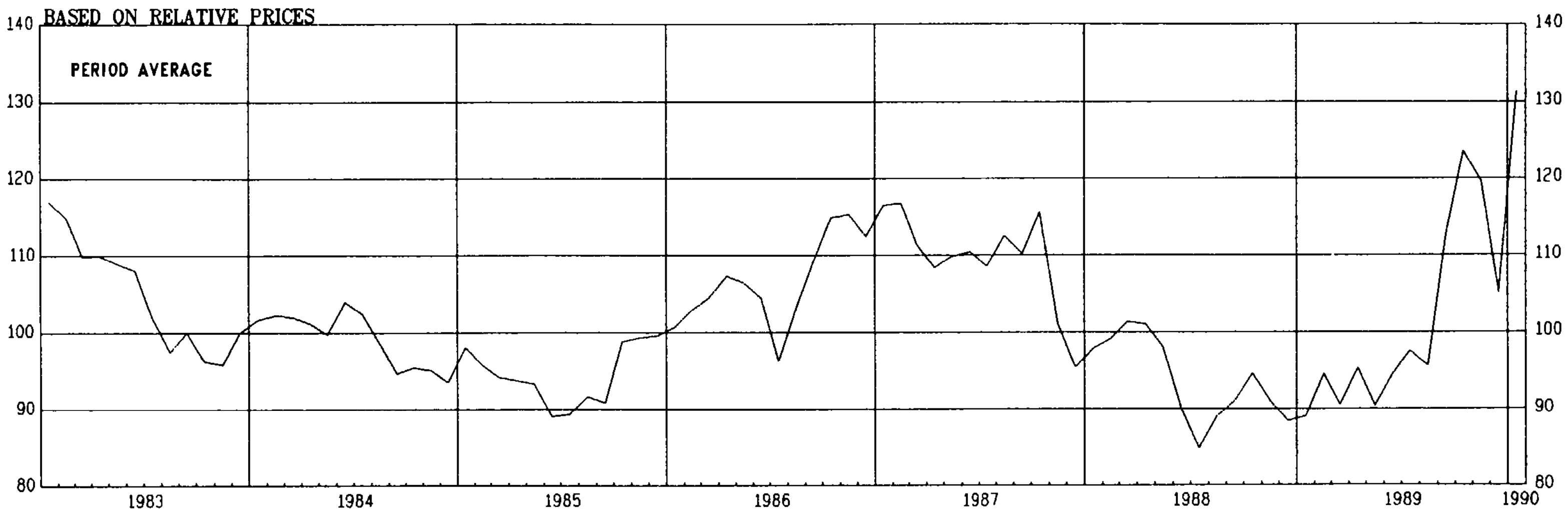
Sources: Data provided by the Yugoslav authorities; and staff estimates.
1/ Program.

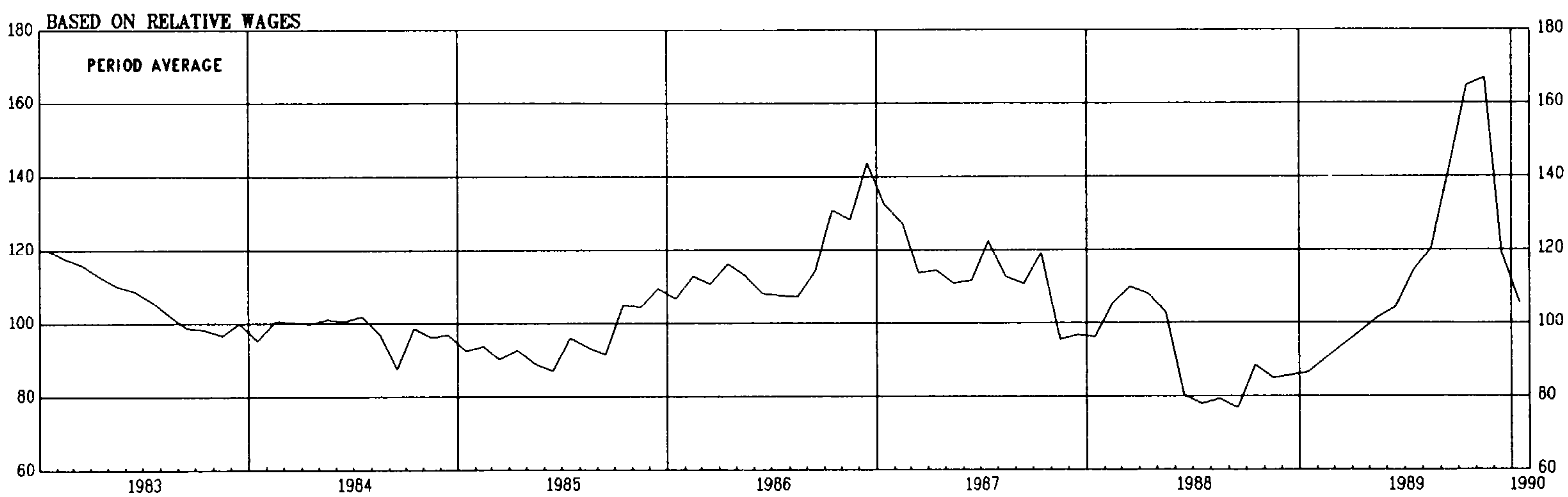
CHART 6

YUGOSLAVIA

REAL EFFECTIVE EXCHANGE RATE DEVELOPMENTS 1/

(Dec 1983 = 100)





Sources: International Financial Statistics and staff estimates.

1/ Using average monthly exchange rates.

positive US$1.7 billion, presumably reflecting in part a net increase in unregistered suppliers' credits associated with a marked rise in the value of imports, the overall balance of payments in convertible currencies showed a surplus of US$3.4 billion (Table 8). As a result, gross reserves increased from US$3.3 billion at the end of 1988 to about US$6.1 billion by the end of 1989 (five months of imports of goods and nonfactor services from the convertible currency area).

The strength of the balance of payments in 1988-89 reflected the impact not only of the dinar devaluations carried out in 1987 and May 1988, but also the shift to positive real interest rates in 1988. The doubling in annual tourism earnings since 1985 to US$2 billion, moreover, suggests that structural factors also contributed to the underlying strength of the external sector. Throughout 1989, the nominal exchange rate of the dinar was changed in line with relative rates of inflation. However, with the sharp acceleration of inflation in the second half of the year, the nominal rate of depreciation of the dinar at times lagged behind the rate of domestic inflation before catching up again in subsequent months (Chart 6).

III. The Program for 1990

1. Objective and basic strategy

On December 18, 1989, the Yugoslav authorities announced a comprehensive disinflation program to correct the economic, structural, and institutional weaknesses of the economy in a medium-term framework. Following approval by the Federal, Republican and Provincial Assemblies, the implementation of the program was initiated on January 1, 1990. The primary objective of the 1990 program is to bring inflation down to very low levels. The authorities have chosen a strategy to achieve this objective in a short period of time, which they believe will avoid a long period of adjustment and will contain adverse effects on output and employment.

In the initial phase of the program, policies are designed to break decisively the inertia of inflation. Accordingly, the nominal exchange rate of the dinar, nominal wages, and the prices of transportation, public utilities, and a number of key industrial goods have been frozen for a period of six months. At the same time, domestic residents have been given the right to convert dinars freely into foreign exchange. The sustainability of these anchors is backed by a strong foreign exchange position, a very restrictive monetary policy, and a major fiscal effort. Additional revenues have been identified to cover the fiscal operations previously carried out by the National Bank as well as provide support for the reform and rehabilitation of the banking system and the restructuring of loss-making enterprises. Monetary and fiscal policies seek to bring inflation down rapidly and sharply, that is, toward 1 percent per month by mid-1990.

Prior to the start of the program, the principal factors that had impeded a major tightening of monetary policy were removed and the first phase of a far-reaching plan to rehabilitate the banking sector and restructure loss-making enterprises was initiated. These reforms, together with the introduction of a law defining and regulating property rights of socially owned capital and the implementation of a set of integrated laws on accounting and financial operations, provide the basis for a major strengthening of financial discipline, and should thereby contribute to the credibility and sustainability of the disinflation program. 1/

2. Program outlook

The program strategy to bring down inflation promptly will severely restrain domestic demand in 1990 while the supply side response to the stabilization and the introduction of structural reforms is expected to be felt only with some lag. Accordingly, private consumption and public sector material consumption as well as fixed investment are projected to decline in real terms. The liberal import policy and stable nominal exchange rate are expected to stimulate imports to grow at more than twice the rate of growth of exports in 1990. During this year, the gross social product is expected to decline by no more than 2 1/2 percent. Economic activity is expected to recover in 1991 led by an expansion of investment and further export growth.

With respect to the external balance, as noted, the program projects a substantial increase in imports reflecting the estimated impact of further liberalization implemented in 1989. However, tourism earnings and remittances are expected to continue buoyant and a further increase is foreseen for export volume, so that the current account surplus should decline only by about US$0.7 billion to US$1.3 billion in 1990. The program contemplates financial support from the IMF, the World Bank, and bilateral creditors in the form of a rescheduling of principal payments under the auspices of the Paris Club, to buttress the credibility of the fixed exchange rate and the liberalized exchange and trade regime. These resources are also expected to underpin the authorities' intention to accept the obligations of Article VIII soon. Thus, the program targets an increase of gross foreign reserves of US$2.9 billion, to a level equivalent to six months of imports of goods and nonfactor services.

1/ The structural and institutional reforms incorporated in the program have been debated in Yugoslavia for many years. Little progress toward implementation was made until March 1989, when the Government undertook a major effort to adopt the legal framework required to permit implementation of the reforms.

3. Exchange rate, wages and price policies

The role played by cost elements in driving inflation and indexation techniques in sustaining its momentum required that these factors be controlled from the start. The exchange rate and wages were assigned the task of anchoring the program and have been fixed in nominal terms in the first phase. These anchors are accompanied by a partial freeze on prices of key items representing about 20 percent of the total weight of the retail price index. 1/ All other prices of goods and services continue to be freely determined. By abstaining from a complete price freeze, the authorities accepted a somewhat higher rate of inflation in the initial phase of the program, but they expect to contain the buildup of price distortions that would need to be corrected in the future. In the event, the monthly average rate of inflation decelerated from a monthly rate of 58 percent in December 1989 to 41 percent in January 1990. However, the deceleration of inflation was considerably sharper when measured on an end-of-period basis: it declined from 64.3 percent in December 1989 to 17.3 percent in January. Inflation in the last ten days of January is estimated to have fallen further to about 4 percent. With inflationary pressures still running higher than initially anticipated, the authorities agreed with the staff that the program would need to rely more heavily on monetary restraint to halt inflation inertia and thus safeguard the exchange rate and wage anchors.

With respect to the exchange rate, the new dinar was fixed at Din 7 per deutsche mark (DM) on December 18, 1989, and free convertibility of dinars into foreign exchange by domestic residents went into effect on January 1, 1990. 2/ The authorities intend to maintain this rate at least through June 30, 1990. The DM was chosen as a peg because of the importance of that currency in Yugoslav trade and because in recent years it has become a unit of account and a store of value for a large segment of the Yugoslav population.

The adoption of the fixed exchange rate, together with the introduction of convertibility of the dinar for domestic residents, represented bold policy measures that carried an element of risk for the balance of payments. Since the exchange rate was fixed and until the end of January 1990, the dinar appreciated by about 30 percent in terms of relative prices, somewhat higher than what had been anticipated. However, in terms of relative wages, which is a more appropriate measure of the relative costs of production, the dinar depreciated (Chart 6). The continued strength of the balance of payments position, during a

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1/ In the two-month period prior to imposing the freeze, prices of these key items, covering energy, transportation, PTT, and major industrial goods, were raised substantially in real terms.

2/ Concurrently with the introduction of the stabilization program, the old dinar was replaced by a new dinar at the rate of 10,000 old dinars for 1 new dinar.

period when a major exchange and import liberalization was undertaken, suggests that the fixed exchange rate policy remains consistent with the balance of payments objective of the program; looking ahead, continued consistency will require that the wage policy be adhered to as planned and that appropriate demand and interest rate policies are pursued. Should unanticipated price developments entail a sizable real appreciation of the dinar, the program provides that exchange rate policy will be reviewed in consultation with the management of the Fund.

Reflecting the broad support for the program, Yugoslavia experienced a sharp increase in capital flows in the period following the pegging of the exchange rate, and gross reserves increased by US$1.2 billion in the first six weeks of 1990. The bulk of this inflow reportedly reflected the repatriation of export receipts that Yugoslav enterprises had built up abroad in the months immediately prior to announcement of the program. The pegging of the nominal exchange rate, while nominal interest rates on domestic credits were at about 30 percent, also prompted enterprises to repatriate foreign assets to reduce their reliance on domestic financing.

The other key inflation anchor of the program is wage policy. For the first six months of 1990, wages have been capped at a level equal to that paid out in December 1989, which correspond to wages earned in November, adjusted by up to 20 percent for workers in most productive sectors and in education and health. Wages in the public sector were not adjusted. To protect the incomes of the lowest income earners, enterprises with distributed net personal incomes below 79 percent of the average in the relevant republic and province were permitted to raise their wage up to 80 percent of the average. The effect of these adjustments is to freeze net incomes in the first six months of 1990 on average at a level no more than 20 percent above the net wage earned in November 1989. The decision to keep average monthly net personal incomes to this level is in reaction to a difficulty that arose in December 1989, a month when reflecting initial uncertainty about the coverage of the wage freeze law, average net wages exceeded by 28 percent the November level, well above that envisaged by the law. The authorities have now clarified the intent of the law and have instructed the National Accounting Service to bring nominal wages back in line with it. In accordance with this instruction and to underscore the importance of the wage anchor in the program, the authorities are prepared for the ceiling described above on average monthly net personal income per worker to constitute a performance criterion. Given the monthly rate of inflation in December 1989 and January 1990, the real wage in accordance with the ceiling over the two-month period is estimated to have declined by 46 percent. However, coming after a 45 percent increase in real wages in the 12-month period to November 1989, the wage freeze has received broad political support as a necessary element of the economic program.

The exchange rate and wage anchors have been set through June 1989. Policies for the period beyond midyear will be set in the course of the mid-term review on the basis of the following considerations. The wage freeze has been designed specifically as a temporary measure to be replaced at midyear by interim wage controls. It is expected that these controls will take the form of a return to the social compact whereby wages are linked to those in the previous period and to achieved rates of accumulation, as was in operation in the period October-December 1989. Wage payments in enterprises with recorded losses in their last periodic accounts would be restricted to 95 percent of income payments in the previous month, adjusted for movements in the cost of living. With regard to exchange rate policy beyond midyear 1990, it will need to be closely coordinated with the above-described interim control over wages and take into account balance of payments developments since the start of the program.

Over the medium term there is a need to transform wage determination procedures in accordance with the requirements of a market economy. Hence, the authorities intend to introduce a system of collective bargaining when financial discipline has been adequately strengthened and can be relied upon to check excessive wage demands.

4. Monetary policy

The task allocated to monetary policy in the reduction of inflation is crucial and the NBY intends to achieve this objective by limiting the expansion of net domestic assets within the--generally declining--quarterly ceilings of the program (Table 5). These ceilings take into account the contribution of the projected overall balance of payments surplus to base money growth, as well as expected developments in the demand for real dinar balances. The program assumes that the demand for real dinar balances stabilizes in the course of the first six months of 1990. Thereafer, as confidence improves, dinar demand is projected to expand so that for the 12 months ending December 1990 no change in the velocity of circulation of dinar balances is foreseen. This contrasts sharply with continuous increases in velocity registered since the early 1980s. The validity of projecting a rising demand for real dinar balances in the second half of the year will, of course, very much depend on the inflation outcome and other developments in the first half of the year. For this reason, performance criteria for the second half of 1990 will be set in the course of the six-month review on the basis of an analysis of developments in the first half of the year.

In carrying out its task, the NBY will monitor closely total bank credit expansion and changes in its net foreign assets, including bilateral clearing balances which in the past have been a significant source of unforeseen monetary expansion. As an additional tool for monetary management, the NBY is developing a monthly foreign exchange cash flow projection consistent with the balance of payments forecast. In the initial stages of the program, the NBY is likely to rely mainly on increases in legal reserve requirements and limits on credits by banks to maintain monetary control. Accordingly, in February 1990, the NBY reimposed limits on dinar credits in the banking system, introduced measures to reduce rediscounts by March 31, 1990 to 70 percent of the end-December 1989 level, and imposed the obligatory purchase of NBY bills (yielding 51 percent of the discount rate) in an amount equal to 1.3 percent of all dinar liabilities of less than one-year maturity.

In the future, the NBY intends to rely more heavily on rediscount policy and the sale and repurchase of NBY bills as instruments of monetary management. In preparation of this policy shift, the NBY has recast its rediscount policy and lending in the form of rediscounts on selective credits will be phased out. Already all such credits are charged the full discount rate, and the provision of subsidies to agriculture has been shifted to the federal budget. Liquidity management will be carried out through a nonselective rediscount window in combination with a bills policy. However, the effective functioning of the latter policy will have to wait until the recently opened interbank money market has had time to become established and interbank confidence has increased.

In the initial phase of the program, as long as the temporary limits on bank credit apply, the discount rate is not expected to function as a key instrument of reserve money management. However, the NBY intends to review frequently the level of the discount rate (set at an annual rate of 23.4 percent on January 1, 1990) and adjust it to ensure its consistency with the monetary objectives. In particular, it will maintain the discount rate above the rate at which the NBY sells bills in the market. With the expected development of the bill policy into an important instrument of controlling the expansion of reserve money, a tightening of monetary policy is expected to be reflected in increases in both the bill rate and the discount rate.

Interest rates on bank deposits and credits are to be freely determined in the market. Nevertheless, the NBY intends to monitor interest rate developments closely and is prepared to guide interest rates to help achieve the objectives of the program. In this regard, the authorities intend to use their influence to avoid either highly negative or highly positive real interest rates as such rates have adverse consequences for savings and investment decisions. In an effort to reduce the existing large spread between deposit and loan rates, the NBY in February 1990 raised the interest paid on obligatory reserves on sight deposits from 12.5 percent of the discount rate to 25 percent. 1/ Even so, the spread is likely to remain relatively wide until the sizable portfolio of nonperforming assets of banks has been reduced through the bank rehabilitation program.

1/ Deposit rates in January range from 3 - 6 1/2 percent on sight deposits to 12 1/2 - 14 percent on 12-month deposits. Loan rates were in the 20-30 percent range for good quality clients.

5. Fiscal policy

Fiscal policy for 1990 is designed to encompass a considerably larger area of operations than had been covered in preceding years. The program also makes provision to cover all expenditures from current revenues without recourse to net borrowing and targets a small surplus equivalent to 0.8 percent of GSP. To help ensure the desired outcome and strengthen federal control over fiscal management, the Federal Assembly approved a decision prohibiting all public sector entities from borrowing from banks or in the domestic market during 1990.

Considerable caution is required when comparing the 1990 fiscal program with previous years, because the current program incorporates a number of fiscal operations which in previous years had not been consolidated within the public sector accounts and which had been financed, either directly or indirectly, by monetary expansion. Specifically, at the level of the Federal Government, the 1990 budget now makes provision for certain subsidies to agriculture and for servicing the accumulated valuation losses on foreign currency deposits at the NBY, both of which had previously been financed by the NBY. It also covers the debt servicing costs of US$1 billion worth of foreign debt owed by enterprises in the poorest regions of the country, and incorporates for the first time contributions to the social costs of adjustment. In addition, given the importance of a sound and efficient banking system, unencumbered by regional biases, the Federation has taken charge of the costs of rehabilitating banks. Accordingly, the federal budget includes transfers to the newly created Federal Bank Rehabilitation Agency to cover the interest cost on government-guaranteed debt instruments used to purchase nonperforming assets of banks.

The budgets of the republics, provinces, and local government agencies have been augmented to cover part of the social costs of adjustment as well as transfers to regional enterprise restructuring funds. These funds have been set up to provide assistance to major nonviable enterprises for which bankruptcy is not considered feasible, either because the enterprise has the nature of a public utility, or because of its importance for the regional economy. In these cases, restructuring programs are to be undertaken to reduce and eventually eliminate operating losses through a combination of cost retrenchment, accelerated retirements, layoffs and--in 1990--reliance on the full-year impact of major price increases in real terms in the PTT, energy and transportation sectors that were implemented in the period prior to the price freeze imposed on December 18, 1989.

The authorities have made considerable effort to curtail spending on ongoing fiscal programs from the 1989 budget exercise. However, given the severe constraints on spending in both 1988 and 1989 it was not possible to make significant further economies without compromising the quality of public administration and postponing much needed improvements in the fields of education and health. Nonetheless, the policy of a fixed exchange rate and maintaining unchanged wages and salaries at the December 1989 level, is expected to contribute to spending restraint. In addition, some savings were generated by consolidating at the republican and provincial levels the numerous local self-management communities of interest that organize collective consumption in such areas of social insurance, pensions, health and education. Some of these savings, however, were offset by the increase at the federal level of spending for national defense.

Taking into account all these factors affecting spending in 1990, total public consumption expenditure is projected to rise by about 4.5 percent of GSP to 30.6 percent, a level comparable to that of the 1986-87 period before a concerted effort was undertaken in 1988-89 to reduce traditional fiscal spending. The above-described additional spending programs are estimated to constitute approximately 5 percentage points of public spending in 1990. (See Chart 4 for an overview of new spending programs incorporated in the public sector.) Notwithstanding the rise in total public spending, the authorities continue to give high priority to reducing such spending in relation to GSP over the medium term. Consistent with that policy, the program places nominal limits as a performance criterion on total general and collective spending. To help ensure that the bank rehabilitation agency and the enterprise restructuring funds are adequately financed from fiscal transfers--and hence are able to carry out their important tasks of reforming the banking and enterprise sectors--the program also establishes minimum fiscal transfers to these entities as a performance criterion.

To achieve the targeted surplus in 1990, while at the same time increasing public spending as described above, requires a major fiscal revenue effort. Most of the policy-based revenue effort is concentrated at the federal level. A new turnover tax of 3 percent applicable to most goods was introduced from January 1, 1990, and is estimated to yield 1.6 percent of GSP. Revenues from import duties are projected to rise by 1.0 percent of GSP in 1990 on account of the 18 percent programmed increase in the value of imports and the full-year impact of the upward revisions in duties and levies introduced in the period July-October 1989. To help ensure that the budgeted level of customs duties and levies are obtained, the authorities plan to amend the customs regulations by March 31, 1990, with the objective of generating Din 8 billion (equivalent to approximately 1 percent of GSP) of revenues at an annual rate. Implementation of this measure, which is likely to encompass a reduction in exemptions, constitutes a performance criterion for purchases after March 31, 1990.

At the nonfederal level, existing taxes and contributions were considered to be adequate to cover all but 0.6 percent of GSP of the budgeted spending. Consequently, the republics and provinces have given assurances to the Federal Government that they are prepared to mobilize additional fiscal revenues from taxes and contributions equal to 45 percent of the uncovered enterprise losses in 1989, as verified by the National Accounting Office. These revenues are estimated to be equivalent to 0.6 percent of GSP.

The process of rapid disinflation is expected to have a beneficial effect on revenues throughout the public sector even without discrete changes in tax policy. The program estimates this effect at about 1.5 percent of GSP, one half the drop that took place in 1989 when inflation surged. The size of this effect of course depends on the extent with which inflation comes down. These developments will be analysed in the context of the first review of the program.

6. Provisions for the social costs of adjustment

The Government has estimated that as a result of the structural reform and stabilization, approximately 200,000 workers (2 percent of the labor force) will be affected by technological redundancy, bankruptcy, and illiquidity in enterprises in 1990. The additional fiscal cost of providing unemployment benefits and retraining has been projected to be equivalent to 0.6 percent of GSP in 1990. These benefits are intended to provide a protective shield for the vulnerable sectors of society during the adjustment process, and thereby bolster public support for the program. The financing of social welfare in Yugoslavia has traditionally been the exclusive responsibility of local authorities. However, for 1990, the Federal Government has decided to cover in its budget a third of the above-mentioned additional costs, for providing support to local governments with insufficient funds for meeting the social cost of adjustment in their respective regions.

Coincidentally, the republics and autonomous provinces introduced in 1989 a social security scheme based on minimum guaranteed income for the family. The financial cost of operating this scheme in 1990 is now estimated to be approximately 0.2 percent of GSP higher on account of the projected impact of the stabilization program.

7. External sector policies

The strong balance of payments position in 1989 has allowed for a significant acceleration of the import liberalization program. All restrictions on imports of goods and services that were being maintained for the purpose of protecting the balance of payments have now been eliminated. Specifically, the import regime under which import entitlements were adjusted quarterly in light of export performance was completely phased out and virtually all goods and services previously covered by this regime have been moved to the list of totally free imports. With this change, the LB regime accounts for about 88 percent of total imports from the convertible area on the basis of 1988 import weights. This compares to a share of only 12 percent in 1987. About 12 percent of convertible imports on the basis of 1988 import weights, comprising mainly agricultural products, textiles, and certain metals, remain subject to quotas for the purpose of protecting domestic production.

Equally important for the structural reform program is the recent decision to liberalize the criteria that stipulate which enterprises can engage in foreign trade. Thus, any enterprise is now permitted to import directly all raw materials, intermediate goods, and capital equipment used by the enterprise. Moreover, enterprises that according to their registration with commercial courts are authorized to produce and sell specific goods and services in Yugoslavia, are now automatically permitted to import and export the same goods and services. These changes entail an important broadening of the access to imports that is expected to have a significant impact on supply bottlenecks and to exert downward pressure on prices.

Since the beginning of the year, domestic residents have been permitted to freely convert dinars into foreign exchange. While restrictions on outward transfers of capital have not been liberalized and the existing regulations governing the sale of foreign exchange for certain services such as medical and educational expenses have not been modified, the introduction of convertibility of the dinar for residents has greatly reduced the constraints associated with these regulations. The new policy on convertibility also is expected to encourage the repatriation and surrender of foreign exchange. In this context, the authorities also have expressed their intent to accept the obligations of Article VIII, if possible by the end of 1990.

The authorities in 1988-89 pursued a policy of increasing the level of convertible international reserves in anticipation of launching a comprehensive disinflation program. In their view, such a program required a high level of international reserves and broad support from the international community in terms of additional sources of reserves to defend the credibility of the program. The authorities strongly believe that a high level of foreign reserves is necessary to ensure the sustainability of the exchange rate policy and the convertibility of the domestic currency, and to confront successfully the uncertainties arising from the comprehensive liberalization of the import system. A strong reserve position also is seen by the authorities as providing a measure of protection against the vulnerability of the balance of payments to changes in the flow of earnings from tourism and remittances which traditionally have been quite volatile. Almost US$4 billion of annual foreign exchange inflows in 1990 are in connection with such earnings. Finally, the programmed reserve position serves to underpin the intention to move to Article VIII status, as was indicated already.

As part of their debt and reserve management policies, the authorities have approached the Paris Club for a rescheduling of principal payments falling due on debt originally contracted before the existing cut-off date and on previously rescheduled debt. Under the assumption that the Paris Club will agree to the authorities' request to reschedule 100 percent of above-mentioned principal payments falling due since mid-1989, relief in 1990 could amount to US$640 million (in addition to an estimated US$274 million of principal payments carried over from the second half of 1989). Taking into account anticipated disbursements under the IBRD's SAL and assumed purchases from the Fund, total external support in 1990 is projected to amount to US$1.2 billion, excluding import related credits. (Table 8 provides an overview of the convertible balance of payments.)

An important feature of Yugoslavia's debt management policy has been the decision to benefit from the discount prevailing in the secondary market for Yugoslav commercial bank debt through a program for debt buybacks and swaps. Since the initiation of this program in late 1988, the face value of commercial bank debt has been reduced by about US$1.2 billion, equivalent to about 17 percent of the stock of such debt outstanding by the end of 1988, with an average discount accruing to Yugoslavia of about 45 percent. Most of the transactions are debt-for-export swaps. The buyback and swap program is genuinely market based and the NBY does not provide credit to facilitate the program. The authorities feel that the strong balance of payments position is consistent with a continuation of market-based debt buybacks and swaps in 1990.

Unanticipated surpluses in the transactions with the nonconvertible currency area have been a major feature of external developments in recent years and have contributed to the problems of monetary management. While the authorities continue to seek ways to facilitate an increase in imports from the clearing area, it has been decided to invoke measures aimed at curtailing exports in the event that the claims under the clearing arrangement exceed certain quarterly targets. If necessary, the NBY will suspend the practice of immediately crediting enterprises with the dinar counterpart of exports and instead issue transferable claims that will be settled on a first-come first-served basis once the claims under the clearing arrangements are in line with the targets. The implementation of this policy may give rise to a multiple currency practice.

8. Institutional and structural reforms

The institutional and structural reform elements of the economic program are closely tied to the stabilization effort. Indeed the success of the stabilization effort depends to a considerable extent on the prompt implementation of the reforms that already have been legislated.

The key structural reforms currently being implemented are: (1) the transformation of banks from institutions owned by enterprises and run for the benefit of these same enterprises, into fully capitalized, profit-motivated institutions with equity ownership; (2) the transformation of socially owned enterprises into legal entities with proper capital and the clarification of the ownership status of these enterprises; and (3) the removal of legal restrictions affecting privately owned firms and enterprises with mixed ownership.

The success of banking reform will depend to a large extent on strict adherence to the bank licensing provisions established by the NBY, including a realistic appraisal of bank loan portfolios and prompt intervention by the NBY in banking institutions failing to meet the licensing provision. Banks with impaired assets exceeding capital by more than 100 percent are expected to be subject to the liquidation or bankruptcy provisions established under the Law on Bank Rehabilitation. For banks with impaired assets of less than 100 percent of capital the rehabilitation process envisages the replacement of such assets at par, after all existing capital and reserves have been exhausted, by debt instruments guaranteed by the Federation and bearing a 7 percent rate of return. A separate agency has been set up to carry out the rehabilitation process financed from the federal budget and by a 0.7 premium for deposit insurance applied to all commercial bank deposits on December 31, 1989. In the period prior to the formal operation of the agency, the Federal Government intends to start purchasing impaired bank assets against government debt instruments. These assets will be transferred to the rehabilitation agency when it initiates its operations.

The rehabilitation of banks requires that operating losses of nonviable enterprises no longer be financed by the banking system. However, a sudden cutoff of financing to loss-making enterprises would lead to numerous bankruptcies and dislocations under the provisions of the new laws on accounting and financial operations. To keep these dislocations within socially acceptable limits while at the same time rehabilitating the banks, the authorities have set up, on a regional basis, enterprise restructuring funds which will provide temporary financial support for certain enterprises undergoing restructuring (through cost cutting, layoffs, accelerated retirements, etc.) that function as public utilities (energy, PTT, transport) or are of major regional economic importance. Provisions have been made in the program to finance these funds in two ways. First, a federal law requires that profitable enterprises place 4.5 percent of their realized income in special joint reserve funds. Forty percent of these funds will be pooled at the level of republics and provinces to help cover some of the losses in those regions. Second, the assemblies of the republics and provinces have agreed to raise revenue equivalent to 45 percent of the 1989 gross enterprise uncovered losses, and transfer these resources to the respective regional funds.

These reforms are complemented by an integrated set of laws designed to tighten financial discipline and induce socially owned enterprises to operate as profit-oriented organizations. The revisions of the accounting law aim to prevent distortions of enterprise accounts through improper valuation of inventory and inadequate provision for depreciation and nonperforming assets. The revised law also establishes the requirements for writing off nonperforming assets according to more stringent rules. These changes should provide a better overview of the wage payment capabilities of enterprises. The law on financial operations defines sanctions against illiquidity and establishes the conditions triggering bankruptcy proceedings. It also limits severely the use of promissory notes to finance losses and tighten conditions for the payment of wages.

IV. Medium-Term Outlook

The medium-term scenario presented in this section is based on the premise that the authorities will persevere with the adjustment program described in this paper. It assumes in the short term the implementation of a very restrictive monetary policy, a strong fiscal effort, the maintenance of adequate exchange and interest rates, and the implementation of market-oriented systemic reforms. The medium-term scenario also projects economic growth of 2 1/2 - 3 percent over the projection period.

Other specific assumptions are that: (1) imports are further liberalized, enabling a cumulative increase in convertible imports in the next three years (1990-92) of around 25 percent in volume terms; (2) export momentum slows somewhat to stabilize at an annual growth rate of 4 percent over the medium term; (3) consistent with WEO projections, export and import prices are such that the terms of trade remain essentially unchanged during 1992-95; (4) workers' remittances remain constant in nominal terms over the medium term; (5) tourism earnings, which more than doubled during the last five years, will register some marginal growth in real terms during the projection period; and (6) new import-related credits from official creditors are maintained constant at present levels relative to imports.

On this basis, the medium-term external outlook (Appendix V) illustrates the potential for an early return to balance of payments viability; that is, beyond the proposed program period (mid-1991), no further rescheduling nor new exceptional financing is assumed from either official bilateral creditors or commercial banks. However, this should not be taken as evidence that exceptional assistance is unwarranted. Given the considerable uncertainty about the impact of import liberalization and the introduction of convertibility of the dinar, as well as the possibility of adverse external shocks, such assistance might well be necessary. Nonetheless, the need for exceptional external assistance is likely to be relatively modest by the standards of most middle-income countries with recent debt servicing problems.

The strong commitment of the Yugoslav authorities to the economic program provides assurances that the balance of payments will remain strong as presented in the medium-term outlook. Fund exposure to Yugoslavia accounts for only a small proportion of Yugoslavia's total external debt--it is equivalent to about 6 percent of exports in convertible currencies. As the total stock of debt is expected to decline and gross reserves are projected to be maintained at around seven months of imports over the medium term, there does not appear to be a significant risk on present prospects that Yugoslavia would encounter difficulties in fulfilling its repurchase obligations under the proposed arrangement as they become due. Moreover, Yugoslavia's past record of repurchases has been excellent. For these reasons the staff believes that the proposed use of Fund resources by Yugoslavia is consistent with the need to safeguard the revolving character of these resources.

V. Performance Criteria, Review Clauses, and Prior Actions

The quantified criteria for monitoring performance under the program are: (1) quarterly ceilings on the net domestic assets of the NBY; (2) end-of-quarter limits on the net indebtedness of the public sector; (3) cumulative quarterly cash limits on public sector spending; (4) cumulative quarterly minimum cash transfers from the public sector to the Federal Bank Rehabilitation Agency and the republican and provincial enterprise restructuring funds; (5) a ceiling on the average monthly net personal income in the social sector; (6) cumulative quarterly ceilings on foreign borrowing; and (7) end-of-quarter targets for the net foreign assets of the banking system. These performance criteria have been established through June 30, 1990 (the foreign borrowing ceiling through the end of 1990) and indicative criteria have been provided through December 31, 1990. In addition, all purchases beyond March 31, 1990 are subject to the implementation of amendments to the customs regulations. The criteria are described more fully in the Economic Policy Memorandum attached to the letter of intent (EBS/90/35) and are summarized in Appendix III. The customary clauses on exchange restrictions, multiple currency practices, bilateral payments agreements inconsistent with Article VIII, and import restrictions for balance of payments purposes are also applicable as performance criteria during the program period.

The program provides for two reviews with the Fund to assess its implementation. The first, a performance criterion for purchases after June 30, 1990 will, in particular, examine exchange rate and wage policy and will set quantitative performance criteria for the period through December 31, 1990. The second review is a performance criterion for purchases after December 31, 1990 and will set quantitative performance criteria for the period through the end of the stand-by arrangement.

A number of measures related to fiscal policy have been singled out as of major significance for the integrity of the program. The program calls for these measures to have been taken prior to the discussion by the Executive Board of Yugoslavia's request for a stand-by arrangement. These actions are (1) implementation of a legal provision prohibiting public sector borrowing from banks and in the market for the duration of the arrangement; (2) approval of the laws establishing and regulating the operation of the Federal Bank Rehabilitation Agency and the republican and provincial enterprise reconstruction funds; and (3) implementation by the republics and provinces of measures for the funding of enterprise rehabilitation and reconstruction. All these actions have now been taken.

To help implement the program, the Government expects to continue receiving technical assistance from the Fund in the areas of money market reforms, bank supervision, and fiscal cash management. The World Bank has been requested to provide assistance with bank rehabilitation, enterprise restructuring, and tax reform. The authorities have also asked--and the Fund has accepted--to assign a resident advisor to Belgrade to help in the implementation and monitoring of the program. A staff member is expected to take up this assignment in early April.

VI. Staff Appraisal

Faced with spiraling inflation, toward the end of 1989 the Yugoslav authorities mapped out a bold and comprehensive program of rapid disinflation in the context of a broader plan to transform Yugoslavia into a market economy over the medium term. This program, which was introduced at the beginning of 1990, builds on several strengths in the economy achieved in the past several years with financial support from the Fund: a much improved balance of payments and reserve position; a unified exchange market relatively free of restrictions on current transactions; largely positive real interest rates; and a domestic price structure relatively free of distortions.

The primary objective of the program is to bring inflation down to low levels in a very short timeframe while safeguarding the external position of the economy. If effective, the strategy should contain the length of the period of adjustment as the beneficial effects of low inflation together with those coming from the structural reforms underway ought to lead to increased investment and a consequent resumption of economic growth starting in 1991. The critical hurdle is to break decisively with the momentum of inflation. To this end, in the initial period, the program relies on a fixed nominal exchange rate for the dinar, a strict cap on nominal wages, and a partial price freeze. These anchors will be supported by a severely restrictive monetary policy which, sustained by a substantial fiscal adjustment effort, should ensure the sharp immediate reduction in inflation envisaged in the program.

The strategy is bold and the objectives of the program are ambitious, indeed. The authorities are aware and gave careful consideration to the potential risks ahead, particularly those for the balance of payments and the social order entailed by their reliance on a fixed exchange rate and a wage freeze in a setting where inflation is yet to be brought to a halt. On the external front, the risk relates to the impact on the exchange rate of recent domestic price developments and their possibly adverse consequences for the trade and current accounts of the balance of payments. On the incomes front, a serious risk arises from the marked decline in real wages that has occurred also recently. The authorities' decision to push ahead with their bold strategy is based on a judgment that both of these risks are manageable. Externally, the strength of the balance of payments and reserve position suggest that some real exchange rate appreciation can be accepted without irreparably endangering the medium-term external viability of the economy. This judgment presupposes, of course, not only that tight demand management policies--including a realistic interest rate policy--are adhered to as envisaged in the program but also that the strict incomes policy holds. Domestically, the decline in real wages at the outset of the program needs to be seen in the light of the sizable--and possibly, unsustainable--real wage increase that took place in the period preceding the wage freeze. It is to be noted that the broad political support for the program suggests that the judgment of the acceptability of the risks associated with recent real wage developments has been corroborated by events.

Looking ahead, there can be no doubt that the continued sustainability of the exchange rate and wage anchors will hinge critically on the ability of the program's policies to underpin them by delivering the sought-after sharp reduction in inflation rapidly enough. In this respect, the staff would stress that the introduction of the convertibility of the dinar, in itself a step in the right direction and, as such, most welcome, is not without risks. In particular, convertibility virtually eliminates the margin for policy slippages which would tend to leak rapidly through the external accounts. Were unanticipated adverse price developments to occur, the staff would urge the authorities to monitor external developments closely and stand ready to strengthen their policy stance in the context of the consultations with Fund management on exchange rate policy envisaged in the program. Adverse price developments would also bring pressure to bear on the wage front. It will be critical for the effectiveness of the strategy that such pressure be firmly resisted to prevent a new round of wage-price adjustments that would inevitably undermine the exchange rate and seriously endanger the feasibility of the monetary and fiscal program.

As noted, the exchange rate and wage anchors are supported by a very restrictive monetary policy in the early stages of the program. Indeed, its stance has been tightened in response to higher-than-anticipated inflation in the beginning of the year. For its implementation, the authority of the NBY has been strengthened and a wide array of monetary control instruments has been prepared. However, the management skills of the NBY remain largely to be tested and, therefore, the authorities have prudently opted initially to support their reserve management policy by the reimposition of temporary limitations on bank credit. The staff cannot overstress the importance of close monitoring of developments in the monetary aggregates and the external sector flows. If required, the NBY should be prepared to react quickly to protect the price and balance of payments objectives of the program.

The authorities will be well advised to pay particular attention to the monetary impact of the unanticipated net external inflows which have arisen in the initial months of the program. At the same time, they should be ready to face a possible reversal of capital flows, should it occur in the period prior to the end of the preannounced six-month fixed exchange rate regime. Convertibility requires that domestic interest rates be both attractive and broadly competitive with international rates. In this context, the policy of market-determined interest rates on bank deposits and credits, although acceptable in principle, may need to incorporate a degree of discretionary guidance on the part of the monetary authority, should market forces remain weak until the process of bank rehabilitation has been substantially completed.

Monetary management is to be assisted importantly by the strong fiscal effort that has been incorporated in the program, which is intended, inter alia, to generate the necessary fiscal resources to initiate the rehabilitation of the banking system and the restructuring of loss-making enterprises. The program also provides resources to meet the expected social costs of structural reform. The staff welcome the strengthened role of the federal authorities in public finance resulting from the integration within the budget process of a number of operations of a fiscal nature that previously had been carried out by the banking system. Such integration will impart transparency to fiscal policy and enhance its effectiveness. Inevitably, however, the inclusion of these additional expenditures into the budget has required a significant revenue effort to achieve the programmed public sector surplus. The staff strongly support the Government's decision to raise the bulk of the additional revenues at the federal level--even though the tax choices at this level are limited. The recent steps taken to raise revenues are commendable, but the authorities should not delay the implementation of the amendments to customs regulations that are required to fully protect the fiscal program. The staff also welcome the resolution prohibiting all net borrowing by public entities for the duration of the program and would urge the prompt adoption of legislation to provide the Federal Government with broader tax authority.

The staff support the exchange and trade liberalization that the Government has undertaken, which cannot but contribute to the efficiency of the economy. On this broad front, the staff both support and welcome the authorities' intention to formally accept the obligations of Article VIII soon. In the circumstances, the program provides for a further buildup of net international reserves of about US$2.9 billion, an increase that the authorities consider not only desirable but necessary to support the credibility of the fixed exchange rate policy and to confront any pressures that may arise from the process of trade liberalization and the introduction of convertibility of the dinar. The proposed access to Fund resources provides an additional safeguard to the authorities. In this regard, the staff strongly endorse the view that the requested stand-by arrangement represents a potential source of reserves to buttress the credibility and effectiveness of the authorities' policies. The staff consider that the authorities' concerns to protect their program are well based given the risks at stake. Indeed, as an additional support to deal with the uncertainties associated with a process of rapid disinflation, the program envisages the conduct of two reviews with the Fund to assess developments and provide the opportunity for undertaking policy adjustments, should these prove warranted. Over the medium term, uncertainties remain with regard to the outlook for the balance of payments, which are of concern to the authorities. This concern is behind their request for official debt rescheduling, which they see as a means of reducing those uncertainties.

The staff welcome and support the comprehensive nature of the institutional and structural reform measures, the prompt and complete implementation of which is indispensable for the durability and effectiveness of the stabilization program. Particularly important in this regard are the reforms relating to the authority of the NBY, the rehabilitation of banks, and the restructuring of enterprises. These reforms, in conjunction with the laws defining ownership, accounting rules, and financial operations should result in a tightening of budget constraints and over the medium term turn banks and enterprises into profit-oriented economic units, well set for operating in a market setting. The staff agree with the authorities' view that a lasting reduction of inflation is unlikely unless the problems of lack of financial discipline are resolved. In support of these reforms, the authorities have requested assistance from the World Bank in the form of structural adjustment and financial sector loans.

The authorities are fully cognizant that the ultimate success of the program lies in steadfast policy implementation and close monitoring of developments. Accordingly, the Government has established management teams covering key policy areas that report directly to the Prime Minister. The authorities expect to continue benefiting from technical assistance in the fields of bank supervision and rehabilitation, money and capital markets development, enterprise restructuring, and fiscal reform. The Government also has requested a Fund resident advisor in Belgrade to assist in the monitoring and implementation of the program. This request has been accepted and a staff member will take up the post in April.

The staff note the existence of an exchange restriction evidenced by arrears arising from the suspension of principal payments to official creditors pending the conclusion of rescheduling arrangements. In this context, the Yugoslav authorities have requested a meeting of the Paris Club soon after Board approval of their request for a stand-by arrangement. It is also to be noted that a multiple currency practice may arise in connection with the issuance of transferable certificates for the proceeds of exports to certain nonmember countries. The staff also note and endorse the authorities' decision to cancel enhanced surveillance for Yugoslavia effective upon approval of their request for a stand-by arrangement.

In sum, it is clear that the course on which the Yugoslav authorities have embarked is fraught with risks. But the potential returns to their bold strategy in terms of prospective price stability, external strength, and enhanced efficiency are commensurate with those risks. The authorities have already taken important steps that will be supported by the implementation of tight domestic financial policies and of wide-ranging structural reforms. Risky though the strategy is, it does offer the best hope of bringing inflation under control and setting the increasingly open Yugoslav economy on a path of sound growth and balance of payments viability. For these reasons, the staff believe that the economic program of the Yugoslav authorities deserves the support of the Fund in the form of a stand-by arrangement.

VII. Proposed Decision

The following draft decision is proposed for adoption by the Executive Board:

1. The Government of Yugoslavia has requested a stand-by arrangement for the 18-month period beginning March --, 1990 in an amount equivalent to SDR 460 million.

2. The Fund approves the stand-by arrangement attached to EBS/90/35, Supplement 1.

3. The Fund waives the limitations of Article V, Section 3(b)(iii).

4. The Fund notes the cancellation by Yugoslavia of the enhanced surveillance approved for it in Decision No. 8221-(86-45), adopted March 12, 1986.

Table 1. Yugoslavia: Gross Social Product and Aggregate Demand

	In Millions of Dinars	In 1983 Prices, Percent Change						
	1988	1984	1985	1986	1987	1988	1989 Est.	1990 Forecast
Private consumption	7,456.3	-1.0	--	4.5	-0.3	-2.2	--	-0.4
Public consumption 1/	1,297.0	-1.6	2.0	4.6	-1.5	2.0	-1.0	-2.0
Gross fixed investment	2,719.3	-8.7	-3.7	3.5	-5.1	-6.0	0.5	-2.5
Final domestic demand	11,472.6	-3.3	-0.8	4.2	-1.7	-2.8	--	-1.1
Stockbuilding 2/	-483.7	4.8	-0.6	0.7	-4.9	-2.5	2.1	1.4
Total domestic demand	10,988.9	1.7	-1.5	4.9	-6.9	-5.6	2.5	0.5
Exports of goods and nonfactor services	4,666.4	10.1	8.2	2.0	-0.6	5.8	7.2	3.9
Imports of goods and nonfactor services	3,920.1	-0.5	2.3	8.8	-5.8	1.8	12.7	12.5
Foreign balance 3/	746.3	3.7	2.3	-2.2	1.8	1.7	-1.4	-3.2
GSP, demand side	11,735.2	5.5	0.9	2.4	-4.7	-3.5	0.8	-2.9
Statistical discrepancy 2/	1,161.5	-3.2	-0.2	1.2	3.5	1.3	--	0.2
GSP, production side 4/	12,896.7	2.0	0.7	3.5	-1.1	-2.0	0.8	-2.5
GSP, weighted average 5/	12,606.3	2.8	0.8	3.2	-2.0	-2.3	0.8	-2.6
Revised statistical discrepancy 2/	871.1	-2.4	-0.1	0.9	2.6	0.9	--	0.1

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

1/ Material expenditures only.
2/ Staff calculations expressed as changes in percent of preceding year's weighted GSP at constant prices.
3/ Changes in percent of preceding year's weighted GSP at constant prices.
4/ Equal to official estimate of gross social product, adjusted by staff estimate of stock appreciation included in gross output.
5/ GSP estimated by staff as 25 percent of demand-side estimate of GSP plus 75 percent of production-side estimate of GSP.

Table 2. Yugoslavia: Prices and Wages

	Retail Prices	Net Personal Income 1/ Nominal	Net Personal Income 1/ Real	Retail Prices	Net Personal Income 1/ Nominal	Net Personal Income 1/ Real
	(Percentage change from one year earlier)			(Change during period)		
1985	75.99	78.26	2.78	79.50	97.08	6.12
1986	88.11	108.23	10.11	92.00	124.73	15.64
1987	118.72	105.46	-6.74	167.40	108.36	-23.00
1988						
January-March	154.83	146.18	-4.83	14.54	22.91	6.32
April-June	159.47	150.92	-4.56	35.52	10.04	-17.57
July-September	202.33	150.35	-15.27	47.07	38.25	-2.24
October-December	239.19	212.52	-5.26	53.84	75.92	12.71
1989						
January-March	346.78	317.37	-2.24	62.25	75.22	10.29
April-June	587.04	636.45	14.97	104.90	113.54	7.81
July-September	973.48	1,378.49	38.85	150.46	185.59	9.47
October-December	2,049.13	2,676.51	30.66	230.67	193.73	-13.14
1990 Program						
January-March	3,013.8	1,961.66	-34.37	64.85	-6.6	-43.30
April-June	1,645.0	893.37	-45.91	2.96	--	-2.84
July-September	684.9	...	...	3.03	...	...
October-December	157.9	...	...	3.03	...	...

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

1/ Net personal income per month in the socialized sector.

Table 3. Yugoslavia: Socially-Owned Enterprises: Accumulation and Losses 1/

(As percent of GSP)

	1985	1986	1987	1988	1989
Accumulation and net reserves	12.0	9.1	5.1	5.8	8.8
Losses	3.0	3.1	7.5	6.5	9.9
Net accumulation	9.0	5.9	-2.4	-0.7	-1.1

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

1/ Due to frequent changes in the accounting rules applicable to socially owned enterprise, yearly data are not strictly comparable.

Table 4. Yugoslavia: Broad Money Indicators

(In percent of M2X outstanding at beginning of year)

	1988				1989				1990 Program			
	Jan.-Mar.	Jan.-June	Jan.-Sept.	Jan.-Dec.	Jan.-Mar.	Jan.-June	Jan.-Sept.	Jan.-Dec. Prel.	Jan.-Mar.	Jan.-June	Jan.-Sept.	Jan.-Dec.
					(At exchange rate of beginning of year)							
M2X	4.5	16.3	42.6	97.0	11.8	54.7	174.1	815.1	5.6	8.0	14.2	18.5
Dinar M2	4.8	17.0	41.6	96.6	13.3	54.0	172.9	814.4	4.7	6.1	11.4	14.8
F/C deposits	-0.2	-0.7	1.0	0.4	-1.6	0.7	1.2	0.6	0.9	1.9	2.8	3.7
NDA	3.4	14.1	33.6	87.5	10.1	47.9	156.3	791.6	-0.7	2.4	4.9	9.5
Dinar credit	5.7	21.5	45.1	115.7	20.5	75.5	227.5	1,221.2	-1.3	1.1	3.0	7.0
F/C credit	-0.1	0.8	2.0	0.9	-0.3	-0.7	-0.7	-0.6	0.6	1.3	1.9	2.5
Other items	-2.2	-8.2	-13.5	-29.1	-10.2	-26.9	-70.5	-429.1	--	--	--	--
NFA	1.1	2.2	9.0	9.5	1.7	6.7	17.7	23.5	6.3	5.6	9.3	9.0
					(At current exchange rates)							
M2X	10.4	53.1	113.0	243.4	46.5	175.4	523.8	2,172.5	5.6	8.0	14.2	18.5
Dinar M2	4.8	17.0	41.6	96.6	13.3	54.0	172.9	814.4	4.7	6.1	11.4	14.8
F/C deposits	5.6	36.0	71.4	146.8	33.2	121.4	350.9	1,358.1	0.9	1.9	2.8	3.7
NDA	15.7	95.0	170.1	359.3	75.0	265.8	712.0	2,773.3	-0.7	2.4	4.9	9.5
Dinar credit	5.7	21.5	45.1	115.7	20.5	75.5	227.5	1,221.2	-1.3	1.1	3.0	7.0
F/C credit	4.9	31.8	60.9	114.5	28.7	94.0	256.4	971.3	0.6	1.3	1.9	2.5
Other items	5.1	41.7	64.1	129.1	25.7	96.3	228.2	580.9	--	--	--	--
NFA	-5.3	-42.0	-57.2	-115.9	-28.4	-90.4	-188.2	-600.8	6.3	5.6	9.3	9.0
Memorandum item:												
Cumulative inflation from beginning of year	16.1	55.7	129.4	251.2	62.3	232.5	732.7	2,653.4	22.0 1/	25.0 1/	29.0 1/	33.0 1/

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

1/ Inflation is on an end-of-period basis. Hence it excludes the carry-over of inflation from December 1989 to January 1990.

Table 5. Yugoslavia: Reserve Money Indicators 1/

(In percent of RMX outstanding at beginning of year)

	1988				1989				1990			
	Jan.-Mar.	Jan.-June	Jan.-Sept.	Jan.-Dec.	Jan.-Mar.	Jan.-June	Jan.-Sept.	Jan.-Dec.	Jan.-Mar.	Jan.-June	Jan.-Sept.	Jan.-Dec.
(At exchange rate of beginning of year)												
RMX	-2.8	1.5	13.2	31.5	0.9	15.8	55.5	304.3	-1.2	-1.6	-0.9	-0.2
Dinar reserve money	-0.5	3.6	10.1	30.8	0.4	12.7	55.6	304.4	-1.2	-1.6	-0.9	-0.2
F/C liabilities to banks	-2.2	-2.1	3.1	0.7	0.5	3.1	-0.2	-0.1	--	--	--	--
NDA	-4.8	-1.1	0.2	17.5	-0.4	11.4	39.4	278.9	-9.7	-9.8	-13.7	-13.8
Dinar credit	2.8	11.1	13.5	37.6	5.0	19.6	47.5	224.0	-3.5	-3.2	-3.0	-2.1
F/C credit	-0.1	0.4	0.4	1.1	-1.2	2.6	2.8	2.4	--	--	--	--
Liabilities to banks and public sector deposits	-3.5	-5.6	-16.0	-21.9	-3.9	-9.7	-31.4	-77.0	-6.2	-6.6	-10.7	-11.7
Other items	-4.0	-7.0	2.3	0.7	-0.4	0.2	21.3	128.4	--	--	--	--
NFA	2.1	2.6	12.9	14.0	1.3	4.4	16.0	25.4	8.5	8.1	12.8	13.6
(At current exchange rates)												
RMX	6.1	57.9	124.6	259.6	53.0	185.8	555.2	2,298.4	-1.2	-1.6	-0.9	-0.2
Dinar reserve money	-0.5	3.6	10.1	30.8	0.4	12.7	55.6	304.4	-1.2	-1.6	-0.9	-0.2
F/C liabilities to banks	6.6	54.3	114.5	228.7	52.5	173.0	499.6	1,994.0	--	--	--	--
NDA	5.7	73.6	122.7	258.1	52.3	190.5	505.4	1,903.6	-9.7	-9.8	-13.7	-13.8
Dinar credit	2.8	11.1	13.5	37.6	5.0	19.6	47.5	224.0	-3.5	-3.2	-3.0	-2.1
F/C credit	0.5	4.4	8.0	18.8	4.9	23.2	64.0	265.5	--	--	--	--
Liabilities to banks and public sector deposits	-3.5	-5.6	-16.0	-21.9	-3.9	-9.7	-31.4	-77.0	-6.2	-6.6	-10.7	-11.7
Other items	5.9	63.7	117.2	223.5	46.4	157.3	425.3	1,491.0	--	--	--	--
NFA	0.4	-15.8	1.9	1.5	0.6	-4.8	49.8	394.8	8.5	8.1	12.8	13.6
Cumulative inflation from beginning of year	16.1	55.7	129.0	251.2	62.3	232.5	732.7	2,653.4	22.0 2/	25.0 2/	29.0 2/	33.0 2/

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

1/ Reserve money as defined in the program includes currency, giro accounts and F/C liabilities to banks.

2/ Inflation is on an end-of-period basis. Hence it excludes the carry-over of inflation from December 1989 to January 1990.

Table 6. Yugoslavia: Public Sector Developments, 1/2/

	1985	1986	1987	1988	Est. 1989	Prog. 1990
	(As percent of gross social product) 3/					
Revenue	26.6	31.1	30.2	30.7	27.6	31.4
Expenditure	26.6	30.9	31.0	29.4	26.1	30.6
Overall position	--	0.2	-0.8	1.3	1.5	0.8
	(Percentage change from year earlier)					
Revenue	77.1	122.1	109.1	195.8	1,289.0	376.4
Expenditure	75.7	120.5	115.6	176.0	1,275.3	390.6

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

Note: Coverage of expenditures in 1990--and hence the overall public sector position--is not comparable to that of previous years.

1/ Both revenue and expenditure are on a cash basis; and exclude receipts and payments on account of indexation of principal of deposits and loans through 1989. The revenue figures prior to 1990 have been adjusted for the inflation-induced loss of public sector net assets with the banking system.

2/ Public sector is "narrowly" defined to consist of the Federal Government, republics and provinces, local governments, and public entities charged with providing health, education, unemployment, and other such benefits.

3/ Figures on gross social product used are staff estimates for years prior to 1989. For 1989 and 1990 these are official estimates. The 1990 official estimate has been adjusted for inflation to date.

Table 7. Federal Budget, 1989 and 1990

(As a percent of GSP) 1/

	1989	1990
Total revenue	5.6	9.2
Taxes	4.8	8.5
Turnover tax	(3.1)	(4.4)
Customs duty and other levies	(1.7)	(4.5)
Fees and other taxes	(0.1)	(4.0)
Contributions of republics and provinces	0.8	0.7
Dividends from operation surplus of NBY	--	--
Total expenditure	6.6	8.7
Defense and administration	4.1	5.0
Transfers to other public sector agencies	0.7	1.0
For less developed regions	(0.4)	(0.4)
For invalidity payments and veterans' protection	(0.3)	(0.4)
For social cost of adjustment	(--)	(0.2)
Interest on public debt	0.8	0.8
Subsidies	1.0	1.7
To agriculture	(0.2)	(0.3)
Foreign trade related	(0.6)	(0.8)
For bank rehabilitation	(--)	(0.4)
Others	(0.1)	(0.2)
Others	--	0.2
Deficit (-); surplus (+)	-1.0	0.5
Financing		
From sale of bonds	--	--
From sale of securities	--	--
Decrease (+) in deposits at the NBY	(0.2)	(-0.5)
Unspecified	1.2	--

Source: Data provided by the Yugoslav authorities.

1/ Official Yugoslav estimates of GSP have been used to derive the percentages presented in the table. The official figure for 1990 has been adjusted for inflation to date.

Table 8. Yugoslavia: Balance of Payments with the Convertible Currency Area, 1984-90 1/

(In millions of U.S. dollars)

	1984	1985	1986	1987	1988	Estimate 1989	Program 1990
Exports, f.o.b.	6,470	6,496	7,249	8,572	9,624	10,519	11,710
Volume (percentage change) 2/	12.6	4.1	0.2	9.7	8.6	7.2	5.0
Unit value (percentage change)	-8.1	-3.6	11.4	7.8	3.4	2.0	6.0
Imports, c.i.f.	7,675	8,267	9,739	9,610	10,212	11,971	14,160
Volume (percentage change) 2/	-4.4	7.6	9.4	-8.5	2.4	14.9	11.6
Unit value (percentage change)	—	0.1	7.6	7.9	3.8	2.0	6.0
Trade balance	-1,205	-1,771	-2,490	-1,038	-588	-1,452	-2,450
Services (net)	1,984	2,115	2,735	2,105	2,798	3,462	3,750
Workers' remittances	1,697	1,635	1,620	989	1,488	1,497	1,400
Tourism	860	909	1,160	1,606	1,966	2,047	2,200
Interest payments	-1,579	-1,610	-1,690	-1,790	-1,922	-1,804	-1,650
Other	1,006	1,181	1,645 3/	1,300	1,266	1,722	1,800
Current balance	779	344	245 3/	1,067	2,210	2,010	1,300
Medium- and long-term capital (net)	-59	-92	-1,351	-819	-147	-51	-17
Loans received (net)	33	3	-1,121	-617	-72	74	223
Drawings	(2,841)	(2,932)	(2,636)	(2,837)	(3,536)	(2,535)	(2,890)
Refinancing	[1,750]	[1,900]	[1,650]	[1,747]	[1,979]	[1,390]	[1,060]
Other	[1,091]	[1,032]	[986]	[1,090]	[1,557]	[1,145]	[1,830] 5/
Repayments (-)	(-2,808)	(-2,929)	(-3,757)	(-3,454)	(-3,608)	(-2,461)	(-2,667)
Refinancing	[-1,750]	[-1,900]	[-1,650]	[-1,747]	[-1,979]	[-1,240]	[-1,060]
Other	[-1,058]	[-1,029]	[-2,107]	[-1,707]	[-1,629]	[-1,221] 4/	[-1,607]
Loans extended (net) (-)	-92	-95	-230	-202	-75	-125	-240
Short-term capital through banking system	-96	-36	350	-65	-267	-237	-250
Other short-term capital, including errors and omissions	-100	58	1,493	-752	207	1,688	1,183
Other financing flows	—	—	—	—	—	—	640 6/
Overall balance	524	274	737	-569	2,003	3,410	2,856
Financing	-524	-274	-737	569	-2,003	-3,410	-2,856
Use of Fund credit	10	-66	-271	-505	-454	-575	4
Purchases	290	251	156	—	159	—	337
Repurchases	-280	-317	-427	-505	-613	575	333
Reserve movements (increase -)	-534	-208	-466	1,074	-1,549	-2,835	-2,860

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

1/ Data are based on market exchange rates.

2/ Derived from official estimates of volume and unit values for total trade flows.

3/ Incorporates an upward official adjustment of US$213 million for previously underestimated service receipts from processing of goods; not comparable with data for previous years.

4/ Excludes nonpayment of scheduled principal payments to the Paris Club in the second half of 1989 amounting to US$274 million.

5/ Includes potential disbursements under the World Bank SAL II in an amount of US$300 million.

6/ Potential rescheduling with the Paris Club covering principal payments falling due in 1990 could cover these projected other financing flows.

Table 9. Yugoslavia: Balance of Payments with the Nonconvertible Currency Area, 1984-90

(In millions of U.S. dollars)

	1984	1985	1986	1987	1988	Est. 1989	Prog. 1990
Current account	-302	478	855	152	277	256	-185
Exports, f.o.b.	3,666	4,127	3,835	3,231	3,155	2,900	2,845
Imports, c.i.f.	4,237	3,968	3,357	3,400	3,117	2,940	-3,375
Trade balance	-571	160	478	-169	38	-40	-530
Services (net)	269	319	377	321	239	296	345
Long-term capital	-129	169	-55	-73	-414	-205	-740
Loans received (net)	-119	163	-67	-56	158	-140	-150
Drawings	(140)	(457)	(151)	(213)	(268)	(100)	(100)
Repayments (-)	(-259)	(-294)	(-218)	(-269)	(-110)	(-240)	(-250)
Loans extended (net) (-)	-10	6	12	-17	-572	-65	-70
Debt reduction	--	--	--	--	--	--	-520
Short-term capital (net)	--	--	--	--	4	--	--
Errors and omissions	-11	-213	100	52	68	126	--
Total	-442	434	900	131	-65	177	-925
Bilateral balance (surplus -)	442	-434	-900	-131	65	-177	925

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

Selected Economic and Financial Indicators, 1985-90

	1985	1986	1987	1988	1989 Preliminary	1990 Program
	(Percentage changes on same period, previous year unless otherwise specified)					
National income, prices, and costs:						
GSP at constant prices 1/	0.8	3.2	-2.0	-2.3	0.8	-2.5
GSP deflator	82.9	83.6	119.7	193.5	1,220.0	401.0
Retail price index (end of period)	78.9	92.0	167.4	251.2	2,653.0	33.0 10/
Cost of living (end of period)	85.7	90.6	170.6	240.6	2,676.0	61.5 11/
Real net wages	2.8	10.1	-6.7	-7.8	14.7	...
External sector (convertible currency area)						
Export volume	4.1	0.2	9.7	8.6	7.2	5.0
Import volume	7.6	9.4	-8.5	2.4	14.9	11.6
Terms of trade (deterioration -)	-3.7	3.5	-0.1	-0.4	--	—
Nominal effective exchange rate) (depreciation -) 2/	-42.0	-40.9	-68.2	-71.6	-95.7	...
Real effective exchange rate (depreciation -) 2/	2.1	9.1	-18.6	-7.1	14.6	...
Public sector 3/						
Total revenue	79.1	122.1	113.3	195.7	1,306.5	337.2
Total expenditure	75.7	120.5	115.6	176.0	1,275.3	390.6
Money and credit						
Net domestic assets	61.3	77.8	144.9	234.7	1,858.8	7.4
Broad money (M2X)	60.4	84.8	129.5	243.4	2,172.5	18.5
Velocity (end-period) 4/	8.7	8.0	12.9	0.8	19.4	13.5
Dinar velocity (end-period) 5/	13.9	0.7	47.3	16.3	29.0	--
Interest rate (annual rate end of period, one year savings deposit)	63.0	56.0	134.0	... 6/	... 6/	...
	(In percent of GSP)					
Public sector expenditure 3/	26.6	30.9	31.0	29.4	26.1	30.6
Federal government expenditure 12/	6.5	6.8	6.9	6.4	7.7	8.6
Public sector surplus 3/	--	0.2	-0.8	1.3	1.5	0.8
Gross fixed investment	24.6	25.1	22.9	21.6	21.4	20.3
Broad money (M2X); period average	50.8	46.7	42.2	42.9	33.7	30.7
Dinar broad money; period average	28.2	26.9	21.8	18.4	12.3	12.0
Convertible current account balance	0.9	0.5	1.8	4.5	3.5	2.2
Global current account balance	2.1	2.1	2.1	5.1	3.9	1.9
External convertible currency debt; end of period	48.8	37.0	34.0	37.4	29.7	29.4
	(Other ratios and data)					
External debt service ratio 7/	44.1	46.6	42.0	35.9	29.1	24.3
Of which:						
Interest payments 7/	15.8	14.5	13.2	11.4	10.3	8.6
Gross external reserves 8/	14.9	15.1	9.5	17.0	27.7	34.2
Overall balance of payments with convertible currency area (in millions of U.S. dollars) 9/	274.0	737.0	-569.0	2,003.0	3,410.0	2,856.0

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

1/ Weighted average of demand and production estimates.
2/ End of period over end of preceding period.
3/ On a cash basis for the consolidated public sector excluding communities for material production; expenditures cover general and collective consumption. Public sector surplus prior to 1990 is with inflation adjustment.
4/ GSP relative to M2 (excluding public sector deposits); calculated using end-year level of M2.
5/ GSP relative to dinar M2 (excluding public sector deposits); calculated using end-year level of dinar M2.
6/ Indexation of principal of time deposits of greater than three-month maturity and one-year maturity; one-year deposits yield a real interest rate of 8 percent.
7/ For convertible currencies, in percent of exports of goods and services with remittances on a net basis.
8/ In weeks of convertible merchandise imports.
9/ Equivalent to the change in gross reserves of the banking system plus net repurchases to the Fund.
10/ Measured from January 1, 1990.
11/ Includes carryover of inflation from December 1989 to January 1990.
12/ From 1989 onwards, includes extrabudgetary items.

Yugoslavia--Fund Relations

(As of January 31, 1990)

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 1,135.2 million, or 185.2 percent of quota.

(c) Fund credit: SDR 522.2 million, or 85.2 percent of quota, of which: credit tranche: SDR 213.4 million; SFF: SDR 97.9 million; and EAR: SDR 210.9 million; (34.8 percent, 16.0 percent, and 34.4 percent, respectively, of quota).

(d) Reserve tranche position: none

(e) Current Operational Budget (maximum use of currency): not applicable

(f) Lending to the Fund: none.

III. Stand-by arrangements and special facilities

(a) Last stand-by arrangement approved in principle on June 1, 1988 for an amount of SDR 306 million or 50 percent of quota, and became effective on June 28. The arrangement expired on June 28, 1989: only two purchases of SDR 61.2 million each were made.

(b) On April 29, 1985 the Executive Board approved a stand-by arrangement for an amount of SDR 300 million (49 percent of quota). The arrangement expired on May 15, 1986: the full amount was purchased.

(c) On April 18, 1984, the Executive Board approved a one-year stand-by arrangement for an amount of SDR 370 million (60 percent of quota), which was used in full.

(d) On June 6, 1980 the Executive Board approved a stand-by arrangement effective through December 31, 1981 for an amount of SDR 339.33 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.

(e) 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.

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

IV. SDR Department

(a) Net cumulative allocation: SDR 155.2 million.

(b) Holdings: SDR 0.25 million, or 0.16 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. Financial obligations due to the Fund (in SDR millions)

	Overdue Financial Obligations (1/31/90)	Principal and Interest Due 1/ 1990	1991	1992
Repurchases	--	259.9	113.1	102.5
Charges and Interest	--	63.5	63.7	66.1
Total	--	323.4	176.8	168.6

1/ Data are projected on the basis of outstanding purchases and the assumption that all purchases requested under the stand-by arrangement are made as scheduled.

B. Nonfinancial Relations

VII. Exchange rate arrangement

The currency of Yugoslavia is the Yugoslav dinar. On December 18, 1989 the exchange rate of the dinar was fixed with respect to the deutsche mark and a new dinar was introduced: the value of the new dinar was equivalent to 10,000 of the old dinars and the exchange rate was fixed at new Din 7 per DM 1. All transactions with the exception of those effected under the procedures set forth for certain CMEA countries with which Yugoslavia has bilateral payments arrangements take place at the fixed official exchange rate.

Yugoslavia maintains an exchange restriction subject to approval under Article VIII as evidenced by debt-servicing arrears to official creditors.

VIII. Last consultation

The staff report for the 1989 Article IV consultation (SM/89/181, 8/17/89) was considered by the Executive Board at EBM/89/23, 9/12/89. The Executive Board's decision, adopted on September 12, 1989, reads as follows:

Enhanced Surveillance

The decision approving enhanced surveillance for Yugoslavia adopted on March 12, 1986 (EBM/86/45) under the Fund's policy on enhanced surveillance shall be suspended until the next Article IV consultation or Fund approval of a stand-by arrangement for Yugoslavia, whichever comes first.

Decision No. 9250-(89/123)
Adopted September 12, 1989

Table 10. Yugoslavia: IMF Position, January 1990 to September 1991

(In millions of SDRs)

	Outstanding	Scheduled						
	Jan. 31, 1990	2 Months to Mar.31, 1990	3 Months to June 30, 1990	3 Months to Sept. 30, 1990	3 Months to Dec. 31, 1990	3 Months to Mar. 31, 1991	3 Months to June 30, 1991	3 months to Sept. 30, 1991
Transactions under credit tranche policies, net	--	5.4	-33.9	34.8	-3.4	43.2	33.7	44.2
Purchases	--	65.7	65.7	65.7	65.7	65.7	65.7	65.9
Ordinary resources	--	21.9	21.9	21.9	21.9	21.9	21.9	22.0
Enlarged access resources	--	43.8	43.8	43.8	43.8	43.8	43.8	43.9
Supplementary financing facility	--	--	--	--	--	--	--	--
Repurchases	--	60.3	99.6	30.9	69.1	22.5	32.0	21.7
Ordinary resources	--	24.4	24.4	16.9	12.7	8.4	4.2	7.7
Enlarged access resources	--	14.1	27.8	14.1	27.8	14.1	27.8	14.1
Supplementary financing facility	--	21.9	47.4	--	28.6	--	--	--
Total Fund credit outstanding (end of period)	522.2	527.4	493.5	528.2	524.9	568.1	601.8	645.9
Ordinary resources	213.4	210.9	208.4	213.4	222.6	236.1	253.8	268.1
Enlarged access resources	210.9	240.6	256.6	286.3	302.3	332.0	348.0	377.8
Supplementary financing facility	97.9	75.9	28.5	28.5	--	--	--	--
				(In percent of quota)				
Total Fund credit outstanding (end of period)	85.2	86.0	80.5	86.2	85.6	92.7	98.2	105.4
Ordinary resources	34.8	34.4	34.0	34.8	36.3	38.5	41.4	43.7
Enlarged access resources	34.4	39.2	41.9	46.7	49.3	54.2	56.8	61.6
Supplementary financing facility	16.0	12.4	4.6	4.6	--	--	--	--

Source: International Monetary Fund.

Quantitative Performance Criteria for 1990

	1990			
	Jan.-March (Performance Criteria)	Apr.-June (Performance Criteria)	July-Sept. (Indicative)	Oct.-Dec. (Indicative)
Net domestic assets of the NBY (quarterly ceilings) 1/	115,890	115,790	109,600	109,410
Net indebtedness of the public sector (end of period limits) 1/	120,921	120,421	118,721	116,921
Public sector spending (cumulative end of period cash limits) 1/	51,100	109,000	175,000	250,000
Transfer from the public sector to the bank and enterprise funds (cumulative end of period minimum cash transfers) 1/2/	1,470	3,285	5,360	7,435
Average monthly net personal income per worker in the social sector (maximum limit during period) 3/	2,602	2,602	...	...
Net foreign assets of the banking system (minimum end of period targets) 4/	6,000	6,050	7,050	7,130
Foreign borrowing (cumulative end of period disbursements) 4/	900	1,500	1,800	2,600

Source: Economic Policy Memorandum.

1/ In millions of new dinars.
2/ From the federal budget to the Bank Rehabilitation Agency and from the republican and provincial budgets to the enterprise restructuring funds.
3/ In new dinars per month.
4/ In millions of U.S. dollars.

Financial Relations with the World Bank

(In millions of U.S. dollars; as of December 31, 1989)

I.	Structural Adjustment Loan	
	Amount approved: US$275.0 million	
	Appraised: February 28-March 18, 1983	
	Board approval: June 28, 1983	
	Actual loan closing date: June 30, 1985	
	A. First tranche: US$175.0 million	
	Disbursed through December 31, 1983	31.0
	Disbursed January 1-December 31, 1984	144.0
	Subtotal	175.0
	B. Second tranche: US$100.0 million	
	Released: August 23, 1984	
	Disbursed: August 23-December 31, 1984	57.0
	Disbursed: January 1-June 30, 1985	43.0
	Subtotal	100.0
	Total disbursed	275.0
II.	IBRD gross commitments (loans approved by the Board)	
	FY 1984 (July 1, 1983-June 30, 1984)	
	Middle Neretva Hydro Supplemental Loan	61.0
	Sixth Railway Project	110.0
	Third Power Transmission Project	120.0 1/
	Seventh Industrial Credit Project Loan (2 loans)	70.0
	Fertilizer Sector Loan	90.0 2/
	Total	451.0
	FY 1985 (July 1, 1984-June 30, 1985)	
	Montenegro Regional Development Project	40.0
	Visegrad Hydropower Project	125.0
	Bosnia Forestry Project	35.0 2/
	Petroleum Sector Project Loans (3 loans)	92.5
	Total	302.5
	FY 1986 (July 1, 1985-June 30, 1986)	
	First Highway Sector Project	121.5
	FY 1987 (July 1, 1986-June 30, 1987)	
	Industry Energy Conservation and Substitution	90.0
	FY 1988 (July 1, 1987-June 30, 1988)	
	Second Highway Sector Project	68.0 3/
	Export Industries Project (3 loans)	120.0 4/
	Total	188.0
	FY 1989 (July 1, 1988-June 30, 1989)	
	Seventh Railway Project	138.0 5/
	Istria and Slovene Coast Water Supply Project (2 loans)	60.0 5/
	Total	198.0
III.	Disbursements 6/	
	January 1-December 31, 1983	260.7
	January 1-December 31, 1984	204.5
	January 1-December 31, 1985	251.9
	January 1-December 31, 1986	201.3
	January 1-December 31, 1987	184.0
	January 1-December 31, 1988	145.7
	January 1-December 31, 1989	122.0
IV.	Position of the World Bank (as of December 31, 1989) 7/	
	Total amount disbursed and outstanding	1,806.0
	Total amount undisbursed loans	363.9 8/
	Total	2,169.9

Source: IBRD.
1/ This loan was subsequently reduced at the time of loan effectiveness to US$115.05 million.
2/ The offer of the Bank loans was withdrawn in July 1986.
3/ This loan was subsequently reduced at the time of loan effectiveness to US$61.6 million.
4/ The offer of the Bank loans was withdrawn in August 1989.
5/ Not yet signed/effective.
6/ Excludes SAL.
7/ Includes SAL.
8/ Excludes loans not yet signed/effective.

Medium-Term Convertible Balance of Payments Projections, 1989-95

(In millions of U.S. dollars)

	1989	1990	1991	1992	1993	1994	1995
Exports	10,519	11,710	12,787	13,964	15,176	16,414	17,754
Imports	-11,971	-14,160	-15,638	-17,061	-18,524	-20,035	-21,670
Trade balance	-1,452	-2,450	-2,851	-3,097	-3,348	-3,621	-3,917
Workers' remittances	1,497	1,400	1,452	1,508	1,567	1,630	1,695
Tourism	2,047	2,200	2,304	2,418	2,537	2,665	2,800
Interest payments	-1,804	-1,650	-1,701	-1,714	-1,681	-1,621	-1,549
Other services, net	1,722	1,800	1,867	1,939	2,015	2,096	2,179
Current account	2,010	1,300	1,071	1,055	1,090	1,148	1,209
Capital account	-288	373	122	-218	-563	-717	-739
Loans received (MLT), net	74	863	322	-18	-413	-567	-589
Official bilateral, net	100	291	28	-171	-253	-283	-328
Disbursements	500	715	790	861	935	1,012	1,094
Rescheduling 1/	804	640	293	--	--	--	--
Amortization	-1,204	-1,064	-1,054	-1,032	-1,189	-1,294	-1,423
Official multilateral, net	10	436	294	153	140	166	189
Disbursements	400	830	680	578	628	679	734
Amortization	-390	-394	-386	-425	-488	-513	-545
Commercial banks, net	--	--	--	--	-300	-450	-450
Disbursements	--	--	--	--	--	--	--
Rescheduling 2/	860	1,060	783	575	575	575	575
Amortization	-860	-1,060	-783	-575	-875	-1,025	-1,025
Other, net	-36	136	--	--	--	--	--
Loans extended	-125	-240	-200	-200	-150	-150	-150
Short term, net	-237	-250	--	--	--	--	--
Errors and omissions	1,688	1,183	--	--	--	--	--
Overall balance	3,410	2,856	1,193	837	527	432	470
Financing	-3,410	-2,856	-1,193	-837	-527	-432	-470
IMF, net	-575	4	109	-140	-102	-158	-188
Gross reserves	-2,835	-2,860	-1,302	-697	-425	-274	-282
Memorandum items:							
Export volumes (percent change)	7	5	5	5	4	4	4
Import volumes (percent change)	15	12	7	5	4	4	4
Current account (as percent of GSP)	3.5	2.2	1.7	1.6	1.5	1.5	1.5
Debt service ratio (as percent of exports of goods and services)	29	24	21	19	20	20	19
Interest service ratio (as percent of exports of goods and services)	10	9	8	8	7	6	6
Reserves (months of merchandise imports)	7	8	8	8	8	7	7

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

1/ Includes potential rescheduling with official creditors under the Paris Club.

2/ Includes only rescheduling already obtained under the 1988 MYRA with commercial banks.

Yugoslavia: Stand-By Arrangement

In the letter dated February 23, 1990 and annexed Economic Policy Memorandum ("the Memorandum") circulated as EBS/90/35 (2/23/90) from the Governor of the National Bank of Yugoslavia and the Federal Secretary for Finance of Yugoslavia, requesting a stand-by arrangement and setting forth (a) the objectives and policies that the authorities of Yugoslavia intend to pursue for the period of this stand-by arrangement; and (b) understandings of Yugoslavia with the Fund regarding reviews that will be made of progress in realizing the objectives of the program and of the policies and measures that the authorities of Yugoslavia will pursue for the remaining periods of this stand-by arrangement.

To support these objectives and policies, the International Monetary Fund grants this stand-by arrangement in accordance with the following provisions:

1. For the period of 18 months from March [--], 1990, Yugoslavia will have the right to make purchases from the Fund in an amount equivalent to SDR 460 million, subject to paragraphs 2, 3, 4, 5, and 6 below, without further review by the Fund.

2. a. Purchases under this arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 65.7 million until May 15, 1990, the equivalent of SDR 131.4 million until August 15, 1990, the equivalent of SDR 197.1 million until November 15, 1990, the equivalent of SDR 262.8 million until February 15, 1991, the equivalent of SDR 328.5 million until May 15, 1991, and the equivalent of SDR 394.2 million until August 15, 1991.

b. None of the limits in a. above shall apply to a purchase under this stand-by arrangement that would not increase the Fund's holdings of Yugoslavia's currency in the credit tranches beyond 25 percent of quota or increase the Fund's holdings of that currency resulting from purchases of borrowed resources beyond 12.5 percent of quota.

3. Purchases under this stand-by arrangement shall be made from ordinary and borrowed resources in the ratio of 1 to 2, provided that any modification by the Fund of the proportions of ordinary and borrowed resources shall apply to amounts that may be purchased after the date of modification.

4. Yugoslavia will not make purchases under this stand-by arrangement that would increase the Fund's holdings of its currency in the credit tranches beyond 25 percent of quota or increase the Fund's holdings of that currency resulting from purchases of supplementary financing or borrowed resources beyond 12.5 percent of quota:

a. During any period in which:

(i) the ceiling on the net domestic assets of the National Bank of Yugoslavia referred to in paragraph 4 and Appendix A of the Memorandum; or

(ii) the ceiling on the average monthly net personal income per worker in the social sector referred to in paragraph 24 and Appendix D of the Memorandum;

has not been observed; or

b. During any period in which the data at the end of the preceding period indicate that:

(i) the limit on expenditures of the public sector referred to in paragraph 14 and Appendix C of the Memorandum; or

(ii) the limit on the net indebtedness of the public sector referred to in paragraph 12 and Appendix B of the Memorandum; or

(iii) the minimum level of the cash transfers from the federal budget and the budgets of the republics and provinces to the bank rehabilitation and enterprise restructuring funds referred to in paragraph 16 of the Memorandum; or

(iv) the target for the net foreign assets in convertible currencies of the banking system, referred to in paragraph 33 and Appendix F of the Memorandum; or

(v) the limit on the disbursement of foreign debt referred to in paragraph 32 and Appendix E of the Memorandum;

has not been observed; or

c. After March 31, 1990, until the intentions described in paragraphs 15 and 17 of the Memorandum to implement the amendments described therein to the customs regulations have been carried out; or

d. After June 30, 1990 or after December 31, 1990, respectively, until the reviews contemplated in the third paragraph of the letter have been completed and suitable performance criteria have been established in consultation with the Fund, or, after such performance criteria have been established, while they are not being observed; or

e. If Yugoslavia:

(i) imposes or intensifies restrictions on payments and transfers for current international transactions; or

(ii) introduces or modifies multiple currency practices other than those resulting from adaptation of the practice of settling claims under the clearing arrangements for transactions with the nonconvertible area; or

(iii) concludes bilateral payments agreements which are inconsistent with Article VIII; or

(iv) imposes or intensifies import restrictions for balance of payments reasons.

When Yugoslavia is prevented from purchasing under this arrangement because of this paragraph 4, purchases will be resumed only after consultation has taken place between the Fund and Yugoslavia and understandings have been reached regarding the circumstances in which such purchases can be resumed.

5. Yugoslavia will not make purchases under this stand-by arrangement during any period of the arrangement in which the member has an overdue financial obligation to the Fund or is failing to meet a repurchase expectation pursuant to the Guidelines on Corrective Action in respect of a noncomplying purchase, or pursuant to Decision No. 9331-(89/167), on early repurchase expectations related to debt and debt-service reduction operations.

6. Yugoslavia's right to engage in the transactions covered by this arrangement can be suspended only with respect to requests received by the Fund after (a) a formal ineligibility; or (b) a decision of the Executive Board to suspend transactions, either generally or in order to consider a proposal, made by an Executive Director or the Managing Director, formally to suppress or to limit the eligibility of Yugoslavia. When notice of a decision of formal ineligibility or of a decision to consider a proposal is given pursuant to this paragraph 6, purchases under this arrangement will be resumed only after consultation has taken place between the Fund and Yugoslavia and understandings have been reached regarding the circumstances in which such purchases can be resumed.

7. Purchases under this arrangement shall be made in the currencies of other members selected in accordance with the policies and procedures of the Fund, and may be made in SDRs if, on the request of Yugoslavia, the Fund agrees to provide them at the time of the purchase.

8. The value date for purchases under this stand-by arrangement involving borrowed resources will be determined in accordance with Rule G-4(b) of the Fund's Rules and Regulations. Yugoslavia will consult the Fund on the timing of purchases involving borrowed resources in accordance with Rule G-4(d).

9. Yugoslavia shall pay a charge for this arrangement in accordance with the decisions of the Fund.

10. a. Yugoslavia shall repurchase the amount of its currency that results from a purchase under this stand-by arrangement in accordance with the provisions of the Articles of Agreement and decisions of the Fund, including those related to repurchase as Yugoslavia's balance of payments and reserve position improve.

b. Any reductions in Yugoslavia's currency held by the Fund shall reduce the amounts subject to repurchase under (a) above in accordance with the principles applied by the Fund for this purpose at the time of the reduction.

c. The value date of a repurchase in respect of a purchase financed with borrowed resources under this stand-by arrangement will be normally either the 6th day or the 22nd day of the month, or the next business day if the selected day is not a business day, provided that repurchase will be completed not later than seven years from the date of purchase.

11. During the period of the stand-by arrangement, Yugoslavia shall remain in close consultation with the Fund. These consultations may include correspondence and visits of officials of the Fund to Yugoslavia or of representatives of Yugoslavia to the Fund. Yugoslavia shall provide the Fund, through reports at intervals or dates requested by the Fund, with such information as the Fund requests in connection with the progress of Yugoslavia in achieving the objectives and policies set forth in the letter and annexed Memorandum.

12. In accordance with the third paragraph of the letter, Yugoslavia will consult with the Fund on the adoption of any measures that may be appropriate at the initiative of the Government or whenever the Managing Director requests consultation because any of the criteria in paragraph 4 above have not been observed, or because he considers that consultation on the program is desirable. In addition, after the period of the arrangement and while Yugoslavia has outstanding purchases in the upper credit tranches, the Government will consult with the Fund from time to time, at the initiative of the Government or at the request of the Managing Director, concerning Yugoslavia's balance of payments policies.