RESTRICTED

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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

REPORT AND RECOMMENDATION

OF THE

PRESIDENT

TO THE

EXECUTIVE DIRECTORS

ON A

PROPOSED LOAN

TO THE

YUGOSLAV INVESTMENT BANK

FOR THE

BELGRADE-BAR RAILWAY PROJECT

March 11, 1968

REPORT AND RECOMMENDATION OF THE PRESIDENT
TO THE EXECUTIVE DIRECTORS ON A
PROPOSED LOAN TO THE YUGOSLAV INVESTMENT BANK
FOR THE BELGRADE-BAR RAILWAY PROJECT

1. I submit the following report and recommendation on a proposed loan in an amount in various currencies equivalent to $50 million to Jugoslovenska Investiciona Banka (Yugoslav Investment Bank) to assist in financing the completion of a railway from Belgrade to the port of Bar on Yugoslavia's southern Adriatic coast.

PART I. HISTORICAL

2. The Bank has made ten loans to Yugoslavia for a total amount of $281.2 million of which $248.2 million was outstanding as of January 31, 1968. Following the permanent settlement of the Yugoslav prewar external debt in French francs in 1958 and the temporary settlement of the debt in sterling, Swiss francs and US dollars in 1959, a permanent settlement of the US dollar debt was reached in March 1967, of the sterling debt in June 1967, and of the Swiss franc debt in November 1967.

3. The proposed loan would be the third for railways in Yugoslavia. A loan of $35 million (361 YU) was made in 1963 for construction of the Sarajevo-Ploce railway line; and a loan of $70 million (395 YU) was made in 1964 for the reconstruction and modernization, including electrification, of the main lines of the Yugoslav railway system.

4. The Yugoslav Government first submitted the Belgrade-Bar railway project to the Bank for preliminary consideration in February 1966, and subsequently requested a loan of about $80 million. Following Bank missions to Yugoslavia in the fall of 1966 and in July 1967, it was concluded that the project was acceptable for Bank financing in the amount of $50 million. Negotiations were held in Washington from February 5 to 20, 1968. Principal members of the Yugoslav delegation were Mr. M. Bojanic, General Manager of the Yugoslav Investment Bank, Mr. G. Popovic, Economic Counsellor of the Yugoslav Embassy in Washington, and Mr. T. Batev, Director Investment Department, Community of Yugoslav Railways.

5. Yugoslavia is a Part II member of IDA but has received no IDA credits. It has applied for membership in IFC. The following is a summary statement of Bank loans to Yugoslavia as at January 31, 1968:

Loan Number	Year	Borrower	Purpose	Amount (US$ million) Bank	Undisbursed
20 YU	1949	Federal Government	Industry	2.7	--
51 YU	1951	Federal Government	Industry, Power, Agriculture & Transport	28.0	--
73 YU	1953	Federal Government	Industry, Power, Agriculture & Transport	30.0	--
277 YU	1961	Yugoslav Investment Bank	Power	30.0	.2
318 YU	1962	Yugoslav Investment Bank	Power	30.0	.2
344 YU	1963	Yugoslav Investment Bank	Roads	35.0	--
361 YU	1963	Yugoslav Investment Bank	Railways	35.0	--
395 YU	1964	Yugoslav Investment Bank	Railways	70.0	50.5
485 YU	1967	Yugoslav Investment Bank	Roads	10.0	8.4
504 YU	1967	Yugoslav Investment Bank	Industry	10.5	10.5
		Total		281.2	
		of which has been repaid to Bank and others		33.0	
		Total now outstanding		248.2	
		Amount sold	4.6		
		of which has been repaid	1.6	3.0	
		Total now held by Bank		245.2	
		Total undisbursed			69.8

6. Execution of most of the projects has been satisfactory. The closing dates of the two power loans (277 and 318 YU) were postponed by about 18 months because of delays which were outside the control of the Yugoslav authorities. Both projects are now practically completed. Progress on the first railway project (361 YU) was delayed last year primarily because of a major increase in its cost which had to be covered by additional contributions from the Federal Government and the Republics concerned. Agreement has recently been reached upon Government action to cover cost over-runs on both railway projects (361 and 395 YU) and work is now progressing

satisfactorily. The Sarajevo-Ploce railway project (361 YU) is now substantially completed. The railway modernization project (395 YU) was delayed mainly by slow awarding of contracts resulting largely from the 1965 foreign exchange reform and by modification of designs. The project should be completed in 1971. The Bank has reached agreement with the Government, the Yugoslav Investment Bank and the Railways for prompt action in the future to meet increased costs on railway projects financed by the Bank. Work on the highway loan of 1963 was completed on schedule in 1966 and work on the highway loan of 1967 is proceeding very well, somewhat ahead of schedule and within the original cost estimates.

7. The Bank is presently appraising various industrial enterprises in Yugoslavia for a proposed second loan for industrial modernization. Discussions have continued for over two years, so far without result, between the Yugoslav Investment Bank, a Yugoslav enterprise and foreign companies on an aluminum project involving possible Bank financing.

PART II. DESCRIPTION OF THE PROPOSED LOAN

8. Borrower: - Yugoslav Investment Bank

Guarantor: - Socialist Federal Republic of Yugoslavia

Beneficiary: - Zeljeznicko Transportno Preduzece Beograd and Zeljeznicko Transportno Preduzece Titograd (Railway Transportation Enterprises Belgrade and Titograd)

Amount: - various currencies equivalent to $50 million

Purpose: - to assist in financing the completion of a railway between Belgrade and Bar

Amortization: - amortization in semi-annual installments beginning March 1, 1974 and ending March 1, 1993

Interest Rate: - 6-1/4 per cent

Commitment Charge: - 3/4 of 1 per cent

Relending Terms: - the proceeds of the loan would be passed on by the borrower as part of the Government grant contribution to the beneficiary enterprises.

PART III. THE PROJECT

9. A report entitled "Appraisal of the Belgrade-Bar Railway Project--Yugoslavia" (TO-620a) is attached.

The Yugoslav Railway System

10. Railways provide the backbone of Yugoslavia's transportation system. The main lines of communication run northwest to southeast along the Sava-Danube valley serving the principal agricultural and industrial areas of the country. In the west and north the railway system has been developed almost to Western European standards, but in the south development did not really begin until the establishment of the Yugoslav state in 1919. The mountains across the center of the country block access to the coast except at a few points and are a serious handicap to transport. The recently completed standard gauge railway between Ploce and Sarajevo, and the proposed railway between Belgrade and Bar, will substantially complete the railway network.

11. In 1966 the railways accounted for 55 per cent of the freight ton-km and 41 per cent of the passenger traffic. While the absolute level of railway traffic is expected to be maintained or to increase gradually, the percentage of railway to total traffic will continue to decline. Despite the more rapid growth of highway, river, and air transport, the railways will long remain important for the routes served and the types of traffic carried.

12. The organization of the railways is based on the Yugoslav concept of "workers' self-management", and is decentralized. There are six railway transportation enterprises responsible for the operation of the system. There are also about 70 auxiliary enterprises which are responsible for such matters as the maintenance and repair of track, the repair of rolling stock and the design and supervision of new construction. The "Community of Yugoslav Railways", in which all the enterprises are represented, is responsible for the supervision and coordination of railway matters for the whole country as well as for general questions such as rates and tariffs, technical standards and overall planning. The formulation of transport policy and the coordination of transport matters is the responsibility of the Federal Secretariat for Transport and Communications. Although these arrangements appear complex, the enterprises cooperate well with one another and the railways are efficiently operated.

13. The various enterprises have their own separate finances. Since 1966 each enterprise has retained its own earnings, and established its own schedules of rates and fares within the overall policy of the Community of Railways. For the Skopje and Titograd enterprises, government subsidies are being provided at a declining rate from 1966 through 1970 when they are scheduled to cease. A consolidation of the accounts of all the railway enterprises shows that for the system as a whole operating revenues in 1967 were about $330 million equivalent and operating expenses about $328 million. In 1966, before the economic recession, the figures were more favorable, with operating revenues of about $351 million equivalent and operating expenses of about $333 million equivalent. The Railways' earning position has not been satisfactory. Agreement has been reached that by increases in rates and fares and other measures the Railways will earn a return of at least 3.5 per cent in 1970 and at least 6.0 per cent in 1972 and thereafter.

14. In addition to construction of the Sarajevo-Ploce and Belgrade-Bar lines, the railways are carrying out a seven-year investment plan, 1964-70, which provides for capital investments of about $658 million equivalent over the seven-year period. The main items of the plan are: 1) the electrification and installation of modern signalling equipment on three main lines, 2) the construction of six new marshalling yards, 3) renewal of the permanent way, bridges and structures of the entire system, 4) purchase of locomotives and rolling stock, and 5) remodelling of stations and freight yards, and the conversion of narrow gauge to standard gauge lines. The Bank is helping to finance the first two items of the seven-year investment plan under Loan 395-YU. The railways are financing the purchase of locomotives and other rolling stock as far as possible from suppliers' credits, and the improvement of line and station capacities mainly from their own funds but also in part from loans from interested cities and republics. The remainder of the plan will be financed by the railways' own funds.

The Belgrade-Bar Project

15. The only major railway construction project now planned in Yugoslavia is the completion of the Belgrade-Bar railway line, for which the loan here proposed would be used. The project is the completion of standard gauge single track, electrified line from Belgrade to Bar for a total length of 462 km. and includes earthworks, structures, track, buildings, and the procurement and installation of signalling, telecommunication and electric traction equipment. Two sections of the railway, totalling about 90 km, have been in operation since 1959 without electric traction or final signalling. Work is in progress on some sections and completion of the project is scheduled for the end of 1972. The project is defined to include also the supply of motive power and rolling stock, although Bank financing is not required for this part of the project. The project will be constructed by the Railway Transportation Enterprises of Belgrade and Titograd. The organization and staff of the railway enterprises are competent both administratively and technically. The authorities have undertaken to expand the port of Bar so that it can handle the traffic arising from completion of the project.

16. The major economic benefits of the project consist of (a) savings on traffic which now has to travel on longer circuitous routes by truck and by standard and narrow gauge lines, (b) inducement of traffic that cannot at present move because of prohibitive costs or the lack of any transport outlets and (c) other benefits such as shorter sea transport distance to Bar and electrification of existing sections of the line. The quantifiable expected benefits to the Yugoslav economy in the railway's zone of influence affect principally agriculture, forestry and minerals. The economic rate of return of the project is estimated to be 8-1/2 per cent, calculated from January 1, 1968 to the end of the railway's economic life of 35 years.

17. There are also other benefits which have to be taken into account and which cannot be reflected in an economic rate of return. A major policy of the Government has been the promotion of the less developed areas to achieve a more balanced economic structure within Yugoslavia and specifically

to promote greater national cohesion between the underdeveloped Republic of Montenegro and the richer republics. Investment in infrastructure in these areas permits the better utilization of manpower and other resources of the region and mitigates some of the problems resulting from large discrepancies between incomes in different regions of the country.

18. The estimated total cost of the project, including contingencies, which the proposed loan would assist in financing, is $211 million equivalent for the period 1968-72. According to the Law on Participation of the Federal Government in Financing the Investment Works of the Completion of the Belgrade-Bar Railway Line, dated July 1966, 85 per cent of the total cost of the project will be provided as a grant by the Federal Government of Yugoslavia, 8.3 per cent by the Republic of Serbia, and 6.7 per cent by the Republic of Montenegro, the latter for investments in their territories.

19. The foreign exchange component of the project will depend on the awarding of contracts between local and foreign bidders, and is estimated to range between a minimum of about $24 million (11 per cent of the project or 48 per cent of the loan) and about $70 million (33 per cent of the project or 140 per cent of the loan.) The total amount of contracts to be put to international competitive bidding and costs of foreign consultants, including contingencies, is estimated at $142 million. The Bank is proposing to provide about a third of this amount, or an amount near the mean between the estimated minimum and maximum foreign exchange component, i.e. $50 million. It is proposed that the full amount be provided regardless of the outcome of the bidding.

20. All the contracts in which foreign suppliers and contractors might be interested (i.e. earthworks and structures, supply of rails, points, crossings and accessories, signalling, telecommunication and electric traction equipment) would be subject to international competitive bidding. Contracts for sleepers, ballast and track-laying, buildings, and miscellaneous items, are not suitable for international competitive bidding.

21. As for previous railway loans to Yugoslavia, bids would be evaluated taking into account existing customs duties, which for goods to be imported for the project average about 12 per cent.

The Borrower

22. The proposed loan, which would be guaranteed by the Yugoslav Federal Government, would be made to the Yugoslav Investment Bank, an investment institution established in 1956. The proceeds of the loan would be passed on by the Yugoslav Investment Bank as part of the Federal Government grant contribution to the beneficiary enterprises. Where, as in the loan now proposed, the loan proceeds are passed on as grants, the Federal Government undertakes to provide the Investment Bank with the funds required for debt service. The Investment Bank has served as a conduit for seven Bank loans to Yugoslavia since 1961, totalling $220.5 million. Its

activities remain substantially as described in Appendix 1 of the Appraisal Report of Yugoslav Industrial Projects (LA-Za) dated June 29, 1967 which was distributed to the Executive Directors on July 3, 1967.

PART IV. LEGAL INSTRUMENTS AND AUTHORITY

23. The draft Loan Agreement between the Bank and the Yugoslav Investment Bank, the draft Guarantee Agreement between the Socialist Federal Republic of Yugoslavia and the Bank and the Report of the Committee provided for in Article III, Section 4 (iii) of the Articles of Agreement are being distributed to the Executive Directors separately. The draft Loan and Guarantee Agreements are substantially similar to those of the previous loans to the Yugoslav Investment Bank and contain the usual provisions for railway projects.

24. Under Section 3.06 of the Guarantee Agreement, the Government will agree to enable the Yugoslav railway system to realize sufficient revenues to (i) cover all their operating expenses including depreciation and (ii) earn an adequate return on the value of their net fixed assets.

PART V. ECONOMIC SITUATION

25. An Economic Memorandum dated March 6, 1968 is attached. A report on the Yugoslav economy (EA 162a) circulated to the Executive Directors on September 21, 1966 and an updating memorandum circulated on July 3, 1967 recorded the impressive growth of the Yugoslav economy since World War II, described the economic reform of July 1965 and the measures associated with it, and reviewed the subsequent progress of the economy until the early months of 1967. These papers outlined the comprehensive changes in relative prices, in taxation, in the banking and credit mechanism, and in foreign trade regulation which together constituted the economic reform and marked a further major step towards the creation of an economy guided by market forces and one in which a freer exchange of goods and services with the rest of the world would lead to a more efficient allocation of resources. The attached Memorandum reviews developments in the Yugoslav economy during 1967, and concludes that despite the difficulties encountered in carrying out the economic reform, much has been achieved in providing the framework needed to secure a more efficient use of resources and in laying the foundation for a resumption of economic growth. The memorandum also concludes that the problem of servicing the country's external debt, though difficult, appears manageable and that Yugoslavia continues to be creditworthy for Bank lending.

PART VI. COMPLIANCE WITH ARTICLES OF AGREEMENT

26. I am satisfied that the proposed loan would comply with the Articles of Agreement of the Bank.

PART VII. RECOMMENDATION

27. I recommend that the Executive Directors adopt the following Resolution:

RESOLUTION NO. ____

Approval of Loan to Yugoslav Investment Bank in an amount equivalent to U.S. $50,000,000 to be guaranteed by Socialist Federal Republic of Yugoslavia

RESOLVED:

THAT the Bank shall grant a loan to Yugoslav Investment Bank to be guaranteed by Socialist Federal Republic of Yugoslavia in an amount in various currencies equivalent to fifty million United States dollars (U.S. $50,000,000), to mature on and prior to March 1, 1993, to bear interest at the rate of six and one-quarter per cent (6-1/4%) per annum, and to be upon such other terms and conditions as shall be substantially in accordance with the terms and conditions set forth in the form of Loan Agreement (Belgrade-Bar Railway Project) between the Bank and Yugoslav Investment Bank, and the form of Guarantee Agreement (Belgrade-Bar Railway Project) between Socialist Federal Republic of Yugoslavia and the Bank, which have been presented to this meeting.

George D. Woods
President

Attachments

Washington, D.C.
March 11, 1968

FILE COPY

YUGOSLAVIA

Memorandum on the Economic Situation

1. A report on the Yugoslav economy (EA-162a) circulated to the Executive Directors on September 21, 1966, and an up-dating memorandum circulated on July 3, 1967, recorded the impressive growth of the Yugoslav economy since World War II, described the economic reform of July 1965 and the measures associated with it, and reviewed the subsequent progress of the economy until the early months of 1967. This memorandum reviews developments in the Yugoslav economy during 1967 against the background of the economic reform.

2. Yugoslavia has achieved a remarkable rate of economic growth over most of the post-war period, with gross material social product[1/] rising on average by 9-10% annually. This rate of growth has reflected in part a high rate of investment, which in most years absorbed over 40% of the gross material product. The Yugoslav authorities have progressively moved away from the system of central direction of the economy adopted immediately after the war; the economic reform of July 1965 marked a further major step towards the creation of an economy guided by market forces.

3. Despite the fast rate of growth, by the early 1960's certain weaknesses in the structure of the economy had emerged. The great emphasis given to the expansion of manufacturing had resulted in a distortion in the pattern of production, reflected in lagging output of agricultural products and basic raw materials and deficiencies in power and transport services. Sheltered by severe restrictions on external trade, industrial diversification had been pressed to the point where in some sectors too great a range of products was produced in too small a quantity to be economic. Moreover, the diversity of production and the emphasis given to developing the capital goods industries required high investments if industry were to keep pace with advances in technology and remain competitive. It also became clear that with a limited internal market, the continued growth of the economy required a greater emphasis on production for export and greater specialization.

4. Thus the economic reform of July 1965 and the measures associated with it were designed to provide the framework for a more efficient allocation of resources, partly by limiting still further political influences in investment decisions, partly by correcting long-standing distortions in relative prices, and partly by measures to integrate more closely the Yugoslav with the world economy. The latter measures included devaluing the dinar (from $1=7.5 to $1=12.5), approximately halving customs tariff rates and liberalizing imports. These changes occurred over several years. The major reductions in the taxation of economic enterprises, designed to leave with the enterprises the major responsibility for investment decisions, occurred in 1964, the devaluation of the dinar and the principal price

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1/ The gross material social product corresponds to the gross national product in customary national accounting concepts, but excludes certain services such as public administration and defense, education, health and professional services.

adjustments in July 1965 and the liberalization of imports and the foreign exchange regime in January 1967.

5. For the devaluation of the dinar and import liberalization to be effective, it was essential that the inflationary conditions of 1963 and 1964 should be greatly moderated. Thus major policy objectives and major achievements of the past two years have been the curbing of inflationary pressures and the strengthening of the country's external position. With a restrictive credit policy the money supply has barely increased since the beginning of 1965, and there has been a marked decline in the rate of increase of prices. Producer prices were stable during 1967 at the average level prevailing in 1966 after increases of 15% and 11% in the two preceding years, and the cost of living index rose by 7% in 1967 compared with 32% and 28% in 1965 and 1966 respectively. The rise in living costs in 1967 reflected largely increases in indirect taxation (particularly on liquor and tobacco), further adjustments in rents and increased costs of services. Credit restraint and the devaluation of the dinar brought a marked strengthening of the balance of payments, with a sharp reduction in the current deficit from the level of almost $213 million in 1964. The deficit amounted to only $36 million in 1966 and provisional figures indicate a slightly larger adverse balance on current account in 1967.

6. The cost of these considerable achievements was a marked slowdown in the growth of the economy and some increase in unemployment. Output in 1966 rose by about 8%, almost equalling the fast expansion achieved in earlier years, but this was mainly due to an exceptional year in agriculture. Industrial production rose by little more than 4% compared with growth rates averaging 11% annually from 1960 to 1965. Though 1967 was also a good crop year, agricultural output as a whole is estimated at 2-4% below that of 1966. In industry, experience in different branches varied markedly, but the overall index of industrial production showed no increase in 1967 over 1966. A decline in fixed investment depressed demand in the investment goods industries, and although private consumption increased with sharp rises in personal savings and greater imports of selected consumer goods, output of the consumer goods' industries as a whole declined slightly in 1967. Employment in the socialized sector of the economy was estimated at 3.4 million in November 1967, about 40,000 less than a year before. There was some movement of unskilled labor back into private agriculture in which returns had increased following two good seasons and the major price adjustments of recent years.

7. One of the aims of the economic reform was to achieve higher levels of consumption with some reduction in the share of investment in the social product. It was hoped that with a more efficient use of investment resources and the incentive of higher living standards, a satisfactory rate of growth of output could be maintained. In giving effect to this aim taxes on the incomes of enterprises were abolished and this together with other tax adjustments made possible an expansion of personal incomes. The extent of the increase in personal incomes in recent years was, however, greater than the authorities had expected. Real personal incomes in the social sector were 12% greater in 1966 than in 1965 and rose again by 7%

in the first 11 months of 1967, much more than the rise in labor productivity. The rise in personal incomes brought a relative reduction of investment funds of economic enterprises, and although the rate of investment continued at a relatively high level, fixed investment as a proportion of output fell from 32% in 1964 to 24% in 1966. It is probable that there was a further decline in the ratio of fixed investment to output in 1967. Total investment as a proportion of output declined less sharply, from 43% in 1964 to 37% in 1966, because of large additions to inventories as producers in a number of industrial branches met increasing difficulty in disposing of output. Further additions to inventories in 1967, which absorbed resources that might otherwise have been used to finance fixed investment, were regarded by the Yugoslav authorities as excessive.

8. The decline in domestic demand came at a time when, with a slowdown in the Federal German economy and the implementation of the agricultural policies of the EEC, the demand for many Yugoslav exports slackened in convertible currency markets, and new opportunities for Yugoslav workers abroad were curtailed. The number of Yugoslavs working abroad in 1967 at 300,000 remained unchanged from 1966. Exports rose by 2.7% to $1.25 billion in 1967 (compared with an increase of 14% annually in 1960-66); the increase in exports to convertible currency countries in 1967 reflected largely the exceptional crops (particularly maize) of 1966, while expanded exports of manufactures to bilateral trading partners tended to exacerbate the problem of the persistent trade surplus with those countries. Imports rose by 8.4% to $1.71 billion in 1967 (compared with increases of 11.5% annually in 1960-66), but with rising invisible earnings (largely from tourism) and a small net capital inflow, convertible currency reserves at $134 million in December 1967 were well maintained. The progress of the economic reform and the modernization of industry require expanded imports from the West; imports of raw materials and semi-finished goods, liberalized in January 1967, increased rapidly in the year. A renewed expansion in Western Europe would assist Yugoslav exports in 1968, but it is clear that the continued growth of net invisible earnings of convertible currencies will also be particularly important in the future. Gross earnings from foreign tourism are estimated to have risen by about 20% in 1967, following increases of about 30% annually in 1965 and 1966, and further growth is expected in 1968.

9. As indicated above, restrictive credit policies have been applied in the past three years. The Yugoslav authorities have stated their firm intention to continue the policy of credit restraint for as long as is necessary to permit the economic reform to be successfully concluded. But while maintaining overall restraint, they plan to provide some stimulus to expansion by increasing credit to finance production for export and by expanding medium-term credit to assist Yugoslav suppliers of equipment to compete more effectively in both domestic and foreign markets. Consumer credit which fell by almost 30% in the past two years will also be moderately increased. These measures do not imply a major reversal of past credit policies, and the reconciliation of selective credit expansion with overall restraint will be aided by further progress towards surplus in the public sector. Government budgets have been in moderate surplus in recent years,

and the authorities have taken steps to eliminate the deficits of the social security funds which emerged in the past three years.

10. The structural changes envisaged by the economic reform can only occur rather slowly. However, there has already been encouraging progress in agriculture, though aided by good seasons, and substantial investments are being made in expanded capacities and in modernization of infrastructure - railways, roads, electric power - and of basic raw materials - iron and steel, non-ferrous metals, chemicals, and petroleum products. Progress towards increased specialization in production is also being made. Yugoslav enterprises in a number of industrial branches have agreed between themselves to rationalize production, and many have eliminated unprofitable product lines. New arrangements with foreign firms are being made, which often enable Yugoslav enterprises to benefit from more modern technologies and in some cases involve an exchange of components with the foreign partner. The new law on private foreign investment in Yugoslavia is designed to attract capital and technical know-how to help modernize the economy, and the authorities plan gradually to proceed to further import liberalization as a spur to increased efficiency.

11. The structural changes in the economy and the modernization of industry require large investments, and progress has been hampered by the reduction in savings of enterprises in favor of greater personal incomes. Under the system of workers' self-management great discretion in determining the level of personal incomes rests with the economic enterprises, but while the growth of incomes has moderated in recent months, the Yugoslav authorities are considering how future increases in personal incomes might be linked more closely to productivity gains. The authorities are also considering how to increase the effectiveness of the banking system in mobilizing and channelling investment funds to the most productive uses.

12. Yugoslavia's total external debt outstanding, repayable in convertible currencies (including undisbursed) at June 30, 1967, was $1.86 billion, $30 million greater than in December 1966. The amount undisbursed totalled $520 million. $400 million of the total debt is owed to international organizations, $800 million represents suppliers' and bank credits, and $635 million official loans from Western countries. Loans from East European countries totalled $310 million equivalent, of which only $16 million had been disbursed. While the country's external debt has risen appreciably in recent years, approximately doubling since 1963, with the fast growth of foreign exchange earnings, the debt service ratio has risen quite moderately. In the past two years as the growth of the economy has slowed, the increase in the total foreign debt has greatly moderated and the debt service ratio has not risen. Nevertheless, with Yugoslavia's heavy reliance on suppliers' credits, reflecting the limited availability of longer-term loans from the West, and with only limited success in bilateral debt re-scheduling negotiations, debt service in convertible currencies in the next four years is heavy, being equivalent on average to about 25% of prospective convertible currency earnings. This figure is high but it must be realized that it represents Yugoslavia's total obligations to Western

creditors, not only those of the public sector.

13. To make possible further substantial progress in import liberalization, some strengthening of Yugoslavia's external reserves will be needed. In this context and having regard to Yugoslavia's obligations to the I.M.F., the authorities are aiming to achieve a moderate over-all surplus in the balance of payments in the next several years. The authorities do not expect that having regard to Yugoslavia's internal needs in this period the country could do more than be in broad balance or in small surplus on current account and could not now become a capital exporter on a significant scale. Hence she will need to borrow abroad an amount at least sufficient to roll over the bulk of the existing external debt. This would amount on average to about $250 million in each of the next three years. There seem good prospects of rolling over suppliers' credits, but Yugoslavia will clearly need further assistance, preferably on longer-term.

14. In retrospect, it appears that the attainment of the objectives of the economic reform has proved more difficult and the process of adjustment required of enterprises slower than was earlier expected. The marked shift in the use of resources from investment to personal consumption added to the difficulties, as did the slackening of growth in some Western economies which came at a rather critical time in the implementation of the economic reform. Nevertheless considerable progress has been made in providing the framework needed to secure a more efficient resource allocation. The Yugoslav authoritieshave shown great determination in pursuing the objectives of the reform and have been ready, if necessary, to make quite far-reaching adjustments in economic and social policies. The country's external debt position has not worsened in the past year, and the problem of servicing the external debt, though difficult, appears manageable. In these circumstances, Yugoslavia's performance can be considered as satisfactory and an adequate basis for further Bank lending.

Europe Department
March 6, 1968

Yugoslavia

Annex 1 STATISTICAL APPENDIX Attachment

Gross Material Social Product

1967: D 104.01 billion (Preliminary)
Rate of growth (1960-65): 7.5%
(1966) : 8.0%
(1967) : 1.0% (Preliminary)
Per capita (1967) : U.S. $500 (approx.) 1/

Per cent of Gross Social Product	1966
Agriculture and forestry	31
Mining and manufacturing	33
Construction	7
Transport and communications	8
Trade and catering	15
Other	6

Per cent of Gross Social Product	1966	1962-65
Gross investment	37	41
Gross savings	37	40
Current deficit on the balance of payments	--	1
Investment income payments	1	0.5
Government current revenues	18	23

Money and Credit	Change in 1967	Rate of Change 1962-66
Total money supply	- 0.2%	14%
Time and savings deposits	+60.0%	20%
Short-term credit to private sector	+ 9.9%	13%
Rate of change in prices (retail)	+ 1.9%	18%

Public Sector Operations 2/	1966 (D. billion)	Rate of Change 1964-66
Government current receipts	17.6	9.0%
Government current expenditures	16.3	9.6%
Surplus	1.3	--
Government capital expenditures	0.9	--

1/ Adjusted to OECD National Accounts concept.

2/ Excluding social security funds

External Public Debt (U.S. $ million)	1967 (June)	1960-66 Average
Total debt outstanding	2,173	1,240
Annual debt service	302	155
Ratio of debt service to foreign exchange earnings	16%	14%

Balance of Payments (U.S. $ million)	1966	Rate of Change 1960-65
Exports	1220	14%
Imports	- 1575	9%
Net invisibles of which	261	26%
interest payments	- 70	31%
Net current balance	- 36	--

Foreign Exchange Reserves (U.S. $ million)	1967 (December)	1960-66 Average
Convertible currencies	134	73
Payments agreements	187 (Nov.)	39

I.M.F. Position (U.S. $ million)	1967 (Dec.)	1960-66 Average
Quota	150	124
Drawings outstanding	141	85

Europe Department

March 1, 1968