DOCUMENT OF INTERNATIONAL MONETARY FUND
AND NOT FOR PUBLIC USE

FOR
AGENDA

EBS/87/79

CONFIDENTIAL

April 13, 1987

To: Members of the Executive Board

From: The Acting Secretary

Subject: Yugoslavia - Consolidation of External Debt vis-à-vis Official Creditors

The attached paper is proposed to be scheduled for consideration by the Executive Directors on Monday, April 20, 1987.

Mr. Lipschitz (ext. 8866) or Mr. Bennett (ext. 8873) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

Yugoslavia: Consolidation of External Debt vis-à-vis Official Creditors

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

Approved by L.A. Whittome and J.T. Boorman

April 13, 1987

I. Introduction

On March 30, 1987 the Yugoslav authorities met in Paris with official creditors to discuss the restructuring of maturities falling due in the second phase of the debt consolidation period, May 16, 1987 through March 31, 1988. 1/2/ The restructuring for this period had already been agreed upon in principle in April 1986 and bilateral agreements had been negotiated on this basis. However, the activation of the agreement and the proportion of maturing debt to be restructured was to be decided upon by the participants on the basis of an assessment of policies and developments in Yugoslavia (EBS/86/96, 4/25/86) in the context of Enhanced Surveillance by the Fund. To this end, the participants in the meeting had at their disposal the recent staff report on the 1986 Article IV consultation with Yugoslavia (SM/87/53, 2/20/87 and Supplement 1, 3/12/87) and the Chairman's Summing-Up (SUR/87/29, 3/19/87) of the Executive Board Meeting (EBM/87/45, 3/13/87). The meeting was also given a statement (attached) by the Chairman of the Yugoslav delegation on current economic developments in Yugoslavia and the stance of policies.

It was agreed at the meeting that the creditors would reschedule 84 percent of the maturities falling due from May 16, 1987 through March 31, 1988 "after consulting on the basis of a further assessment by the Fund Managing Director of the measures" described in the Statement of the Chairman of the Yugoslav delegation (hereafter "the

---

1/ Mrs. Junz (EUR) and Mr. Keller (ETR) attended this meeting.

2/ In principle, agreement on rescheduling for this period could be postponed until May 15, 1987, but the agreed minute initialed on April 17, 1986 envisaged a meeting on or before March 31, 1987 to decide on the rescheduling in order to dovetail with the activation of the second phase of the MYRA agreement between the Yugoslav authorities and their commercial bank creditors. The preconditions for activating the second phase of the MYRA with the commercial banks include comparable treatment by official creditors.

Statement"). A description of these measures and other recent developments follows in section II, and an appraisal of them in section III.

II. Recent Developments and the Statement on Policy Measures

As described in the recent staff report on Yugoslavia, in December 1986 the Government of Yugoslavia enacted a number of laws aimed at structural reform of the Yugoslav economy. New accounting regulations for enterprises--involving a more complete revaluation of assets and the requirement that funds set aside for amortization be unavailable for distributions as wages--were expected to improve enterprise liquidity while constraining wage awards. Penalties applying to loss-making and illiquid enterprises, in the form of bankruptcy and rehabilitation procedures, were also sharpened. In the Statement of March 30, 1987, the Chairman of the Yugoslav delegation reaffirmed his Government's commitment to the reforms introduced in December. In this regard, he accepted that the reforms would lead to increased bankruptcies and labor dislocation, and explained that the Government would attempt to alleviate such social problems through the utilization of special funds. He also referred to the authorities' intention to revise the Associated Labour Act so as to improve enterprise management at the cost of lessening the job security of workers.

In February four intervention laws were passed. 1/ Two of the laws concerned the control of wages and two were related to the control of public expenditure. The first intervention law provides that for the financial sector 2/--where incomes rose faster in 1986 than average incomes in the economy--the monthly nominal wage bill of enterprises in the first half of 1987 will remain at the level prevailing in the last quarter of 1986. The second intervention law concerns employees in enterprises outside the financial sector. In the first quarter of 1987 the wage bill in these enterprises will be frozen at the level of the last quarter of 1986; subsequently, an adjustment will be made to reflect changes in revenue per worker once enterprise accounts for the first quarter become available. 3/ A third intervention law affirms the

---

1/ An intervention law, which remains in force for a limited period of time, allows for the rapid implementation of measures, thereby appreciably shortening the normal procedure of moving laws through the Assemblies of each Republic and autonomous Province. The Board was informed of these four intervention laws at the time of the discussion of the Article IV consultation with Yugoslavia.

2/ The term "financial sector" is used in this context to refer to banks, self-management communities of interest, insurance companies, lotteries and special business associations.

3/ This measure was subsequently slightly modified in certain instances to address special circumstances, e.g., highly seasonal industries. In the "noneconomic" sector, e.g., the Federal Government, the rise in wages will be limited to that in the economic sector.

rule (described in the staff report) governing roughly half of public sector expenditures in 1987; it requires that the growth of this spending be limited to nine tenths of the growth of incomes. Strong sanctions are reportedly being introduced to ensure strict implementation of this rule. The fourth intervention law limits nominal public sector ("noneconomic, nonproductive") investment in 1987 to 90 percent ot its average level in 1984-85--that is, to a level equivalent to about one third of real investment spending in 1986. The official Statement notes that the measures implemented through these four intervention laws were economically painful and politically unpopular. Nevertheless, the Government of Yugoslavia was firmly committed to the consistent application of these laws.

On April 1, in accordance with the interest rate formula adopted on January 1, 1987, 1/ the discount rate of the National Bank was raised from 61 to 81 percent At the same time, a change in the term structure of deposit rates was brought about by setting the six-month rate (rather than the 12-month rate as before) equal to the discount rate. The 12-month rate was then raised by an additional 3 percentage points to 84 percent. By contrast, the three-month rate was increased by only 2 percentage points, to 48 percent,so that it is now even lower than before in real terms. Interest rates on loans are to be at or above the discount rate except for term loans at contractually fixed rates that cannot be adjusted until maturity. As described in the staff report, banks that set lending rates lower than the discount rate will face financial penalties. In the Statement, the authorities acknowledge the importance of positive real interest rates and attribute their inability to apply the formula to deposits of less than six months to the risk of large bank losses, since a part of the long-term loan portfolio of the banking system continues to bear contractually fixed interest rates.

The main domestic economic issue remains high and rising inflation. The economic program of the Yugoslav Government (described in the recent staff report) set the target for inflation during 1987 at 52 percent. In the first quarter of 1987, however, inflation accelerated sharply: the cost of living increased at an annualized rate of around 130 percent (in March the index was 95 percent higher than a year earlier). In response to this rising inflation and workers' unrest over the wage freeze, a partial price freeze was introduced on March 20, 1987. All previously uncontrolled prices that had risen by more than 20.3 percent during the first two months of the year were lowered to a level of 1.203 multiplied by the price level at end-December, 1986 and frozen at that level until June 20, 1987. The 20.3 percent corresponds to the average price rise of uncontrolled prices of industrial goods during January and February of 1987. The weight in the Industrial Producer Price Index of the commodities affected by the measure is 8 percent.

1/ This formula provides for a quarterly adjustment of the discount rate on the basis of the annualized rate of inflation during the previous six months as measured by the producer price index.

In the first quarter of 1987, Yugoslavia achieved a significant reduction of the trade deficit (measured in U.S. dollars) with the convertible currency area. The actual deficit of US$245 million was less than half of both the deficit projected in the economic program and that recorded in the same period of 1986. The trade balance reflects slightly lower-than-expected nominal exports and considerably lower-than-expected nominal imports: compared with the same period of 1986, exports rose by 4.7 percent in terms of U.S. dollars while imports fell by 11.9 percent. It is difficult to envisage the implied large decline in the volume of imports in the first quarter being sustained throughout the year without jeopardizing the Government's growth objectives. The official Statement notes that, in addition to the real devaluation in late February, the authorities are taking action to ensure a larger proportion of foreign financing of imports and are considering other measures to improve incentives to export to the convertible currency area.

III. Staff Appraisal

Many of the measures described in the Statement of the authorities were either described in the recent staff report or in the supplement to it. Some of the measures, however, go beyond what was known at the time of the Board meeting. Of the new measures, the most important is the decision to raise the interest rate on six-month deposits to the level of the discount rate; this makes available shorter-term deposits at an interest rate that should be approximately positive. Although this is a welcome development, it goes only part of the way toward what the staff considers an appropriate interest rate policy. Real rates on deposits of less than six months are now even more negative so that the banking system continues to offer no secure haven for short-term savings other than foreign currency deposits.

On wages, the recent measures reflect the authorities' determination to contain real incomes. Questions remain, however, about the implementation of wage policy and especially about how effective control of wages will be after the expiration of the intervention laws. On prices, while the rationale for the recent partial freeze is clear, the freeze introduces further distortions in the price mechanism. The measure on prices, together with the absence of any new initiative on the allocation of foreign exchange, threatens the credibility of the policy, embraced by the authorities and supported by the Fund, of moving the Yugoslav economy toward greater reliance on market forces.

On the broad question of financial discipline over enterprises, the Statement contains little beyond what was described in the last staff report. In the past, however, efforts in this direction have foundered on their implications for bankruptcies and unemployment. The recent Statement shows an encouraging sense of realism by explicitly taking account of the significant social costs that progress on this front will entail.

Much of the content of the authorities' Statement re-emphasizes policy intentions announced before the conclusion of the last Article IV consultation with Yugoslavia. The effect of these policies on the principal macroeconomic variables--growth, inflation and the external accounts--depends critically on their implementation. It is therefore helpful to have in the Statement a strong confirmation of the Government's determination to implement these policies despite the short-run economic and political difficulties foreseen. On the factual information available to date, however, the staff's uneasiness about economic prospects cannot yet be adequately dispelled.

ATTACHMENT

Presentation by Mr. Svetozar Rikanovic
Federal Secretary for Finance of Yugoslavia

At Paris Club Meeting, March 30, 1987

Mr. Chairman, Representatives of Creditor Countries,
Ladies and Gentlemen,

Let me start by expressing on behalf of the Yugoslav Delegation and in my own name the appreciation for giving us the opportunity to comment on the recent developments of the Yugoslav economy and thus make it easier for you to take the decision on the implementation of II stage of refinancing of Yugoslav debts.

You have been informed about the economic performance of Yugoslavia from the IMF mission report, from the summing up of the IMF Managing Director, Mr. Camdessus, made at the Executive Board meeting, and from the information available from your respective Governments.

I would like to take this opportunity and say that we agree with the way in which Mr. Camdessus assessed our economic performance. He did not only confine to the identification of the shortfalls from 1986, but in an objective manner he also addressed the positive elements and changes and successful economic results achieved in several areas. I believe that such an approach is likely to substantially facilitate the work today both to you and ourselves.

My introductory statement will consist of three parts:

- in Part One, I will focus on the current economic situation in Yugoslavia with a special emphasis on the most critical issues from the IMF staff report.

- Part Two will refer to the economic reforms recently implemented and to those to be adopted in the near future, as preconditions for further introduction of economic principles and market economy.

- And in Part Three, I will highlight some positive results or achievements of the Yugoslav economy in the last year.

PART ONE

At the very outset of the first section let me point out that the Yugoslav Government considers that the economic performance in Yugoslavia in 1986 can neither be painted with dark nor with bright shades only. It is true that not all planned targets were achieved in 1986, some of them without much justification and some due to having been too ambitiously set.

During last year and in early 1987, the high rate of inflation has been of one of the greatest concerns to our citizens and Government and a handicap for our economic stabilization. The trends from the first half 1986 and some other recent months were indicating a three digit inflation. However, with adequate measures the Government managed to curb further increase of retail prices in the latter part of 1986 by 30.7 and the increase of producer prices by 15.4 percentage points. This shift in trends was in our view insufficiently appreciated by both the Yugoslav public and by the IMF mission, because 1986 ended with an increase of retail prices and of producer prices of 92 percent and 67.6 percent, respectively despite this shift. The Yugoslav Government admits that larger curbing of inflation was not accomplished principally because, contrary to our expectations, a too high real increase in the public consumption and personal incomes took place, which was not backed by a corresponding improvement in labor productivity and/or growth in national product.

It is my wish that you are properly and fully informed that even before December 31, 1986, and later as well, our Government undertook several steps to prevent undesirable developments in the economic performance of this year.

Already in December of 1986 the Federal Assembly adopted a more firm policy of limiting public and personal consumption. Since the results in the first two months of 1987 did not meet expected targets, the Government proposed in late February and the Federal Assembly adopted four special intervention laws to discontinue misinterpretations from the adopted policies and to introduce more firmly the ceilings determined in the areas of the public and personal consumption. The essence of this legislation is the following:

- First, noneconomic and nonproductive investments in 1987 will be limited, in real terms, to one third of those realized in 1986. Eventual breakthroughs of this limit in any Republic or Province will halt any investment of this kind through an obligatory intervention of the Social Accounting Service - official auditing institution.

- The second intervention law is ensuring that the increase of quarterly expenditures of budgets at all levels and of the spending for social activities be by 10 percent below any increase of revenues in the respective Republic and/or Province. Proceedings and stern sanctions are being introduced to ensure the application of the law without exemption.

- Third, personal incomes of workers and employees whose wage increases accounted for a substantial departure from the determined policy were frozen. This complete freeze is for bank employees, for those in self-management communities of interest, insurance companies, lotteries and special business associations. Wages were frozen at the level of average pays in the fourth quarter of the last year with an obligation that any wages paid out above this level in January and February of 1987 be returned in the forthcoming months.

- Fourth, workers in all other activities will receive personal incomes at the level of the average from the fourth quarter of 1986, but with a possibility for their subsequent increases, provided that their quarterly income statements show an improvement in the labor productivity and/or increase in the revenue per worker.

As you can see, tough and efficient measures were undertaken in the area of consumption when not covered by revenue, thus narrowing the space for inflation.

In such a way part of spending was deliberately reduced to the level which is below the increase of revenues.

Needless to say in this connection that all these measures are economically very painful and politically unpopular. An illustration of that are recent strikes or as we define them "stoppages of work" which were recorded by both the Yugoslav and international press.

The Yugoslav Government does not believe in other alternatives. It is therefore firmly determined that these laws are consistently applied everywhere. Up to now only really justified improvements in one of the four laws were permitted, with its basic intention decidely preserved: to spend only what has been actually produced and earned and what is in line with the increase of labor productivity. (The Yugoslav public and workers had understood that message of the Government and its justification so that work stoppages have practically ceased).

There are some other areas where in our view the IMF report has not addressed sufficiently the positive aspects of changes. This is partly because of the very recent date of the adoption of measure.

Let me first refer to the interest rates policy. On April 1, the discount rate of the National Bank of Yugoslavia will be increased from 61 percent to 81 percent. The interest rates on six months deposits will be, according to the new formula, positive in real terms. Interest rates on 12, 24 and 36 months deposits will increase to 84, 86 and 88 percent, respectively. The decision was taken by the Association of Yugoslav Banks three days ago. At the same time all lending rates, except those of loan agreements signed earlier at fixed rates, will also, as of April 1, be raised to the level of real positive rates in line with the adopted model.

The Yugoslav Government considers the changes in interest rates a significant step toward stimulating savings, toward limiting demand, including the credit demand, and generally, toward an efficient antiinflationary move. We wanted to introduce real positive interest rates on 3 months deposits as well, but this is objectively not possible for the time being.

It has to be taken into account that a considerable portion of bank lendings to the enterprise sector and citizens was contracted with fixed, relatively low interest rates. The Constitution permits neither to the State nor to the banks to unilaterally impose the change in obligations. Thus no increase of contractual fixed rates is possible, as a change to real positive interest rates on all deposits, including 3 months deposits, would lead the banks into losses entailing the consequences of bankruptcy and rehabilitation procedures.

(May I recall in this connection that the bad experience we had with the model for setting the interest rate level in 1986 led us to abandon it. The model was originally agreed upon with the IMF. It relied on forecasts of inflationary movements. But, the reasonable optimism of the forecasts was permanently generating real negative interest rates and this was the reason for abandoning the model. We are now relying only on the exact six months data of producer price movements. The producer prices, as a base, is also a parameter earlier agreed upon with the IMF. Due to temporary lag of these prices in relation to retail prices, the model from the point of view of household deposits does not result in a convincingly real positive interest rate. However, the difference is permanently diminishing, so that in February, for example, producer prices had again a faster rise than retail prices.)

With the aim of fostering financial discipline, a decree on introducing high real positive interest rates for late payments is presently under procedure. In this way debtors will be motivated to much more regularly settle their obligations.

The introduction of real interest rates on all credits will raise the question of whether further administrative regulation of the volume of bank credits is justified. This shift is therefore prepared toward other standard mechanisms for monetary-credit regulations. The application of these mechanisms is expected to start as early as in the third quarter of this year. At the same time all forms of "grey issue" are being identified with an intention that its autonomous flows, to date, be brought under the control of the National Bank of Yugoslavia. Last year our enterprises and internal banks were abolished the right to guarantee notes. This was a step in a good direction but of only a modest extent. It will be indispensable, in our view, not only to impose control over the guarantees of notes, but also to have a full insight into and gain management over interenterprise financing. If we are not successful, new attempts to break through the limits set for the money supply will occur, despite the very restrictive credit-monetary policy.

In 1986 the new Foreign Exchange Law was introduced in Yugoslavia. Its more consistent implementation in the second half of the year allowed for a more successful reallocation of foreign exchange for the fulfilling of fixed and guaranteed foreign obligations, for the needs of exporters and others urgently needing the foreign exchange. On the basis of the experience gained in applying the new Foreign Exchange Law, some supplements to and amendments of the Law were nevertheless made in December 1986, accompanied by a series of amendments in the by-laws. With this the status of active exporters has been improved, a part of foreign exchange could be freely disposed of by the banks, etc.

There has been concern abroad as regards a gap in our foreign exchange liquidity. We do not deny the difficulties we will have: we are facing them even now, but the gap that has been so much insisted on, we do not envisage. Simply because the undertaken policies will enable successful accomplishment of the balance of payments proportions in capital transactions, in addition to goods and services. This understands a more orderly collection of our claims abroad and our new short term, and especially medium and long term borrowings. Some credit arrangements have already been concluded, a new stage of negotiations with the World Bank and other potential creditors is forthcoming, including some commercial banks.

Numerous policies to curb the foreign exchange demand and increase its supply are being undertaken:

- In February a 5 percent higher devaluation of the dinar, in relation to the one regularly implemented according to the formula agreed upon with the IMF, was carried out. This positive margin to the benefit of our exporters will be maintained throughout the year.

- There are other encouraging measures to foster the motivation for a larger and better quality production and larger exports of goods and services to the hard currency area, even at the cost of reducing nonconvertible exports.

- The methodology for setting the exchange rate of the dinar will be reconsidered, in view of significant intercurrency changes in the last and the present year.

- Economic and other measures will radically spur and enforce importers of equipment not to purchase the equipment with a 75 percent cash payment as in 1986. Contrary to this practice, the credit share in such arrangements should be of this magnitude, and

- The domestic interest rates policy will diminish a part of domestic credit attractiveness in relation to the external.

The Yugoslav Government is, however, deeply convinced that a part of changes will have to happen internationally as well, particularly with respect to the length of maturities and interest rate levels, and also with respect to the access of new resources. Intercurrency changes in combination with the clauses contained in loan agreements with the World Bank, for example, have led us to cancel a number of loans already approved to Yugoslavia. The number of cancelled loans in the last three years was larger than in the whole preceding period since the World Bank establishment. The conditions offered and approved for different types of foreign credits and those offered for refinancing are often less favorable in relation to other world debtors with poorer economic performances. It is not good that they have pushed us up to now to a fast net outflow of capital - in 1986 the net outflow totalled one billion dollars - to a practice persistently followed by some countries, and not suitable to us. Even worse would be if these unfavorable conditions or insufficient access to new resources pushed us in future to the practice of some Latin American debtors who, left without real alternatives, are announcing the impossibility to further repay their debts under the prevailing conditions. We do not want to voluntarily follow these examples as they may be neither beneficial to us nor to our creditors.

PART TWO

In the second shorter part of my statement I wish to inform you on behalf of the Yugoslav Government on some, for our creditors, essential economic and institutional reforms already implemented or intended to be executed.

Last December the Government submitted to the Assembly a proposal of important changes in as much as 19 laws. All key Government proposals were accepted. The most important were:

First, the accounting system was radically changed. The earlier practice, allowed by the former accounting system, that in an inflationary environment a part of the balance of assets value spills over or transfers to the income statement allowing for part of assets to be used for current consumption or spending and not limit this to achieved income, only, has been discontinued. Although this change might be logical from an economic point of view and unavoidable, it is very painful because those pushed out from their relatively comfortable position of spenders with not enough contribution deserving that position, will be numerous. The new accounting system has created conditions for economically much more successful income distribution policy and for economically more suitable tax policy. This system also compels the overall banking system to operate upon the principle of real economic categories.

Second, the system of real depreciation was introduced with, essentially, the same economic meaning of the changes of the accounting system.

Third, radical reforms were carried out in the Rehabilitation and Bankruptcy Law. The most important are:

- it has been regulated that bankruptcy procedure may start also in the case of illiquid and not only loss-making enterprises,

- those who decide to serve as rehabilitators have been vested with much broader authorities than before in the sense of imposing their own business and personnel concept over the loss-making and/or illiquid enterprise,

- rehabilitation has been defined as economically serious move bearing great material risks for a rehabilitator if he is not successful in his undertaking. Thus the practice of fictitious rehabilitations is prevented,

- a practice of abusing the banking system has been abolished in the rehabilitation process and the share of banks in the role of rehabilitators limited,

- material risk of workers has been defined and the framework of their personal incomes in the period from showing bad business results until eventual rehabilitation and bankruptcy,

- the rehabilitation period has been shortened. If an enterprise does not find a rehabilitator within six months, the bankruptcy procedure starts.

These reforms will make bankruptcy, even in our economic system, a normal integral part of the economic life, as it already is in other market economies.

The Yugoslav Government is determined in its intention to support the successful enterprises and leave those unsuccessful to the economic fate they deserve in line with success and quality of their business concept. Some clarification is perhaps needed here. This approach, especially in the very beginning of its application, will objectively have limitation in the view of its economic, social and political sustainability. The respect for and recognition of these limits is an integral part of determination to persist with this concept. A massive bankruptcy of enterprises is not considered as the most fortunate outcome of these reforms, but rather a massive fear from bankruptcy which mobilizes for a greater productivity, better utilization of capacities in terms of machinery and live work, restructuring of production in line with the market demand, better quality, etc. But bankruptcies will continue to occur. We are preparing ourselves to alleviate unavoidable social traumas through the utilization of special solidarity funds to provide for the minimum living existence to temporarily jobless workers.

The fourth area of relevant and economic systemic reforms relates to the banking sector. Partly I have already discussed this item. I would like to add that the banks under the new system will be autonomous economic agents which must do their business based on real economic and market principles. The position and authority of the National Bank of Yugoslavia has strengthened. Moreover, its Board of Governors will no more take decisions on the basis of consensus, but rather on the basis of majority vote which makes the National Bank more autonomous and more efficient.

Fifth, with the reforms in the accounting system part of the housing reform has been also executed and its second phase which relates to introduction of economic rents is currently under preparation. As this is not an appropriate moment to talk about this reform, let me only say that specifically in our circumstances, it will be another great opportunity to provide for additional substantial anti-inflation effects.

Sixth, some changes introduced into the Joint Venture Law and by-laws created more favorable environment for performing joint operations with foreign partners for the transfer of capital and profit arising from these dealings. Treaties on the protection of investments against non-commercial risks are under preparation with a number of industrial countries. As a more favorable "climate" for foreign investors has been under preparation for quite some time, we have noted an increased number of requests for the registration of joint enterprises and other forms of long term cooperation in production with foreign partners. The adoption procedure of the Law on Establishment of Mixed Banks in Yugoslavia is also in its final stage.

Seventh, radically better conditions are being prepared for investments in small scale business both in the private and social sectors in order to influence this sort of change in our economic structure and increase employment through investments of the proper funds of our citizens.

I would like to mention here that Yugoslavia is entering the next stage of development with, for the first time, a clearly defined technological development and development strategies in some key sectors, like energy, agriculture, tourism, transport, foreign economic relations with major trade partners, etc.

Let me point out another two major forthcoming undertakings:

- amendments of one of our most important laws governing relations in the economy - the Associated Labor Act - are presently under review. The amendments should enable a more efficient management of enterprises and lessen the currently almost unlimited security of workers with respect to their right to the job. This security is not in line with a great unemployment the country is facing and it slows down the mobility of workers. Another change, the most important one, refers to the amendments of the Federal Constitution which will introduce more favorable conditions for the economic and systemic reforms along the lines of fostering the economic laws and creating market conditions for doing business.

PART THREE

In the final part of my statement I wish to point out that despite some difficulties the Yugoslav economy achieved last year some very outstanding results and shifts.

First, the physical volume of industrial output rose by 3.9 percent, the second largest since 1981.

Second, the growth rate of agricultural output of 7 percent is among the best in this sector.

Third, employment rose by 3 percent.

Fourth, after several years of no increase and still with the above rise in employment, the labor productivity a modest increase was registered for the first time.

Fifth, after several years of directing investments into priority sectors, the first results of structural changes are for the first time noted in the economy of the country.

Sixth, after many years of the balance of payments deficits, the 1986 was the fourth year in a row with surplus on the hard currency area. It is true that this surplus is lower than planned, but we should also be aware that among the highly indebted developing countries Yugoslavia is an exception with its constant surpluses in the balance of payments.

As to the conditions agreed upon with foreign creditors, perhaps we have not fulfilled all the targets agreed upon. But the Yugoslav Government is convinced that the most important target was met: the external financial obligations are regularly settled both in terms of repayments of principal and interest including the obligations falling due after the first refinancing agreement. We really do not believe that any other target in our relations has the same important as this one. If you, our creditors, are of another opinion, we should then inform the Yugoslav Government accordingly, since that would mean that Yugoslavia needs to seriously reconsider its own debt repayment strategy.

I have come here with my associates to inform you in detail about the changes the Yugoslav economy is undergoing. They are exceptionally painful as they extend to every Yugoslav citizen and his living standard which is currently in real terms by 19.8 percent lower than in 1979, despite the high real rise in personal incomes last year. We are making these reforms upon our own initiative, as an independent country, based on our own conviction. We need to build an efficient market-oriented economy, able to provide a higher living standard for the Yugoslavs and to alleviate the burden of foreign debts servicing and to participate on an equal footing in the international division of labor.

Mr. Chairman,

On the basis of my explanation, the Yugoslav Government does expect the creditor countries' governments to support, without any delay, its efforts in the adjustment process. We are convinced that your positive attitude in the form of an explicit confirmation today already of the resumption of refinancing is the only economically and politically adequate and prudent decision for the least three reasons:

- one, now you have the latest and comprehensive insight into the economic circumstances in Yugoslavia,

- two, your positive decisions will bring your financial institutions and your economies a necessary justified tranquility with respect to their operations in Yugoslavia,

- three, the rescheduling will allow the Yugoslav Government to resume the accelerated economic reforms and further implementation of the economic stabilization program without obstacles from abroad.

Please excuse the length of my statement. I very much appreciate your attention. It will be my pleasure to answer any questions or address any issues in which you might be especially interested.

Thank you.