Committee on Balance-of-Payments Restrictions

FULL CONSULTATION WITH YUGOSLAVIA
UNDER THE PROCEDURES OF ARTICLE XVIII:12(b)

Background Paper by the Secretariat

1. This paper has been prepared in accordance with paragraph 7 of the Declaration on Trade Measures Taken for Balance-of-Payments Purposes adopted by the CONTRACTING PARTIES on 28 November 1979 (BISD 26S/205-209).

I. Previous Consultations with Yugoslavia

2. Yugoslavia has consulted regularly in the Committee since 1965. The last full consultation with Yugoslavia was held in 1981. At that consultation, the Committee noted that Yugoslavia's import licensing system and import restrictions did not serve balance-of-payments purposes and that the only regulatory instrument for achieving balance-of-payments equilibrium was the allocation of foreign exchange through self-management agreements among members of republican and provincial Communities of Interest for Foreign Economic Relations. The Committee recommended that the foreign exchange system be simplified, rationalized and made more transparent (BOP/R/122).

3. Since that full consultation, three simplified consultations have been held with Yugoslavia in 1984, 1986 and 1988 (BOP/R/143, BOP/R/163, and BOP/R/179). In the last simplified consultation, the Committee, in the light of the time elapsed since the last full consultation, the evolution of the balance-of-payments situation, and the economic reforms being introduced by Yugoslavia, decided to recommend that a full consultation with Yugoslavia be held during 1990. For technical reasons, this consultation was postponed until March 1991.

II. Subsequent Notifications by Yugoslavia

4. Yugoslavia has regularly notified to GATT the changes made in its import régime. Liberalization affecting 14 products was notified in October 1988 (L/6401). In January 1989, 763 items were transferred to the liberalized import régime (LB), 82 items were transferred to the conditionally liberalized import régime (LBO), 5 items to the quota fixed régime (Qq and Qv) and one item to the licensing régime (L). Accordance was introduced for 8 items and cancelled for 44 items (L/6486). Similarly, on March 1989, 1,085 items were

1"Accordance" is a policy whose aim is to promote direct imports from producing countries, and inter alia to promote from developing countries, by direct purchasing without passing through intermediaries. Imports of goods subject to accordance made directly from suppliers in producing countries can (Footnote Continued)
liberalized and 2 items transferred to the LBO list. Accordance was introduced for 2 items and removed for 23 items (L/6486/Add.1). In April 1989, 237 items were further liberalized (L/6486/Add.2). These changes were fully reflected in Yugoslavia's notification made in May 1990 to the Technical Group on Quantitative Restrictions and Other Non-Tariff Measures (NTM/W/6/Rev.5/Add.4).

5. Further liberalization measures introduced in the period August to October 1990 were notified to the Uruguay Round Negotiating Group on Non-tariff Measures in document MTN.GNG/NG/2/W/91. Subsequent changes in the import régime, published in November and December 1990, have been notified to the GATT in document L/6816 in February 1991.

6. Yugoslavia has also regularly notified products subject to a "special charge" payable on imports of certain agricultural products (L/6510 and L/6660).

III. Yugoslavia's Trade and Foreign Exchange Régimes

A. Import licensing and foreign exchange restrictions

7. In December 1989 Yugoslavia introduced new trade legislation which substantially liberalized its import licensing régime. This legislation, taken in the context of the overall adjustment and anti-inflationary programme pursued by Yugoslavia during 1990, led to an improvement of supplies of imported inputs. In addition, from December 20 1989, full liberalization of external payments for current transactions was introduced.

(i) Import controls up to December 1989

8. Until December 1989, the Yugoslavian import system classified goods into four categories: imports under quota by quantity (Qq) or value (Qv); imports subject to special licensing (L); conditionally liberalized imports (LBO); and liberalized (free) imports (LB).

9. Quotas (Qq, Qv) were imposed on agricultural products, certain mineral products, chemicals and plastics industry products, certain basic raw materials, textile fibres and some yarns and woven fabrics, ferrous and non-ferrous metal products, machines and equipment from Section XVI of the tariff and certain products contained in sections XVII (transport equipment), XVIII (optical, photographic etc. equipment, clocks and watches, musical instruments) and XIX (arms and ammunition) of the customs tariff. The quotas were set globally for each product by the Federal Executive Council, and were allocated among importing firms within the Yugoslav Chamber of the Economy.

(Footnote Continued)

be made freely; in other cases approval from the import licensing authorities is required.
10. Imports subject to licensing (L) by the Federal Secretariat for Foreign Economic Relations included products whose importation was controlled by international agreements for non-economic reasons such as arms, drugs, narcotics, and historical and artistic works. Importation of these products was allowed on an individual basis and for specific purposes.

11. The conditionally free (LBO) régime included items for which import restrictions were maintained for balance-of-payments reasons. Goods on the LBO list could be imported subject to the constraint that the value of an enterprise's LBO imports did not exceed its foreign exchange entitlement. The total value of foreign exchange entitlements for conditionally liberalized imports was established annually for each enterprise, based on its imports and payments for invisible transactions in the previous year, and adjusted quarterly in relation to its export performance. Imports were thus contingent on exports. The LBO régime was phased out in August 1989.

(ii) Import controls since December 1989

12. In December 1989, the Yugoslavian Government implemented the new Foreign Trade Act (Official Gazette of the SFRY, No 63/89). This replaced five earlier statutes regulating foreign trade.²

13. Under the new Act, all enterprises are entitled, upon registration, to carry out foreign trade. The import system classifies goods into three categories: imports under quota by quantity or value (Qq or Qv); imports subject to licensing (L) and liberalized imports (LB).

14. The quota régime covers some 826 tariff lines in all (approximately 20 per cent of Yugoslavia's tariff universe, representing 12.5 per cent of imports). The main product groups remaining under quota are live animals, meat, edible offal, and fish; milk and dairy products; vegetables and fruit; grains and products of the milling industry; oilseeds, oleaginous fruits, and vegetable and animal fats and oils; sugars; various food preparations and residues including pasta, certain vegetable and fruit products, and yeast; beer, wine, spirits and other drinks; unmanufactured tobacco; various minerals and products including iron ores, coal, peat, petroleum; certain chemicals, fertilizers, insecticides, plastics and products; textiles and textile products (see also document COM.TEX/SB/1549/Add.15); primary metals and products thereof; a wide variety of machinery, machine tools, calculating and data-processing equipment, electrical and electronic equipment, vehicles and aircraft; and optical instruments. In its notification to the Technical Group

²These were the Law on Foreign Trade in Goods and Services; the Law on Long-Term Co-Production, Business and Technical Cooperation and the Acquisition of Concession of Property Rights to Technology; the Law on Contracting Capital Investment Projects Abroad; the Law on Construction of Capital Investment Projects by a Foreign Contractor; and the Law on Performance of Business Activities Abroad.
on Quantitative Restrictions (NTN/W/6/Rev.5/Add.4) Yugoslavia has cited balance-of-payments reasons as justification for all items under quota.

15. The import licence list (L) covers principally drugs, explosives, unused postage stamps and banknotes, gold and gold coins, warships and armaments, import of which is restricted for public health or security reasons.

16. All other items imported into Yugoslavia are now free from limitation or licensing requirement, except under the "accordance" procedure. Items under accordance (LBS) comprise 100 tariff lines, including certain fish; coffee, tea, cocoa and pepper; cigarettes (due to be removed from the list shortly) calcium phosphates; iron ore and certain iron products and waste; coal; petroleum; wool; copper products; household crockery; wires and cables; television tubes and helicopters.

17. According to information supplied by Yugoslavia, by October 1990, the LB list (liberalized products) covered some 80 per cent of all tariff lines, representing 87.5 per cent of the value of imports. The import value of liberalized products had thus expanded from 10 per cent of import value at the end of 1987 and 55 per cent on 1 January 1989.

18. Although the previous "conditionally free" (LBO) list no longer exists, the Federal Executive Council retains the right to take emergency measures, if reductions in exports and a fall in foreign exchange reserves jeopardize the functioning of the foreign exchange market, by re-establishing a provisional régime of conditionally free imports linking imports directly with exports sales. According to the Foreign Trade Act, these measures may be in force for no longer than six months.

(iii) Foreign exchange régime

19. Until May 1988, Yugoslavia's exchange rate policy was insufficiently flexible to avoid quantitative constraints on access to foreign exchange. The 1986 Law on Foreign Exchange Operations required all foreign exchange receipts to be surrender to an authorized bank. All transactions in foreign exchange took place in the daily interbank meetings conducted by the National Bank of Yugoslavia, according to an order of priorities laid down by the Federal Executive Council, which allocated first priority to debt servicing followed by payments for essential imports by enterprises that were net exporters to the convertible currency area.

20. In May 1988, a stabilization package was adopted in which a flexible exchange rate policy was introduced. The dinar was depreciated and the emergency provisions of Article 110 of the Foreign Exchange Law which allowed the Federal Executive Council to set priorities, were revoked.

21. As part of the reforms introduced in December 1989, the dinar became convertible for all current transactions. Private Yugoslav citizens have now the right to purchase foreign exchange from the official banking system without restriction, in addition to the right to maintain foreign exchange accounts or foreign exchange savings deposits in any convertible currency. Legal entities' right to maintain foreign exchange accounts is limited to persons with foreign
capital in joint ventures and enterprises engaged in investment activities abroad. Funds held in such accounts are not transferable to other persons or accounts. There is no restriction on the availability of foreign exchange for imported goods in the "free" (LB) category; foreign exchange for items remaining under quota is, however, still allocated among quota holders according to the volume or value of the import quotas.

22. The nominal exchange rate of the new convertible dinar was fixed against the German mark at 7 dinars for 1 DM. The dinar was to fluctuate against other foreign currencies together with the German mark.

B. Other trade measures

(i) Tariff-related measures

23. In April 1989, the Yugoslav Government announced new tariff-related measures aimed at promoting trade with convertible currency areas. Imported equipment, as a part of any foreign investment in a domestic enterprise, would be exempt from customs duty, provided that at least a five-year joint venture contract had been signed with a foreign investment share of at least 20 per cent. At least 40 per cent of the joint venture output must be exported to the convertible currency area. Imported environmental protection equipment was fully exempted from customs duties. The Federal Government also offered other facilities to industries, including exemption from import duty on raw materials and intermediates for the manufacture of products which are to be exported to the convertible currency area.

24. In January 1989, Yugoslavia changed its mechanism for fixing the amount of special charge payable on imports of certain agricultural and foodstuff products, and enlarged the list of products covered by this charge (L/6510). More recently, in November 1989, new changes were introduced in this mechanism. Now, the amount of special charge represents the difference between the average domestic price and import price. The import price is given by the customs value plus customs duties and other charges, except the special charge. The average domestic price is the moving average of the price of domestically produced products subject to special charge, and it is set up at least once a month in order to enable timely adjustment to changes between domestic prices and prices of imported products. The list of products subject to the special charge was included in document L/6660.

25. Data supplied by Yugoslavia show that the average rate of tariffs weighted by import value was 7.1 per cent in 1990. A 1 per cent tax for customs evidence, a special tax of 7.5 per cent on imported products and a 7.5 per cent tax equalization charge (cumulatively equal to 16 per cent) are payable on all commodities not exempt from customs duties. Many agricultural commodities are subject to variable import levies.

(ii) Customs regulations

26. Changes in Customs regulations were introduced in November 1989 with a view to eliminate ambiguities and simplify regulations. Customs formalities
have been streamlined for more expeditious customs clearance, and they have been brought into conformity with the new foreign trade regulations.

27. These changes have focused on clarifying the conditions of sale in the Yugoslav market of goods produced or finished in a free trade zone; exempting certain products and categories of importers from payment of customs duties; introducing objective criteria for calculating customs duties and import levies; and simplifying the procedure of customs supervision and formalities.

28. Preferential tariffs may be applied to imports from developing countries. Customs regulations specify that the duties on imports from countries which do not apply the m.f.n. clause to Yugoslavia, either under international agreement or in practice, are to be increased by 70 per cent above the m.f.n. rates specified in the Yugoslavian tariff. Provisions have also been made for anti-dumping and countervailing duties.

C. Developments in the second half of 1990 and in 1991

29. The Government of Yugoslavia stated its intention to maintain the average tariff level and reduce the current maximum rate. Non-tariff levies as instruments of protection would be retained for the time being, but they will progressively be separated from the budget. Surtaxes would be imposed "in accordance with world practices". Antidumping measures would be used as an instrument of protection against unfair foreign competition. Import quotas would only be retained as a contingency measure and would not apply to more than 10 per cent of total imports. Technical and quality standards were to be improved. Foreign currency restrictions would only be imposed in the event of a disruption in the balance-of-payments which could jeopardize national liquidity.

30. The practice of customs drawbacks would continue. Special incentives would be maintained for exports of agricultural commodities and food products through agricultural funds. The law also envisaged that in exceptional cases, imports of equipment and intermediate goods representing the equity of a foreign partner in a joint venture or paid for by the foreign partner would be exempted from import duties if no less than 45 per cent of the value of the products manufactured in the joint venture was exported to the convertible currency area; however, this provision was not applied.

31. Under provisions regarding incentives for foreign investments in 1991, exemptions from import duties are maintained and Yugoslavia envisages the speedy conclusion of intergovernmental agreements on double taxation, on

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3Exemption from payment of customs duties have been granted for imports of devices and equipment for the protection of the human and work environment; goods which are not manufactured in Yugoslavia and are required by the public services; goods imported into a free trade zone; and goods used in joint ventures.
avoidance of non-commercial risks and on the protection of and incentives to investments.

IV. Recent economic and trade developments

Overview

32. In mid-1988, Yugoslavia embarked upon an adjustment programme which included demand and wage restraint, managed flexible exchange rates, positive real interest rates, liberalisation of imports, and an increased role for the market in setting prices. Results to date have been mixed. In 1989, the authorities followed a policy of domestic price and wage decontrol, together with import liberalization and devaluation of the dinar in line with relative prices. The combination of these policies with an accommodating monetary stance led to a hyperinflationary spiral, with retail price inflation rising to over 2,600 per cent by December 1989. As a result, strict antiinflationary policies were introduced in December 1989, including the pegging of the dinar to the German Mark, and the introduction of currency convertibility for domestic residents. Although monthly inflation dropped to almost zero in April 1990, fiscal policies were not fully implemented, and planned reforms of the financial and enterprise sectors were delayed. Inflation rose again, although it fell by the end of the year. With expectations of devaluation, foreign exchange reserves came under pressure and the balance of payments deteriorated.

33. Yugoslavia's domestic economic performance was generally poor in the period 1988-1990. In 1988, real gross social product (GSP) \(^4\) declined by almost 2 per cent, \textit{inter alia} because of price distortions and the effects of drought on agricultural output. At the same time, inflation as measured by retail prices accelerated to 251 per cent (end-year basis). During 1989, real GSP is estimated to have grown by 0.8 per cent, largely as a result of a recovery in total domestic demand, but an easing of monetary and fiscal policies led to a further increase of more than ten-fold in the rate of inflation. As a result of the anti-inflationary policies introduced in December 1989, the inflation rate dropped to an estimated 119 per cent by the end of 1990. A dramatic fall in public consumption and gross fixed investment, coupled with a higher rate of growth of imports than of exports, resulted in a \(7\frac{1}{2}\) per cent fall in real GSP and an increase in industrial unemployment.

34. Developments in Yugoslavia's external accounts were favourable in 1988, when the current account surplus with the convertible currency area reached US$2.2 billion, equivalent to 4.3 per cent of GSP. The overall balance of payments moved into surplus, and gross external reserves increased by about US$11.4 billion. In 1989, the current account again showed a surplus of US$2 billion (3.4 per cent of GSP) and gross reserves increased by more than

\(^4\)GSP is the total value added in goods plus those services regarded as productive inputs. In 1985, the level of gross domestic product (GDP) is estimated to have been some 7 per cent higher than GSP.
These developments permitted the Government to embark on a programme of debt reduction; total foreign debt is estimated to have fallen from US$21 billion in 1988 to about US$19.7 billion in 1989. The favourable movement in the current account was reversed in 1990 when, according to IMF estimates, a deficit of about US$860 million was recorded, largely due to a sizable increase in the trade deficit. However, gross external reserves grew by US$0.7 billion, mainly due to short-term inflows from advance payments for exports and deferred payments for imports.

**Domestic demand and output**

35. In 1988, real GSP fell by 1.7 per cent (Graph 1). A decline of nearly 4 per cent in total domestic demand was partially offset by an increased current account surplus. Private consumption fell, largely because of restraints introduced by the government on wage and salary payments and of an increase in the rate of inflation. These negative effects on income more than offset the "valuation effect" of the real depreciation of the dinar on the local currency value of the public's extensive foreign exchange holdings. There was almost no growth in public sector consumption (which is defined to exclude public sector wages and salaries and payments for services). In an atmosphere of recession, rising inflation and increased uncertainty about the future, gross fixed investment fell by nearly 6 per cent, with the public sector recording a particularly sharp decline and inventories continuing to shrink.

**Graph 1 - Yugoslavia - Real GSP and total domestic demand**

(Annual percentage change)

Source: IMF.

- GSP, weighted average
- Total dom. demand

*Preliminary.
36. Preliminary figures for 1989 show that real GSP growth recovered to 0.8 per cent. While total domestic demand grew nearly 2 1/2 per cent, the foreign sector made a negative contribution to GSP of almost 1 1/2 per cent, as imports expanded faster than exports. Although hyperinflation and a negative valuation effect may have to some extent outweighed the increase in real wages, private consumption, especially of foreign goods, grew briskly. Public consumption, in contrast, declined. Gross fixed investment recovered slightly largely because of the growth in construction, especially private sector housebuilding. Public investment continued to decline, except in catering and tourism, financial and other services.

37. Estimates for 1990 show a significant 7 1/2 per cent decline in real GSP. Both domestic demand and the external balance contributed to the fall, by 1.5 and 5.9 per cent respectively. Although, by the end of 1990, inflation was reduced to an estimated 119 per cent, private consumption grew by a modest 1 per cent, mainly due to the rise in imports favoured by the relaxation of trade and exchange restrictions. At the same time, public consumption continued to decline and gross fixed investment is estimated to have declined by 7-10 per cent, affected by sustained losses in the enterprise sector and the expectation that the economic contraction would continue.

38. Drought in 1988 helped to push agricultural output down by almost 5 per cent for the second year in a row. Industrial, construction and services output also declined. In 1989, agricultural output recovered, (especially corn, beef and fruit) growing by almost 3 per cent, while industrial production is estimated to have risen by nearly 2 per cent. Due again to drought, agricultural production is estimated to have dropped by nearly 6 per cent in 1990. According to preliminary estimates, industrial production dropped by almost 11 per cent in 1990, following the modest recovery of 1989. Intermediate and capital goods were the most seriously affected.

Incomes and prices

39. In the first half of 1988, the Yugoslav authorities began implementing policies designed to lead to increased market determination of incomes and prices. By the end of May 1988, prices accounting for about 47 per cent of the producer price index were being set freely by enterprises according to costs, margins and expected demand. Although wage controls were eliminated, the "modified social compact on incomes" continued to link gross personal income per worker to the growth of fixed and working capital of an enterprise. The weight of prices determined without prior notification in the producer price index rose to 75 per cent in December 1989. In the sharp disinflation programme launched in that month, nominal wages were fixed at their existing level and the prices of some major inputs and infrastructure facilities (representing some 20 per cent of the retail price index) were frozen for six months, until June 1990. At the end of this period, the weight of prices determined without prior notification rose to 94.1 per cent, with only oil and derivatives subject to direct price control. However, because of indirect criteria required in setting prices for certain goods and services, only
71 per cent of prices in the industrial producer price index could be regarded as completely free by the end of 1990.

40. The price liberalisation measures undertaken in 1987-88, together with the devaluation of the dinar in 1988, released upward pressure created by an accommodating monetary policy. Retail prices rose by 251 per cent and industrial producer prices by 274 per cent from December 1987 to December 1988 (Graph 2). The dinar depreciated by 320 per cent over the same period. In 1989, as wage determination was freed and monetary policy continued to accommodate the circle of price wage exchange rate adjustment, hyperinflation developed, with retail prices rising by 2,665 per cent and industrial producer prices by 2,648 per cent. To help protect the balance of payments, the policy of devaluing the dinar in line with relative inflation was continued; the exchange rate depreciated by almost 2200 per cent. Following the introduction of the new economic programme in December 1989, retail price inflation was cut to 2 per cent by March 1990. With some resurgence in mid-year, the overall rise in retail prices slowed to an estimated 118 per cent over the period December 1989-90. Following the pegging of the nominal exchange rate, the real exchange rate of the dinar appreciated sharply during 1990.

**Graph 2 - Yugoslavia - Price indexes and nominal exchange rate**

(Annual percentage change; end of period)

![Graph 2](image)

Source: IMF

Note: In contrast to the other graphs, this graph uses a log scale on the vertical axis (because of the large range of the growth rates).

**Public finance**

41. Estimation of Yugoslavia's public sector deficit is unusually difficult because of the decentralisation of expenditure and revenue-raising activities.
The practice of maintaining extra-budgetary special accounts and of recording expenditure on a cash basis is a further complication. Moreover, the National Bank of Yugoslavia (NBY) has traditionally subsidised loss-making enterprises and banks, as well as absorbing the exchange rate risk in international transactions. Recent legislation has given more autonomy to the NBY, new regulatory powers over the banking system and eliminated the extrabudgetary accounts.

42. The public sector in Yugoslavia comprises "socio-political communities" (general central and local government); self-managing "communities of interest for collective consumption" (responsible for health care, education, sports, etc.); and self-managing "communities of interest for material production" (authorities responsible for housing, roads, energy, etc.). The figures reported below refer to the narrow definition of the Yugoslav public sector, which is limited to the first two sets of communities.

43. In 1988, the public sector surplus - measured in terms of changes in the nominal value of net cash assets of the public sector held by the banking system - grew to 3.7 per cent of GSP (Graph 3). Real revenue showed no growth, while the real value of expenditure fell by about 9 per cent, partly

Graph 3 - Yugoslavia - Consolidated public sector expenditure and revenue (Narrow definition)* (Percentage of GSP)

Source: IMF.

*Revenue on a cash basis, before transfers within public sector. Expenditure estimated as the difference between revenue and change in net asset position of the banking system.

The narrow definition of the public sector excludes any adjustment of the assets of the public sector for inflation or payments arrears. An estimate of the public sector accounts, including the operation of the NBY, adjusted for inflation shows a deficit of 5½ per cent of GSP in 1988, down from more than 11 per cent in 1987.
as a result of a decline in real wages in the public sector. The share of public expenditure devoted to national defence and administration, education, social security and welfare decreased, while expenditure related to intervention in the economy, housing, investment and consumption subsidies rose.

44. In 1989, the nominal cash surplus grew to 4½ per cent of GSP, with real increases in revenue and expenditure of nearly 8 per cent and 5.2 per cent respectively. In the first half of 1989, real revenue declined by 25 per cent largely because of the effects of inflation on the real value of government revenue 6 and the reduction of certain import duties and social security contributions. In the second part of 1989, measures were taken to diminish the effects of inflation on the real value of government revenue by increasing the tax base and reducing delays in collection; among others, the turnover tax rate and some social security contributions were raised. In contrast to 1988, revenue from direct taxes recorded real growth in 1989 while indirect taxes and other revenue fell in real terms. The fiscal policy for 1989 sought to reduce expenditure in areas related to consumption and to increase it in the area of social services. This was enforced by a law giving the authorities the power to stop transfers to agencies that exceeded their predetermined budgets. As a result, expenditure on national defence and administration continued to decline in real terms while expenditure on education grew by almost 4½ per cent and on social security and welfare by 3½ per cent.

45. Preliminary data covering the first three-quarters of 1990 indicate that the nominal cash surplus contracted to about 2.9 per cent of GSP. Expenditures exceeded the programmed level (especially in wage and pension payments) by 58 per cent. Public sector revenues also exceeded the initial projection, largely because of the broadening of the tax base and increases in local taxes on enterprises. In 1990, public sector entities were forbidden to borrow from banks. This was respected until late December, when some regions obtained credits from their respective national banks.

Money and credit

46. The financial system of Yugoslavia has traditionally been characterised by a central bank burdened by quasi-fiscal operations, although recent legislation has granted it more autonomy; administered nominal interest rates set at a level below the rate of inflation (i.e. negative real interest rates); a large volume of deposits, counted as part of "broad money" (M2), indexed to the rate of inflation, implying less control by the monetary authority over the money supply; and a lending policy for commercial banks which discourages financial

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6 High rates of inflation normally lead to a decline in the real value of tax collections because of erosion of the tax base and delays in collection.
7 Direct taxes comprise profit and income taxes of enterprises and individuals, social security contributions, payroll taxes and property taxes.
discipline, as those banks are owned and managed by enterprises which are at the same time their major borrowers. Monetary policy influenced by these factors was not well suited to controlling inflation. The Yugoslav authorities have been obliged frequently to revise the rules for calculating lending rates and discount rates, and to rely on indexation to cope with the negative real interest rates that result from high and variable inflation rates. This policy has produced not only a very unstable administrative structure of interest rates, but also almost certainly a large misallocation of capital.

47. Foreign currency accounts, widely held by the public, play a key rôle in the Yugoslav money supply. Until October 1988, the dinar value of these accounts was adjusted at the end of each month to take into account changes in the exchange rate, and the resulting dinar amount was included in the domestic money supply figures. Thus, dinar devaluations automatically increased the domestic money supply. In addition, since May 1988, dinar deposit accounts have been indexed to the domestic inflation rate, initially to compensate depositors for negative real interest rates. This, however, also automatically links the growth of the broad money supply (M2) to the domestic inflation rate.

48. In 1988, the removal of price controls and a large nominal depreciation of the dinar (241 per cent on a period average basis against the US dollar) were accompanied by a substantial increase in domestic credit. Despite the introduction of indexed dinar deposits in May 1988, the effect of the depreciation of the dinar on the domestic currency value of foreign currency deposits accounted for the largest share of monetary growth (Graph 4).

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8 These liabilities represent foreign currency deposits held with commercial banks by the public and redeposited at the NBY. Redepositing was prohibited in October 1988, although the stock of foreign currency deposits remained at the NBY during most of 1989. Those deposits of commercial banks were revalued in domestic currency every month and the NBY borne the dinar depreciation loss.

9 The share of foreign currency deposits in broad money reached 58 per cent in 1988 and 62 per cent in 1989. It is reported to have fallen to 46 per cent as at September of 1990 largely as a result of the decline in inflation.
49. In 1988, the broadly defined money supply (M2) increased by an estimated 243 per cent (end of period). This increase was dominated by valuation effects. Even excluding such effects, however, the growth of M2 more than doubled from 46 per cent in 1987 to 97 per cent, largely as a result of the growth in domestic credit.

50. Reflecting these expansionary monetary developments, inflation accelerated in 1989, further encouraged by an average annual depreciation of the dinar of more than 1000 per cent; by the relaxation of incomes policy; and by the continuation of fully accommodating monetary and fiscal stances. In an effort to reduce the cost of borrowing and despite accelerating inflation, the discount rate was fixed nominally. Weak monetary management was further exacerbated by the continued channelling of subsidized credit to agriculture and the covering of foreign exchange losses on the foreign currency redepósits by banks at the NBY. The annual growth rate of M2 accelerated further in 1989 to more than 2300 per cent (nearly 900 per cent, mostly in domestic credit expansion, if valuation effects are excluded). The velocity of total broad money increased by 20 per cent with respect to 1988.

51. Under the stabilisation programme adopted in December 1989, a new dinar, equal to 10,000 old dinars was pegged to the deutschmark at an exchange rate of 1 DM for 7 new dinars. During the first half of 1990, the monetary authorities reduced the net domestic assets of the NBY. However, an unanticipated inflow of capital led to an overexpansion of monetary
aggregates. When prices stabilized in the second quarter of 1990, a renewed demand for dinars took place. Since June, concerns about high lending rates and the need for agricultural loans led the authorities to relax monetary policy at a time of seasonally high liquidity. Inflation picked up and the velocity of money circulation rose. Measures to tighten monetary policy during the last quarter of 1990 were offset by liquidity support given to the banking system and by lack of compliance to the NBY rules by decentralized financial institutions. M2 growth slowed to 38 per cent for the first ten months of 1990, inflation slowed and the domestic currency depreciated by 332 per cent in nominal terms during the first six months of 1990 (Graph 2). As may be seen from Graph 4, valuation effects associated with foreign currency accounts played no rôle in the increase in M2 in the first nine months of 1990. The contribution of net foreign assets to money supply growth rose from some 5 per cent to more than 38½ per cent.

Balance of payments

52. The balance of payments of Yugoslavia in convertible currencies moved from deficit in 1987 to surplus in 1988 (Table 1). This largely reflected increased receipts from tourism earnings and workers' remittances; favourable rescheduling of foreign debt and the availability of new foreign capital; a restrictive foreign exchange and import licensing system; strong growth in exports to industrial countries; and incentives given to exports to the convertible currency area through priority allocation of foreign exchange and import licences. In 1988, the current account surplus more than doubled to nearly US$2.2 billion. Total reserves excluding gold of the NBY and authorized banks rose to US$2.3 billion, or 2.7 months of 1988 merchandise imports in convertible currencies (Graph 5).

Graph 5 – Yugoslavia – International reserves (excluding gold) and months of merchandise imports

53. In 1989, the balance of payments surplus continued to increase as a result of a sizeable rise in the item 'errors and omissions' seemingly related at least in part to the recorded trade financing. Merchandise export growth continued, and there was also a surge in merchandise imports from the convertible currency area as a result of more liberal trade policies and some relaxation of demand management. The current account balance remained at US$2.0 billion, while total reserves excluding gold rose to US$4.1 billion (equivalent to more than 4 months of 1989 merchandise imports).

54. According to estimates by the IMF, Yugoslavia's overall balance of payments surplus fell by nearly two-thirds in 1990. At the end of 1990, however, international reserves excluding gold were about US$5.3 billion, or more than 3.8 months of 1990 merchandise imports. This rise in reserves was largely accounted for by capital inflows resulting from advance payments for future exports and deferred payments for imports.

55. Yugoslavia's transactions with the clearing area declined in importance from more than 25 per cent of exports in 1987 to less than 20 per cent in 1990. From 1 January 1991, all transactions are expected to take place in convertible currencies at world market prices. The downward trend in the importance of international transactions with the clearing area is to be attributed largely to economic difficulties in partner countries, but also to Yugoslav policies directed at promoting trade with convertible currency areas.

The current account

56. In 1988, the surge in merchandise exports, a restrictive commercial policy, and the effect of higher real interest rates on the inflow of workers' remittances into the banking system, caused the current account surplus in transactions with convertible currencies to rise to 4.3 per cent of GSP (Graph 6). The current account surplus with the clearing area countries also increased, largely as a result of unexpectedly low imports from the USSR. In 1989, an increased trade deficit was partly offset by higher net inflows on services account. The current account surplus in transactions with convertible currencies thus dropped to about 3.4 per cent of GSP, while that with the clearing area rose to about 0.7 per cent of GSP. In 1990, the current

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10 The clearing area consists of Albania, Czechoslovakia, the former German Democratic Republic, Mongolia, and the Soviet Union.
the current account in transitions with convertible currencies moved into a
deficit of about 1¼ per cent of GSP. This arose from a surge in merchandise
imports largely resulting from increased cereals purchases associated with the
drought and, in the last quarter of the year, the effects of the Gulf crisis
and anticipation of dinar depreciation and slow growth of merchandise exports.

Graph 6 - Yugoslavia -
Current account balance
(Percentage of GSP)

57. Merchandise exports to member States of the European Communities have
grown rapidly at the expense of the CMEA and other Eastern trading area
countries. This reflects strong growth in the EC, depressed levels of economic
activity in the ETA economies, and non-price incentives to export to the
convertible currency area. The value of Yugoslavia's merchandise exports grew
by 8.3 per cent in 1988 and by about
6.1 per cent in 1989 (Graph 7). Largely as a result of favourable price developments, the value of merchandise exports increased by an estimated 5.2 per cent in 1990. Volume growth, however, declined by almost 1 per cent, following an average growth of about 4.8 per cent in 1988-89. The volume of exports to the non-convertible currency area recorded a negative growth in the period 1988-90 of (Graph 8) per cent per annum.

Graph 7 – Yugoslavia – Value of merchandise trade
(Billion US dollars)

Graph 8 – Yugoslavia – Volume of merchandise trade
(Percentage change)

Note: XC refers to exports to convertible currency area; XN refers to exports to non-convertible currency area; IC refers to imports from convertible currency area; IN refers to imports from non-convertible currency area.

Source: IMF.
58. After the liberalisation of imports that began in mid-1988, merchandise imports transacted in convertible currencies - in particular from EC countries - increased by nearly 11% per cent in 1989 and by 26.8 per cent in 1990. A significant part of the rise was in imports of consumption goods. Volume figures for the convertible currency area show increases of 1.9 per cent in 1988, nearly 16 per cent in 1989 and about 29 per cent in 1990. Meanwhile, merchandise import volume from the non-convertible currency area declined at an annual rate of about 11 per cent in 1988-90.

59. In recent years, machinery and transport equipment, manufactured goods classified by material and miscellaneous manufactured goods constituted almost three-quarters of Yugoslavia's merchandise exports (Table 2). The first two commodity groups also represented more than 41 per cent of Yugoslavia merchandise imports in 1990, although their shares in total merchandise imports have somewhat declined since 1986 in favour of miscellaneous manufactured articles, food, and live animals (Table 3). Mineral fuels, lubricants and related materials represented nearly 19 per cent of total merchandise imports in 1990.

60. In 1990, almost 60 per cent of merchandise exports of Yugoslavia went to developed countries, about 29 per cent to eastern and central Europe, and about 11 per cent to developing countries (Table 4). Major Yugoslav markets in 1990 were, in decreasing order of importance, the USSR, Italy, the Federal Republic of Germany and the United States. In 1990, more than 62 per cent of merchandise imports of Yugoslavia came from developed countries, 24 per cent from eastern and central Europe, and about 13 per cent from developing countries. The major suppliers of Yugoslavia in 1990 were, in order of importance, the Federal Republic of Germany, the USSR, Italy and Austria.

61. Yugoslavia's trade surplus on invisibles grew during each of the last three years. The main items that have grown in importance in the last years have been tourism earnings and other services. However, because of the reporting methods used, some of these items are treated as capital flows. As a result of the tightening of monetary policy during the first half of 1990 and of the possibility of domestic convertibility since January, the sale of foreign exchange to the banking system by domestic residents picked up. This was originally recorded as earnings from tourism and other services while its nature is not that of current transactions. These transactions are reclassified in Table 1.

62. Workers' remittances were stable in 1988-89, but dropped in 1990 by a third, largely as a result of exchange rate uncertainty. Net receipts from tourism were steady in 1988-89 and rose by a third in 1990. Other services (net) have been stable in 1989-90. Reflecting a smaller external debt and lower international rates, interest payments declined in 1990.

The capital account and foreign indebtedness

63. Yugoslavia's capital account balance has been largely influenced in recent years by rescheduling agreements with the Paris Club, private commercial banks and multilateral institutions. These agreements have traditionally covered
only a portion of the total external debt of the country. In 1988, the agreement with the Paris Club covered both principal and interest falling due between April 1 of that year and June 30 1989. The agreement with commercial banks covered the total of the medium- and long-term debt owed to private creditors, as well as some short-term credits owed to private creditors. Between July 1989 and June 1990, the Yugoslav authorities declared a unilateral standstill on repayments of principal. Since August 1988, the Yugoslav authorities have pursued debt buy-back operations with commercial banks. They accounted for 2.0 billion at the end of 1990. The average cost of these operations was 0.59 cents per dollar of debt.

64. In recent years, the short-term capital account largely reflected changes in the short-term foreign debt of the Yugoslav banking system (that is, foreign borrowing by Yugoslav banks primarily for the purpose of providing trade-related financing to Yugoslav firms). Other short-term capital flows also represent inflows related to advances of construction projects. In 1988-89, the deficit in the short-term capital account was relatively stable. It resulted from relaxation of the NBY policy on limits on commercial banks' foreign liabilities. In 1990, Yugoslavia's balance of payments statistics reflected foreign direct investment separately. The item "errors and omissions" has displayed significant variability in recent years. This seems to reflect largely short-terms inflows for advance payments for exports and deferred payments for imports.

65. According to the IMF, Yugoslavia's total external debt has fallen from US$18.9 billion at end-1988 to an estimated US$17.2 billion at end-1990, of which US$16.2 billion is repayable in convertible currencies. The ratio of convertible currency debt to GSP has fallen from 37.4 to 28.2 per cent of GSP. External debt service is estimated to have fallen from 35 to 22 per cent of exports of goods and services in the same period.
Table 1 - Yugoslavia - Balance of payments with the convertible currency area (Millions US dollars)

<table>
<thead>
<tr>
<th></th>
<th>1987</th>
<th>1988</th>
<th>1989</th>
<th>1990*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trade balance</td>
<td>-1 038</td>
<td>-588</td>
<td>-1 452</td>
<td>-4 670</td>
</tr>
<tr>
<td>Exports (f.o.b.)</td>
<td>8 572</td>
<td>9 624</td>
<td>10 519</td>
<td>11 834</td>
</tr>
<tr>
<td>Imports (c.i.f.)</td>
<td>-9 610</td>
<td>-10 212</td>
<td>-11 971</td>
<td>-16 504</td>
</tr>
<tr>
<td>of which: oil imports</td>
<td>-842</td>
<td>-1 023</td>
<td>-1 182</td>
<td>-1 534</td>
</tr>
<tr>
<td>Services and transfers, net</td>
<td>2 105</td>
<td>2 798</td>
<td>3 462</td>
<td>3 812</td>
</tr>
<tr>
<td>Remittances and transfers</td>
<td>989</td>
<td>1 488</td>
<td>1 497</td>
<td>1 015</td>
</tr>
<tr>
<td>Tourism</td>
<td>1 606</td>
<td>1 966</td>
<td>2 047</td>
<td>2 730</td>
</tr>
<tr>
<td>Interest</td>
<td>-1 790</td>
<td>-1 922</td>
<td>-1 804</td>
<td>-1 720</td>
</tr>
<tr>
<td>Other services</td>
<td>1 300</td>
<td>1 266</td>
<td>1 722</td>
<td>1 787</td>
</tr>
<tr>
<td><strong>Current account</strong></td>
<td>1 067</td>
<td>2 210</td>
<td>2 010</td>
<td>-858</td>
</tr>
<tr>
<td>Multilateral loans received, net</td>
<td>-617</td>
<td>39</td>
<td>-108</td>
<td>-362</td>
</tr>
<tr>
<td>Drawings</td>
<td>1 090</td>
<td>1 468</td>
<td>1 145</td>
<td>1 380</td>
</tr>
<tr>
<td>Rescheduling</td>
<td>1 747</td>
<td>2 179</td>
<td>1 350</td>
<td>1 060</td>
</tr>
<tr>
<td>Amortization</td>
<td>-3 454</td>
<td>-3 608</td>
<td>-2 603</td>
<td>-2 802</td>
</tr>
<tr>
<td>Multilateral loans extended, net</td>
<td>-202</td>
<td>-75</td>
<td>-125</td>
<td>240</td>
</tr>
<tr>
<td>Other, net</td>
<td>---</td>
<td>-29</td>
<td>-590</td>
<td>576</td>
</tr>
<tr>
<td><strong>Capital account balance</strong></td>
<td>-819</td>
<td>-65</td>
<td>-823</td>
<td>454</td>
</tr>
<tr>
<td>Errors and omissions</td>
<td>-752</td>
<td>125</td>
<td>2 463</td>
<td>1 681</td>
</tr>
<tr>
<td><strong>Overall balance</strong></td>
<td>-504</td>
<td>2 270</td>
<td>3 650</td>
<td>1 277</td>
</tr>
</tbody>
</table>

*Estimate.

Source: IMF.
Table 2 - Yugoslavia - Principal exports  
(Percentage shares)

<table>
<thead>
<tr>
<th>Shares</th>
<th>1986</th>
<th>1990</th>
</tr>
</thead>
<tbody>
<tr>
<td>Machinery and transport equipment</td>
<td>33.6</td>
<td>29.6</td>
</tr>
<tr>
<td>Manufactured goods classified by material</td>
<td>22.5</td>
<td>26.5</td>
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<tr>
<td>Miscellaneous manufactured goods</td>
<td>17.3</td>
<td>17.4</td>
</tr>
<tr>
<td>Chemicals</td>
<td>11.4</td>
<td>10.0</td>
</tr>
<tr>
<td>Crude materials, except fuels</td>
<td>4.1</td>
<td>6.7</td>
</tr>
<tr>
<td>Food and live animals</td>
<td>8.0</td>
<td>6.3</td>
</tr>
<tr>
<td>Mineral fuels, lubricants</td>
<td>1.9</td>
<td>2.5</td>
</tr>
<tr>
<td>Beverages and tobacco</td>
<td>1.0</td>
<td>0.7</td>
</tr>
<tr>
<td>Other</td>
<td>0.2</td>
<td>0.3</td>
</tr>
<tr>
<td>Total</td>
<td>100.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Source: IMF.
<table>
<thead>
<tr>
<th></th>
<th>Shares</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1986</td>
<td>1990</td>
<td></td>
</tr>
<tr>
<td>Machinery and transport equipment</td>
<td>30.2</td>
<td>25.8</td>
<td></td>
</tr>
<tr>
<td>Mineral fuels, lubricants and related</td>
<td>19.3</td>
<td>18.5</td>
<td></td>
</tr>
<tr>
<td>related materials</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Manufactured goods classified</td>
<td>16.2</td>
<td>15.7</td>
<td></td>
</tr>
<tr>
<td>by material</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Chemicals</td>
<td>14.3</td>
<td>13.0</td>
<td></td>
</tr>
<tr>
<td>Food and live animals</td>
<td>5.9</td>
<td>9.5</td>
<td></td>
</tr>
<tr>
<td>Miscellaneous manufactured goods</td>
<td>3.6</td>
<td>8.3</td>
<td></td>
</tr>
<tr>
<td>Crude materials</td>
<td>9.8</td>
<td>8.0</td>
<td></td>
</tr>
<tr>
<td>Beverages and tobacco</td>
<td>0.2</td>
<td>0.7</td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td>0.5</td>
<td>0.5</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>100.0</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>

*Source: IMF.*
Table 4 - Yugoslavia - Direction of total trade in 1990
(Percentage shares)

<table>
<thead>
<tr>
<th>Destination/Origin</th>
<th>Exports</th>
<th>Imports</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Developed countries</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>of which:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>United States</td>
<td>4.8</td>
<td>4.5</td>
</tr>
<tr>
<td>Austria</td>
<td>4.1</td>
<td>5.5</td>
</tr>
<tr>
<td>Switzerland</td>
<td>1.3</td>
<td>2.1</td>
</tr>
<tr>
<td>EC(12)</td>
<td>45.1</td>
<td>44.0</td>
</tr>
<tr>
<td>France</td>
<td>5.2</td>
<td>5.3</td>
</tr>
<tr>
<td>Germany, Fed. Rep.</td>
<td>15.1</td>
<td>17.9</td>
</tr>
<tr>
<td>Italy</td>
<td>17.2</td>
<td>12.9</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>2.6</td>
<td>2.2</td>
</tr>
<tr>
<td><strong>Other developed countries</strong></td>
<td>4.3</td>
<td>6.5</td>
</tr>
<tr>
<td><strong>Developing countries</strong></td>
<td>11.2</td>
<td>13.3</td>
</tr>
<tr>
<td><strong>Eastern and central Europe and USSR</strong></td>
<td>29.1</td>
<td>24.0</td>
</tr>
<tr>
<td>Czechoslovakia</td>
<td>3.4</td>
<td>3.1</td>
</tr>
<tr>
<td>German Dem. Rep.</td>
<td>1.4</td>
<td>2.5</td>
</tr>
<tr>
<td>Hungary</td>
<td>1.4</td>
<td>2.5</td>
</tr>
<tr>
<td>Poland</td>
<td>3.9</td>
<td>3.7</td>
</tr>
<tr>
<td>USSR</td>
<td>19.0</td>
<td>12.9</td>
</tr>
<tr>
<td><strong>Total trade</strong></td>
<td><strong>100.0</strong></td>
<td><strong>100.0</strong></td>
</tr>
</tbody>
</table>

* Estimated

**Source:** IMF.