Committee on Balance-of-Payments Restrictions

REPORT ON THE CONSULTATION WITH YUGOSLAVIA UNDER ARTICLE XVIII:12(b) AND ON THE YUGOSLAV TEMPORARY IMPORT SURCHARGE

1. In accordance with its terms of reference, the Committee has consulted with Yugoslavia on its import restrictions applied for balance-of-payments reasons and examined the Yugoslav temporary import surcharge. The Committee noted that the previous consultation with Yugoslavia on its import restrictions and its surcharge had taken place in October 1970 (BOP/R/48). In conducting the consultation the Committee had before it a basic document supplied by Yugoslavia in May 1973 under the new procedure of the consultations (BOP/131), and a paper containing background material, dated 12 March 1974, supplied by the International Monetary Fund.

2. The Committee generally followed the plan for such consultations recommended by the CONTRACTING PARTIES (see BISD, Eighteenth Supplement, pages 52-53). The Committee met on 20 March 1974. The present report summarizes the main points of the discussion.

Consultation with the International Monetary Fund

3. Pursuant to the provisions of Article XV of the General Agreement, the International Monetary Fund had been invited to consult with the CONTRACTING PARTIES in connexion with the consultation with Yugoslavia. The representative of the Fund made a statement concerning the position of Yugoslavia as follows:

"During the years 1970-71, Yugoslavia's domestic economy was characterized by increasing demand pressures reflected in rising costs and wage rates and resulting in an accelerating rate of inflation. In order to contain these pressures, the authorities took a number of measures which, because of the strength of the inflationary forces, were slow to take effect. By 1972, however, these measures brought about a sharp decline in the rate of growth of real expenditures. Nevertheless, retail prices increased by 15 per cent in 1972 and by the end of October 1973 they were 17 per cent higher than 12 months earlier. The authorities believed that to a large extent this reflected the considerable increase in world prices of food and raw material, on which Yugoslavia depends heavily.

After deficits in the balance of payments in 1970 and 1971 both on current and overall accounts, there was a sharp reversal in 1972 and 1973. The current account registered a surplus of SDR 385 million and SDR 364 million in these two years respectively. Both exports and net receipts on invisibles increased
while imports, which declined in 1972, resumed their upward trend in 1973. Major factors in this improved performance were increased receipts from tourism and workers' remittances: the former more than doubled and the latter more than quadrupled during the period 1969-73.

During the past two years substantial progress has been made in the liberalization of the exchange and trade system. Among the important measures are (a) steady reductions of customs duty in recent years, including reductions in 1973 (b) large shifts of commodities to the liberalized list in 1973 with the ratio of liberalized imports to total imports reaching 52 per cent in that year compared with 28 per cent in 1972; further additions to the liberalized list are to be effected during the course of 1974, (c) reduction in 1973 and abolition on January 1, 1974 of the linkage system, whereby the import possibilities of enterprises were linked to their export performance, (d) special increases in foreign exchange and commodity quotas in July 1973 for important categories of raw materials, foodstuffs, and spare parts, (e) an important liberalization of certain invisible payments for international freight and passenger lines, and (f) the termination of a bilateral payments agreement. With regard to the import surcharge, which was originally introduced when Yugoslavia faced serious balance of payments difficulties, the proportion of dutiable imports to which the lower rate of 2 per cent applies, has increased substantially and the proportion subject to the 6 per cent rate has correspondingly decreased.

While it is difficult at this juncture to quantify the effect of major developments, in particular that of the energy crisis, it would seem reasonable to expect that in 1974 the balance of payments will be subject to renewed pressures. The Yugoslav authorities believe that a major source of these will be changes in economic activity in Western Europe, which could affect the market for Yugoslav exports, remittances by workers, and tourist expenditures in Yugoslavia. In addition to these indirect effects, there will be a direct impact resulting from the increase of the import price of oil. It thus seems likely that there will be a deterioration of the current account of the balance of payments. Whether or not the overall balance will also be in a deficit will depend on the extent to which recourse is made to foreign borrowings. The current level of outstanding foreign debt is high. The monetary reserves, however, which at the end of 1973 amounted to SDR 1,230 million, are at a reasonably comfortable level in spite of some decline during the early part of 1974.

In view of the above uncertainties, the level of restrictions in Yugoslavia including the maintenance on a temporary basis of the import surcharge, would not seem to be unwarranted.
Opening statement by the representative of Yugoslavia

4. In his opening statement, the text of which is reproduced in the Annex, the representative of Yugoslavia said that over the past three years the rate of expansion of the economy of his country had remained near that achieved during the period 1966 to 1970, namely close to 6 per cent per annum. More recently, the rates of growth of national production, and of industrial production in particular, declined for various reasons, including a poor harvest in 1972 and a slow-down in domestic consumption.

5. The latter had been brought about by various measures designed to reduce demand. These measures had had a certain degree of success in establishing a better balance between domestic production and consumption; however, prices had continued to rise and had reached 19 per cent in 1973 compared to 14.7 per cent in 1972. This had been due not only to domestic factors, but also to rising world prices - in particular of those primary and semi-processed products important in Yugoslav imports.

6. The balance of payments had shown some improvement in 1972 and 1973. The devaluation of the dinar, the establishment of closer links between Yugoslav and foreign enterprises, and the application by many developed countries of the GSP schemes had helped to bring about an expansion of exports. With the exception of 1972, the rate of growth of imports had exceeded that of exports. Accordingly, the deficit on balance of trade rose from US$1,194 million in 1972 to US$1,650 million in 1973. To off-set this deficit, Yugoslavia had had to rely heavily upon its receipts from invisibles, particularly of remittances by Yugoslavs working abroad. It had also had to increase its foreign indebtedness from SDR 2,409 million in 1970 to SDR 3,312 million in 1973; in 1973 debt servicing had absorbed 23.3 per cent of total receipts of convertible currencies.

7. The moderate improvement in the balance of payments had permitted some liberalization measures, including reduction in tariff duties, the removal of the system linking import capacity to export performance, and a reduction in the number of countries with which Yugoslavia maintained bilateral clearing arrangements. Further steps in the direction of liberalization, as well as the establishment of the convertibility of the dinar, would depend not only upon the development of the Yugoslav economy itself, but also upon external events, including movements in world prices and the general level of international economic activity.

Balance-of-payments position and prospects and alternative measures to restore equilibrium

8. Members of the Committee congratulated the Yugoslav representative for the marked improvements that had taken place, both in the Yugoslav economy and in its balance of payments and reserves. They noted that efforts had been made towards
further liberalization, as illustrated by the percentage of imports now under a free régime - some 51 per cent in 1973, compared to 28 per cent in 1972. They also noted that reserves had reached a comfortable level and that there was a surplus on current account at the end of 1973. It was noted that the principal elements which accounted for the surplus in the current account were workers' remittances from abroad and tourism. Whereas some members of the Committee and Yugoslavia considered invisible receipts a particularly vulnerable element in the balance of payments, subject to the fluctuations of economic conditions abroad over which the Yugoslav authorities had no control, other members of the Committee held the view that receipts from invisibles were generally no more vulnerable than export receipts, which were just as sensitive to world economic conditions as services. Concerning the level of reserves, the representative of Yugoslavia pointed out that one factor that had greatly contributed to their creation as stabilization credits.

9. Several questions were asked concerning inflation and the measures that had been taken in Yugoslavia to stabilize prices. The representative of Yugoslavia explained that his Government pursued an incomes policy whereby salary increases were linked to gains in productivity. He pointed out that in the Yugoslav system of "auto-gestion", workers were fully informed of their firms' financial position. At the end of the year, revenue realized by the enterprises as shared out, (1) for fiscal purposes, and (2) for the workers, to be shared among various funds (depreciation, reserves, etc.) and other internal measures consisted of budgetary measures, credit restrictions (fewer credits were granted and their destination was carefully selected). Furthermore, fiscal measures were being introduced which tended to tax more heavily higher incomes, while favouring lower incomes; the aim of these measures was not to equalize incomes, but to ensure a better level of purchasing power for lower incomes. Measures had also been taken for the external sector; tariffs had been reduced by 30 and 20 per cent; the rate of the surcharge on equipment imported for development purposes had been reduced from 6 to 2 per cent. These measures had had multiple effects, but generally the country's gross national product had continued to grow at an acceptable rate, despite the uncertainties of the world situation.

10. Asked to specify what imported goods were expected to have higher prices, the representative of Yugoslavia mentioned imports of petroleum and petroleum products, steel, metals and non-ferrous metals, chemicals, foodstuffs, and textile raw materials - in particular wool and cotton. Improvements in export receipts were also expected, although Yugoslavia was now entering markets in which severe competition existed. Among the products which would probably bring in better receipts were wood, meat, certain qualities of textiles, semi-manufactured non-ferrous metals, some chemicals and pharmaceutical products, and some items in the machinery sector.
11. Several members of the Committee enquired whether the Yugoslav authorities linked the degree of trade liberalization to the level of foreign exchange reserves and, if so, what level would be needed and what other criteria would have to be met to prompt further liberalization. The representative of Yugoslavia explained that the level of reserves was a basic requirement but that the general level of development of the country, as well as of its trade, were also determining factors. It was his Government's intention to liberalize further, and to move towards convertibility of the dinar; however, the present uncertainties in the world economic situation made it impossible to set any firm time-table for future measures, such as increasing the size of quotas and eventually abolishing them. In general, all future liberalization would be effected on a gradual basis, and full liberalization would be conditional on the normal development of trade and the general development of the Yugoslav economy.

12. Several questions were asked concerning Yugoslav measures designed to encourage long-term foreign capital investment. The representative of Yugoslavia explained that a number of measures had been taken under the so-called "Joint Venture" law to attract long-term capital. Repatriation of capital and the transfer of profits were provided for. So far, some eighty-six such "joint venture" agreements had been signed with foreign firms, representing some US$123 millions' worth. The conditions were generally considered attractive, but improvements would be made if necessary. The representative of Yugoslavia added that the goods produced under joint venture agreements were, in priority, to be sold by the joint venture enterprises on foreign markets, according to the existing agreement.

**System and methods of restrictions and effects of the restrictions**

13. Some members of the Committee noted that with respect to several products the liberalization measures described in Yugoslavia's basic document provided for a switch from one type of import category to another. They asked for fuller details on the products included in each list (LB, GBK lists, etc.). The representative of Yugoslavia said that the distribution of tariff items could be seen in Annex II to the Report, divided by general categories of imports. It was also asked whether the Yugoslav Government had a programme of liberalization and whether the representative of Yugoslavia could comment on the expected pace of liberalization in the near future. The representative of Yugoslavia confirmed that a programme existed; all new measures of liberalization had been published in the Official Gazette No. 64, on 12 December 1972, and No. 45, of 16 August 1973. The full implementation of this programme was now conditional on the general world economic situation.
14. Members of the Committee sought clarification regarding the extension of the import surcharge and the rates presently applied. The representative of Yugoslavia confirmed that the surcharge had been extended until 31 December 1974 and that the rates were 2 per cent for capital equipment goods destined for the development of the basic primary products industry and 6 per cent for other goods. His authorities had intended to terminate the surcharge in December 1973 but in view of the present world economic situation they had not considered it appropriate to abolish the measure. He pointed out that the average Yugoslav tariff was low - 11 per cent - and that all tariff positions of 30 per cent and above had been reduced by 30 per cent and those with a duty of 20 per cent had been lowered by 20 per cent. The extension of the surcharge until the end of 1974 was a provisional measure designed to allow the Yugoslav authorities more scope to deal with the uncertainties of the situation. He was convinced that the surcharge would be abolished very soon. Some members of the Committee pointed out that there had been insufficient notification of the changes in the surcharge since 1971. The representative of Yugoslavia undertook to notify the contracting parties promptly of any future changes. It was understood that with regard to the General Agreement, the Yugoslav surcharge was assimilated to measures taken for balance-of-payments purposes; in this case, under the provisions of Article XVIII:12(b).

15. Members of the Committee asked whether the Yugoslav Government intended to terminate its remaining bilateral payments agreements. The representative of Yugoslavia stated that it was his Government's policy to terminate all such agreements. It had not always been possible to do so because termination also depended on the other parties to the agreements. His authorities had noted the International Monetary Fund's recommendation on this point and had every intention of following it. He added that although certain quantities of imports and exports were mentioned in some bilateral trade agreements, they did not involve any discrimination.

16. Questions were raised concerning the agricultural import levy introduced recently. The representative of Yugoslavia explained that the levy on agricultural products was a market stabilization measure designed to ensure competitive prices for domestic producers; it was not a balance-of-payments measure. In reply to a question he said that he did not think it would be feasible for his authorities to consider the elimination of this levy.

17. Another member of the Committee said that his authorities had received complaints concerning long delays for settlement of export credits. In reply the representative of Yugoslavia said that there were no difficulties from a banking point of view to effect transfers within 24 hours of receiving the order; all the more so as there were sufficient foreign exchange reserves. He suggested that the problem may have arisen from an inability of the debtor to deposit the domestic currency with the bank before effecting the transfer. He added that this was a question of private law relations between creditor and debtor and did not involve the Yugoslav authorities.
18. One member of the Committee referred to the 3 per cent special tax on imported goods imposed to offset the burden placed on domestic production by the special internal tax designed to provide funds for earthquake, flood and other disaster relief, and asked whether it could not be incorporated in internal excise taxes. Such tax adjustments did not seem to compensate uniformly the tax burden imposed on domestic products. The representative of Yugoslavia said that this tax was in conformity with the provisions of the General Agreement and that there was no reason to change the present channels of taxation. The 'contingency' tax was levied on imports to compensate for similar fiscal charges on domestic production. The rate of 3 per cent was the average of the rates applied to domestic production. The same member of the Committee requested that efforts be made to make the 1 per cent statistical tax levied on imports conform with the provisions of the relevant Articles of GATT. The representative of Yugoslavia replied that in his authorities' view the tax was in conformity with GATT provisions; he added that there was little likelihood that the 1 per cent statistical tax would be abolished.

19. Several remarks were made concerning the complexity of the Yugoslav import control system. The representative of Yugoslavia said that his authorities were fully aware of the need to simplify the system and that it was making persistent efforts in this direction.

Conclusions

20. The Committee commended the representatives of Yugoslavia for their Government's efforts towards greater liberalization of imports, for the reduction of its reliance on bilateral trade and payments agreements and their intention to move towards convertibility of the dinar. It also welcomed the marked improvements in the Yugoslav balance of payments and reserve position. The Committee did note, however, that despite the liberalization measures taken, a significant number of items remained restricted in various ways and recommended that the Yugoslav authorities pursue further the process of liberalization.

21. With respect to the surcharge, the Committee noted that the measure was temporary and that in its application it conformed with the criteria laid down in the relevant Articles of the General Agreement on import restrictions for balance-of-payments purposes.
ANNEX I

Opening Statement by the Representative of Yugoslavia

Although we have already transmitted documentation on the problems that are the subject of these consultations, I should like briefly to describe the characteristics of Yugoslavia’s economic development over the period under review.

1. During the past three years, i.e. from 1971 to 1973, economic development continued its upward trend. Social product increased at an average annual rate of 5.6 per cent in this period, slightly below the 6 per cent rate recorded for the period 1966-1970. The growth of social product was fairly irregular: after having reached 7.8 per cent in 1971, the growth rate of social product for the economy as a whole slowed down in 1972 and the first half of 1973 (4.3 per cent in 1972, 5 per cent in 1973).

This decline in the growth rate of social product in 1972 and the first half of 1973 brought about, first of all, a slowing down in the growth rate of industrial output. The poor harvest of 1972, due mainly to adverse weather conditions, had a similar effect. While this trend was attributable to a number of factors, the most important of these was the slowing down of domestic consumption as a result of measures taken to stabilize the domestic market.

We believe that in 1974 industrial output could reach a growth rate in the vicinity of last year’s. In relation to this, the growth rate of social product in 1974 would be 6 per cent.

2. During the period under review, one of the main objectives of current economic policy was to achieve a higher degree of stability of economic movements, and above all to bring back domestic consumption to more appropriate proportions. Indeed, the years 1970, 1971 and part of 1972 were characterized by continuing expansion of demand which had begun in earlier years and was adversely affecting the stability of economic movements as a whole. In order to ensure more stable relations in the domestic market, within the framework of balance-of-payments capabilities and to reduce the increase in prices and the rate of inflation, and improve the liquidity ratio of the enterprises, a number of economic policy measures were taken in 1972 and the first half of 1973 including devaluation of the dinar. These measures yielded positive results which restored global equilibrium as between goods supplies and consumption. They also had positive effects on export expansion and the elimination of non-liquidity in the payments of enterprises. The measures mentioned above also contributed to slow down the growth rate of production, in particular industrial production, and consequently to slow down the growth rate of social product.
Despite the positive results achieved in 1973 in the relationship between domestic consumption and goods supplies, it was not possible to contain the upward trend in prices. Indeed, in the period under review the increase in prices was contributable not only to domestic trends (cost inflation) but also to rising prices in the world market, particularly for raw materials and intermediate products which play a dominant role in the composition of Yugoslavia's imports. These factors contributed to maintain the price increase at a high level. The overall increase in prices was of the order of 17.7 per cent in 1971, 14.7 per cent in 1972 and reached 19 per cent in 1973.

3. In the field of foreign economic relations, i.e., the balance of payments, some improvement was recorded in the period under consideration, particularly in 1972 and 1973 in relation to the preceding years. In these two last years, the current balance of payments was in surplus.

In examining the balance-of-payments situation, account must be taken of the following considerations:

- exports showed a continuing growth rate that was more rapid than the growth of production. The world market was affected by a number of factors: currency devaluations, modernization of certain production capacities, establishment of close and long-term links between Yugoslav enterprises and foreign partners in the context of industrial co-operation as well as common investments, implementation of the Generalized System of Preferences by a large number of developed countries etc.

On the other hand, in each year of the period under consideration, imports grew more rapidly than exports except in 1972 when they declined as a result of measures taken under the domestic market stabilization policy. The increase in imports further aggravated the trade deficit, which increased from $1,194 million in 1970 to $1,650 million in 1973. This trade deficit was not covered by invisible earnings such as those from tourism, despite a considerable increase in these, but by an exceptional increase in remittances from Yugoslav workers employed abroad.

It should be underlined, nevertheless, that receipts from tourism and remittances from Yugoslav workers employed abroad are not one of the most stable sources of balance-of-payments receipts. Indeed, they are subject to various influences which make them more vulnerable than goods flows. The chronic and growing trade deficit nevertheless constitutes one of the major problems of balance-of-payments equilibrium. The increase in this deficit is attributable to the still inadequate development and structural disequilibrium of production, a carry-over from earlier years, and to shortcomings in the raw materials sector, for whose development major investments are needed although the requisite economic conditions are present. All these factors indicate that the central problem of achieving equilibrium in balance-of-payments movements can be solved
in the longer term. That is the orientation of Yugoslavia's economic and development policy measures, in the long term.

4. Foreign indebtedness has increased. At the end of 1970 Yugoslavia's foreign debts amounted to SDR 2,409 million and to SDR 3,312 million in September 1973. This high level of indebtedness, in conjunction with unfavourable credit reimbursement terms, resulted in a high proportion of amortization in relation to receipts in the balance of payments. In 1973, amortization represented 19.4 per cent of total foreign exchange receipts, and approximately 23.3 per cent of receipts in convertible foreign exchange.

5. The fact that the balance-of-payments situation had improved slightly made it possible in late 1972 and in 1973 further to liberalize current transactions with other countries.

This liberalization which, is consistent with the GATT principles, includes the following:

- continuing liberalization of imports, effected in two stages- in early 1973 and in September of that year. The value of liberalized imports in relation to overall imports of goods increased from 28.4 per cent in 1972 to 51.6 per cent in 1973, on the basis of the value of imports effected in 1972;

- the liberalization was also made applicable to (1) payment of all operating costs in the transport sector and (2) maintenance costs of agencies abroad;

- 30 per cent reduction of duties on goods dutiable at a rate exceeding 30 per cent, and 20 per cent reduction of customs duties exceeding a rate of 20 per cent;

- the régime linking imports with exports was completely abolished as from 1 January 1974;

- the number of countries with which foreign trade takes place under clearing arrangements has been reduced. In the period under consideration, Yugoslavia switched to payments in convertible foreign exchange with six countries, thus reducing from 18 to 12 the number of countries with which clearing agreements are in effect.

In addition, as already mentioned in the basic documentation, major changes have also been made in the exchange régime and foreign trade system, with the introduction of floating rates of exchange, the creation of a foreign exchange market, etc.

6. As regards the future, in its conception of international economic relations the Yugoslav Government is oriented toward liberalization of current transactions and convertibility of the dinar. This is progressively being achieved in relation with the situation of our balance of payments and economic development and with
the stability of that development. Consequently the implementation of this process continues to be one of the major concerns of our economic policy.

Continuation of the liberalization process largely depends on external factors, and in particular on the current economic situation which has a pronounced impact on the balance of payments. It is not merely a matter of the effects of price fluctuations in world markets, but also of forecasting economic activity in general, in particular in the developed countries on which most of Yugoslavia's economic achievements are focused. The factors mentioned can adversely affect the general balance of payments, particularly having regard to the instability of invisible receipts, in particular receipts from tourism and remittances by Yugoslav workers employed in countries where a slowing down of economic activity is now expected. One must also underline, however, the importance of Yugoslavia's degree of development and economic structure.
## ANNEX II

Number of Items within the BTN According to the Import Régime

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