Committee on Balance-of-Payments Restrictions

DRAFT REPORT OF THE COMMITTEE ON BALANCE-OF-PAYMENTS
RESTRICTIONS ON THE 1968 CONSULTATION WITH YUGOSLAVIA

1. The Committee has conducted the consultation with Yugoslavia in accordance with its terms of reference. It had before it the basic document for the consultation supplied by the Government of Yugoslavia (BOP/77), together with a background document and further supplementary information supplied by the International Monetary Fund. It also had before it the decision taken by the Executive Board of the Fund at its last consultation with Yugoslavia.

2. In conducting the consultation, the Committee followed the plan of discussion recommended by the CONTRACTING PARTIES (BISD, Seventh Supplement, pages 97-98). The consultation was completed on 30 April 1968. This report summarizes the main points made during the discussions.

Consultation with the International Monetary Fund

3. Pursuant to the provisions of Article XV of the General Agreement, the CONTRACTING PARTIES had invited the International Monetary Fund to consult with them in connexion with this consultation. In accordance with the agreed procedure the representative of the Fund was invited to make a statement supplementing the Fund's documentation concerning the position of Yugoslavia. The statement made was as follows:

"The Fund invites the attention of the CONTRACTING PARTIES to the Executive Board decision of 26 February 1968 taken at the conclusion of its most recent Article XIV consultation with Yugoslavia, and particularly to the last three paragraphs which read as follows:

The authorities intend to continue the present policies of financial restraint while applying credit policy selectively to support export and other growth industries. They are also actively considering measures to limit a further rise in personal incomes to the expected rise in productivity. They hope that a moderate revival of growth will occur in 1968 mainly as a result of an expected strengthening of foreign demand. The Fund agrees that continued financial restraint is indispensable for balance-of-payments purposes, and that a firm incomes policy is needed to bring about a redeployment of resources in the economy in order to reconcile the objective of adequate economic growth with internal and external stability."
In 1965 and 1966 the balance of payments was in over-all surplus reflected, for the most part, in an increase of $95 million in credit balances on bilateral clearing accounts. Reserves in gold and convertible currency rose only slightly more than the net use of Fund resources. In 1967, the authorities expect another over-all surplus of about $60 million, almost entirely reflected in the bilateral balances rather than in Yugoslavia's net convertible reserves. The Fund notes the concern of the Yugoslav authorities about the growth of these balances and urges that every endeavour be made to reduce the continued imbalance in bilateral transactions.

Significant import liberalization was introduced at the beginning of 1967 and already has had beneficial effects on the economy. The Fund considers it essential that efforts be made to extend to the maximum extent the range of payments that are free of restrictions. No progress has yet been made in the elimination of bilateral payments agreements with Fund members, and the Fund continues to urge that efforts to terminate these agreements should be pressed ahead strongly.

"The general level of restrictions of Yugoslavia which are under reference does not go beyond the extent necessary to achieve a reasonable rate of increase in its monetary reserves."

Opening statement by the representative of Yugoslavia

4. The representative of Yugoslavia noted that the aims of the economic reforms, which began to be implemented by his country before the 1965 consultation, were threefold: to establish a better "inter-se" price relationship between agricultural and primary products, services and industrial products, to rely more strongly on market criteria in the formation of prices and allocation of investment resources and finally, to decentralize the process of economic decision making. This should lead to the stabilization of internal economic relationships and a long-term development of the economy under stable conditions, together with a more intensive economic co-operation with foreign countries. Concrete measures to implement these aims were enacted in mid-1965 and in the beginning of 1967 throughout 1966, (new rate of the dinar, elimination of export subsidies, new customs tariff, considerable foreign trade liberalization etc.) so that it has only been in 1967 that the full impact of the economic reform was significantly felt. Its positive results are evident but problems have appeared such as increases in prices and incomes and of imports as compared to exports, all of which have put pressure on the stabilization process. Fortunately price increases became more moderate in 1967
and this stabilization tendency continued during the first three months of 1968, which allowed for a free price formation of close to 50 per cent of industrial products. The increase in incomes mentioned has come together with a disparity in the averages of nominal and real incomes, resulting from the fact that Yugoslav enterprises decide themselves on prices and personal income levels within very flexible margins of domestic and foreign competition. A more direct link between incomes and productivity is being sought to remedy this situation. On the positive side stabilization was helped by a slowing down of investment and consumption, by a decrease in the rate of growth of industrial production, together with an increase in stocks. There was also a decrease of liquidity and a substantial increase in bank savings and deposits. Economic indicators for 1966 and 1967 show specially good results in the agricultural field.

5. Considerable changes have come about in the investment policy. Projects up to 1964 were financed mainly from Government funds, while now in the majority of cases they are financed by the banks and the enterprises themselves. Formerly, investment policy was directed towards building new factories and plants, while now policy is focused on modernization. As a result there was an increase in capital investment up to the first half of 1966 which later levelled off and declined following credit and monetary restrictions intended to control credit expansion. According to new regulations the amount of short-term credits to be granted by the National Bank to business banks was dependant on obligatory reserve deposits which such banks had with the National Bank. Furthermore the credit mechanism was linked to the expansion of exports, so that an increase in short-term credits and monetary supply must go hand in hand with an increase in foreign reserves.

6. In so far as the trade balance was concerned, there was a deficit of $355 million in 1966 representing an 81 per cent increase over 1965. This trend continued in 1967 reaching the figure of $455 million for a 28 per cent increase as compared to 1966. Two factors accounted for this situation: firstly, the liberalization measures resulted in a considerable increase in imports. In 1967 imports from convertible currency countries increased by 20 per cent and imports of liberalized goods almost doubled as compared to 1966. Secondly, as a result of the economic reforms many Yugoslav exporters were able to compete satisfactorily in world markets, for others, problems such as structural disproportions, lack of investment and deteriorating external conditions made it very difficult to market some products. In 1967 exports to the convertible currency area increased by only 9 per cent. The trade deficit mainly occurred with the convertible currency countries. This situation affected the overall balance of payments so that the deficit on current account which in 1966 was of $36 million, increased to $49 million in 1967. The net inflow of capital transfers increased in 1966 and 1967. The overall reserves in gold and foreign exchange show a moderate increase since 1965. They reached $115 million in 1966 and $134 million in 1967, which represents the flow of imports of less than two months from convertible currency areas.
7. Under present conditions it appears indispensable to maintain restrictions on certain imports, as described in the basic document for the consultation, in order to safeguard the balance of payments and external liquidity of Yugoslavia. The representative of Yugoslavia concluded by expressing the hope that further developments in his country's balance of payments situation and export possibilities would not impose the necessity of strengthening the existing import restrictions.

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

8. Members of the Committee welcomed the information supplied by the representative of Yugoslavia and congratulated him for the significant progress achieved since 1965. They welcomed the reassurance that the Yugoslav Government is committed to removing restrictions on imports as rapidly as the balance-of-payments permits. The policy of fiscal and monetary restraint, the move towards liberalization of the import régime, the establishment of a realistic exchange rate, and the changes of an institutional nature, were considered to be intricate but indispensable steps towards economic rationality. It was hoped that Yugoslavia's balance-of-payments position would improve as the economic reform brought further efficiency to the economy. Members stressed their continuing support for the Yugoslav Economic reforms and expressed the hope that contracting parties will be as forthcoming as possible in the face of difficulties Yugoslavia is running into with its effort to expand exports.

9. In answer to a number of questions on the bilateral agreements within which his country trades, the representative of Yugoslavia stated that it was his Government's declared policy to eliminate them as soon as feasible. In this respect several steps had been taken with respect to some countries (Greece, Turkey, Algeria, Spain, Afghanistan, Switzerland) in order to terminate existing arrangements; this was not always easy because it was not a decision that depended on Yugoslavia alone. The overall balance-of-payments situation with bilateral countries having the greatest share in Yugoslav foreign trade was favourable to Yugoslavia, mainly because of large receipts on the invisible account. In order not to have large surpluses in the bilateral balances his country was trying to restrain exports to these countries and redirect them towards convertible currency areas. Efforts were also being made to import additional commodities through bilateral agreements. He noted that it was the view of members of the Committee that appropriate steps be taken in the future to reduce his country's reliance on bilateral agreements, but stated that it would be unrealistic not to accept the fact that for a variety of reasons many of these agreements are likely to continue for some time.
10. In answer to a question on the prospects for the balance of payments on current account the representative of Yugoslavia said that prior to the reform in 1965 there had been a surplus, but that in 1966 and 1967 a deficit greater than expected had appeared. His Government hoped to increase exports towards convertible currency countries which, in its view, would be the main factor determining the balance-of-payments position in the future.

11. In reply to a question as to what effect the Trade Expansion and Economic Co-operation Agreement between India, the United Arab Republic and his country was likely to have on Yugoslavia's balance of payments, the representative of Yugoslavia said, that since a special GATT working group had been established to consider the economic and other implications of the agreement he believed that the Committee should not consider this subject now.

12. With respect to a question on the reasons for the high level of inventories the representative of Yugoslavia explained that this situation was the result of several factors, including a restrictive credit policy, by which credit was granted only for goods which were for sale, and with a considerable liberalization of imports which produced a larger inflow of foreign raw materials and other products. A more general explanation was that the adjustment of the economy to the reforms was not the same in all economic sectors, and many enterprises had been unable as yet to achieve the hoped for increases in productivity and quality. Also smaller exports towards bilateral agreement countries should be taken into account. Several measures had been implemented to cope with this situation; namely a selective credit policy allowing a case by case study for credit allocation and a change in the fiscal policy which should result in a transfer of inventories from producing companies to trade companies.

13. The fact that home demand remained fairly active whilst production was being concentrated on exports and industries were being expanded towards the export side brought the risk of domestic inflation. In this context it was asked what incomes policy was being implemented by Yugoslavia. The representative of Yugoslavia replied that personal consumption had also been rising rapidly. To cope with the situation, incomes had been frozen for some categories where the measure of productivity was difficult to calculate. Furthermore, enterprises were being encouraged to use accumulations for working capital investments instead of using it for increases in wages and salaries. This was a difficult task since the reform had given individual enterprises freedom of action in this respect. Nonetheless, enterprises had become aware that if accumulations were not capitalized their relative competitive position would be jeopardized. The idea of linking increases in productivity with increases in income was gaining favour, but no concrete measures in this respect had yet been taken. In this connexion it was asked whether, in view of the demand situation in the Yugoslav economy, would it not be wise to accelerate the liberalization of prices and imports. The Yugoslav representative replied that this was indeed his Government's policy, and as a result the price of about 50 per cent of industrial products traded in the home market were now free of control. But this road had to be followed carefully so as not to produce undesirable effects on the economy as a whole. With respect to the situation in agriculture he agreed that it was easier to augment productivity in the social sector than in the private sector. Nonetheless, since the prices of agricultural products were no longer controlled, farmers were now making larger investments on mechanization.
14. Questions were raised as to whether Yugoslavia has found that its new investment policies in fact induced an interest in Yugoslav investments, and whether further measures are in progress to encourage this interest. The representative of Yugoslavia informed the Committee that up to now two agreements had been concluded under the new foreign investment regulations and that further negotiations were in progress. He believed that it was difficult to expect - at the outset - a considerable flow of foreign investments into his country. They were newcomers to the international capital market and it would take investors some time to get used to Yugoslav regulations and to appreciate the new investment opportunities.

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

15. Members of the Committee expressed their appreciation for the series of measures taken by Yugoslavia to attain a more economic utilization of resources. They believed that the basic direction in which Yugoslavia was moving with respect to liberalization of imports was the right one and hoped that remaining restrictions would be eliminated as soon as the balance-of-payments situation made it possible.

16. Although recognizing the progress made, members of the Committee believed that a complex system of controls was still the salient characteristic of Yugoslavia's foreign trade régime. They wondered whether there might be growing signs of protectionist pressure indicating that the process of liberalizing trade restriction might be slowed down or reversed. In this connexion a number of questions were put to the Yugoslav representative, including a request for an explanation of the significance of the transfer of some 700 items to more restrictive categories, and in particular from the LBO list to the GDK list, which seemed to represent a deliberalization and restrictive measure. In addition it appeared that the importation of some products on the LBO list had been made conditional to the agreement between Yugoslav producers and consumers of these items. Furthermore it seemed that surcharges of up to 20 per cent were now permitted under new anti-dumping regulations. Members asked how these regulations compare with Article VI of the General Agreement and the recently concluded anti-dumping code, and whether any action had been taken under them. The Yugoslav representative was also asked if it was still his country's aim to achieve full convertibility by 1970, and how far off the Government saw its goal of allowing enterprises to retain all their foreign currency earnings for their own use.
17. In reply to these questions the representative of Yugoslavia said that the basic policy of his country was to pursue the liberalization of the foreign trade régime as far as possible. The timing and speed of it had to be determined by the evolution of the general economic situation both in the country and abroad, having special regard to the difficulties which certain Yugoslav exports encounter in some convertible currency countries. It was against this background that the recent measures to which reference had been made could be understood. As regards the anti-dumping legislation it had not been prompted by protectionist consideration nor was it the intention of the Yugoslav authorities to apply it in such a manner. There were no doubt pressures to do so, but they were being coped with. It was important to realize that the establishment of anti-dumping regulations was the normal and necessary consequence of the liberalization process itself, since foreign competition was now one of the main elements in the formation of prices. Furthermore the regulations were fully in agreement with the provisions of Article VI of the GATT. The procedure that had been enacted gave sufficient time to ascertain the facts and determine the existence of dumping and injury. He noted that no anti-dumping or countervailing duty had been applied against contracting parties up to now. With respect to the shift of about 700 items from the LBO list to the GDK list he explained that the LBO list was introduced in order to provide flexibility in the trade of some basic products subject to bilateral agreements. Before signing a bilateral agreement the authorities consulted enterprises on the commodities and quantities they wished to import from that particular country. Once the bilateral agreement was signed, enterprises which had manifested their interest in certain commodities, could import the same commodity from convertible currency countries, but only after having fulfilled their commitments towards the bilateral country. In 1968 a slackening of demand for products from bilateral countries was evident, either because of increased supply from domestic production or from other foreign markets. For this reason it was necessary to shift many items from the LBO list to the GDK list. In fact what had been done was to transfer these items from one restrictive category to another without affecting the general movement towards liberalization. Moreover some 70 items had been changed from the LBO list to the LB list, so that now some 40 per cent of products classified in the SITC nomenclature had been fully liberalized. Although the GDK list may be more restrictive than the LBO list it must be borne in mind that the LBO list was basically a temporary list, because products traded under bilateral agreements varied from year to year. The shift from one to the other was also necessary in order to group the items representing one technological process under the same import category. They asked for a further progress report on the elimination of bilateral clearing agreements and also what was being done to eliminate discriminatory foreign exchange controls. In any case he wished to repeat that the final objective of the Yugoslav trade policy was to liberalize imports to the furthest extent compatible with the balance-of-payments situation. The LBO list was essentially a transitional device.
18. Members of the Committee expressed their concern over the discriminatory aspects resulting from the existence of large surpluses in Yugoslavia's bilateral accounts. These surpluses made it necessary to allocate "foreign exchange contracts" which could only be used for purchases from bilateral countries, leading to an uneconomical allocation of resources. The representative of Yugoslavia made it clear that it was not his country's intention to wilfully discriminate against convertible currency countries. This situation was inherent in the mechanics of bilateral agreements. As had already been stated, all efforts were being made to eliminate the surpluses and the final policy objective was to do away with the agreements as much as possible.

19. In answer to questions on the size of the GDK global quotas and the quotas for consumer goods the representative of Yugoslavia replied that the size of the 1968 GDK global quota for raw materials and production materials was based on the amount of foreign exchange allocated for these imports in 1967, but it had of course been increased to accommodate the items that had recently been transferred to it. Four industrial sectors, falling under GDK, received an allocation which depended on the amount of exports proceeds obtained by those sectors. In so far as consumer goods were concerned they either fell under the LB list - free, the LBO - conditionally free, or the GDK list, consumer goods global quotas applied only to the latter category. The size and details of the global quota for 1968 had just been published in the official gazette of 24 April 1968.

20. A member of the Committee indicated to the Yugoslav representative some payments problems which the exports of certain publications, mainly books, reviews and reading material, were encountering in Yugoslavia, and expressed the hope that this situation could be brought to the attention of the pertinent authorities.

21. The representative of Yugoslavia was asked to what extent his Government would expect to encounter difficulties in maintaining exports to bilateral countries if it eliminated the LBO list. He replied that in 1967 only 30 per cent of total trade with bilateral countries was covered by the LBO list and that its existence was necessary to assure a certain level of imports from bilateral countries for certain products as agreed in individual bilateral agreements. He reiterated that Yugoslavia was taking steps to reduce its exports to bilateral countries.
General

22. The Committee expressed its thanks to the representative of Yugoslavia for the full and frank answers given to the questions they had put to him and welcomed the measures taken by the Yugoslav authorities since the last consultation in the Committee.

23. The representative of Yugoslavia thanked the members of the Committee for their understanding of the situation of his country and undertook to draw his Government's attention to the views that had been expressed.