1. The Government of Yugoslavia has consulted the Fund under Article XIV, Section 4, of the Fund Agreement concerning the further retention of its transitional arrangements.

2. In 1964 economic expansion continued at a high rate. Real social product increased by 12 per cent and industrial production by 16 per cent, about the same as in 1963. Credit policy continued to be relatively easy until the middle of the year and this, together with institutional changes such as the creation of larger disposable resources in the hands of the economic organizations, provided stimulus to the expansion. Despite the impressive increase in production, inflationary pressures which had appeared in late 1963 gained in intensity throughout 1964, as both investment and personal incomes increased sharply. Prices and the cost of living rose significantly, and the balance of payments deficit on goods and services increased from $143 million in 1963 to $255 million in 1964. To restore stability, the authorities tightened credit policy in June and October 1964, and import restrictions were intensified to restrain the sharp increase in imports. The restrictive credit measures produced some results, but did not fully eliminate the pressures on resources which continued through the early months of 1965. The authorities concluded that in order to ensure the sustained growth of the economy, fundamental measures of economic reform would have to be undertaken. To stabilize the economy prior to the introduction of the reform, further restrictive measures affecting bank credit, government budgets, and investment were taken in March 1965. At the same time, to prevent speculative increases in prices, and to gain time for the implementation of the new measures, a temporary freeze was imposed on most prices.

3. The proposed economic reform is intended to correct price distortions inherited from the period when the economy was closely directed by administrative means and to increase reliance on the market mechanism. It involves a further reduction of the role of the political authorities in investment decisions and a substantial adjustment of the external restrictive system. It is expected that these measures will
lead to a more efficient utilization of resources and a strengthening of the balance of payments and thereby will help to sustain a high rate of growth. The Fund welcomes the reform proposals and emphasizes the need for utmost resolution in the pursuit of incomes, credit, and fiscal policies with a view to maintaining the stability of the economy without which the objectives of the reform could not be attained.

4. As part of the reform, the Yugoslav authorities will eliminate quantitative restrictions on imports of raw materials and spare parts, and will liberalize restrictions on imports of capital goods. Some liberalization will also be made in the field of invisible payments. Further, steps will be taken to terminate bilateral payments agreements with Fund members. These changes have an important rôle in ensuring the success of the reform, and the Fund urges the Yugoslav authorities to undertake further liberalization of restrictions as the balance of payments position improves.

5. In concluding the 1965 consultations, the Fund has no other comments to make on the transitional arrangements maintained by Yugoslavia.