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Former Yugoslavia's Debt Apportionment

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TITLE: FORMER YUGOSLAVIA'S DEBT APPORTIONMENT

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ABSTRACT

After the collapse of the former Yugoslavia in 1991, the apportionment of its external debt became one of the crucial issues for establishing political and economic relations between the international community and the newly born countries of Slovenia, Croatia, Bosnia and Herzegovina, Macedonia and Serbia/Montenegro. Over the last four years the new countries undertook a very difficult process of normalizing external financial relations. They regarded normalization as the final step toward full international recognition and the apportionment of debt of the former Yugoslavia was the first step in this process.

This paper discusses key issues of debt apportionment. Following a brief presentation of how the former Yugoslavia's external debt situation developed, the paper explains how, following the collapse of Yugoslavia, the key apportionment principles were agreed: (a) a succession principle, i.e. the five successor republics to the former Yugoslavia; and (b) the apportionment principles with regard to the nonallocated and allocated debt. In addition, it presents the status as of October 1995 of the relationship between individual successor states and their creditors.

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FORMER YUGOSLAVIA'S DEBT APPORTIONMENT^{1/}

I. Introduction

1. After the collapse of the former Yugoslavia in 1991, the apportionment of its external debt^{2/} became one of the crucial issues for establishing political and economic relations between the international community and the newly born countries of Slovenia, Croatia, Bosnia and Herzegovina, Macedonia and Serbia/Montenegro. The new countries fell into arrears (except Slovenia and Croatia, which remained current in relations with international financial institutions (IFIs) and the Paris Club) or faced difficulties with their external debt payments because of collapsed economies caused by war (especially Croatia and Bosnia and Herzegovina), lost internal markets (all of them), and were unable to reach external markets owing to economic blockades and UN economic sanctions against Serbia and Montenegro (especially Macedonia and Serbia/Montenegro). Over the last four years the new countries undertook very difficult process of normalizing external financial relations. They regarded normalization as the final step toward full international recognition and the apportionment of debt of the former Yugoslavia was the first step in this process.

2. This paper discusses the key issues of debt apportionment. It first provides information on how the former Yugoslavia's external debt situation developed and discusses how the debt was internally divided in the country at the time of its dissolution. The second section, explains how, following the collapse of Yugoslavia, the key apportionment principles were agreed: (a) a succession principle, i.e., the five successor republics to the former Yugoslavia; and (b) the apportionment principles in regard to the nonallocated and allocated debt. Recent developments and the current status of the relationship between individual successor states and their creditors are discussed in the third section which also discusses what individual successor states have achieved toward normalizing their financial relations with foreign creditors.

^{1/} The paper was prepared in October 1995.

^{2/} US\$15.3 billion at the end of 1991.

II. Background on the Former Yugoslavia's External Debt

A. High Indebtedness and Debt Restructuring of the 1980s

3. The main characteristic of the Yugoslav economy in the 1970s and 1980s was the ever-deepening economic crisis. During the 1970s, both fixed capital investment and personal and public consumption expanded rapidly, at least partially as a result of increased reliance on foreign resources. By far the most important form of foreign savings used by Yugoslavia in that period was borrowing on commercial terms from the international banking community, where Yugoslavia, like many other middle-income developing countries, had full access to the financial resources of the international capital markets.

4. Between 1972-82, the Yugoslav external debt increased ninefold from US\$2.4 billion to US\$20.3 billion. This dramatic increase was a result of a whole set of internal and external factors. The former were related on the one hand to the deficiencies in the country's import-driven development strategy, that resulted in a growing current account deficit, and on the other to inappropriate and ill-timed economic policy measures. Among the external factors, the second oil shock, the increase in nominal and real interest rates and the economic recession in industrialized countries had the greatest impact. A strong upward trend in the annual volume of the Yugoslav external debt obligations, accompanied by a growing reluctance by the international banking community to provide fresh money to this ever more risky country, resulted in the eruption of the external debt crisis. In 1982, the Yugoslav Government, like governments of some other major debtors among developing countries, faced a severe foreign exchange crisis and had to request the first restructuring of its external debt obligations. In that year also Yugoslavia completely lost its access to international financial markets. The only fresh money that the country succeeded in raising from the banking community in subsequent years was the so-called involuntary lending arranged as an integral part of the restructuring agreements.

5. Since the early 1980s, when Yugoslavia had encountered serious debt-servicing problems, until its dissolution in 1991, the country had taken an almost continuous set of programs with multilateral financial institutions, especially with the International Monetary Fund (IMF) and other groups of foreign creditors. On the basis of arrangements with the IMF, Yugoslavia concluded a number of restructuring agreements (the first in 1983 and the last in 1988) with bilateral creditors (the Paris Club) and with commercial banks (the London Club).

6. Although the conditions under which Yugoslavia signed restructuring agreements were similar to those achieved by other debtor countries, two specific conditions that were accepted during the 1983 negotiations have had and continue to have a major influence on newly independent states' efforts to normalize their relationship with foreign creditors. The first was the creditors' request for the Yugoslav Government to provide a guarantee for servicing not only restructured public and publicly guaranteed debt but also restructured private debt, which was until then not covered by a sovereign guarantee. The second condition accepted in the 1983 restructuring negotiations with foreign commercial banks referred to the so-called "joint and several liability clause", which means that each of the debtors under the contract is liable for the total amount of the debt incurred there under.

7. By stabilization programs carried out as a result of arrangements with the IMF, Yugoslavia succeeded in turning the current account deficit into a surplus in order to service its external debt obligations regularly. But progress made towards external balance was accompanied by a growing internal instability, characterized by curtailed economic growth, unchanged economic systems, accelerated inflation, and widespread microeconomic imbalances (especially in the banking and enterprise sector).

8. Owing to the increased current account surplus and the complete denial of access to financial resources from the international financial markets, the level of Yugoslav external debt did not increase further after 1983. On the contrary, in the last few years of Yugoslavia's existence, it decreased to some US\$15.3 billion mainly as a result of market-based debt conversion transactions in the secondary market.

B. Internal Division of External Debt

9. Because Yugoslavia was constitutionally defined as a federal republic with important fiscal and financial autonomy for the constituent republics, the external debt was internally divided into so-called federal or nonallocated debt (US\$3.1 billion as of end of 1991) and debt allocated to republics (US\$12.2 billion). Nonallocated debt was the debt incurred for use by the federation and consisted mainly of bilateral and commercial credits to the federation; part of the obligations toward bilateral creditors not assigned to projects in the republics or autonomous provinces; and National Bank of Yugoslavia (NBY) obligations under the New Financing Agreement (NFA^{3/}) with commercial banks. In addition, use of IMF credit amounted some US\$683 million. Allocated debt incurred by entities from the republics and autonomous provinces (including all IBRD loans except for SAL I^{4/}); bilateral credits to final beneficiaries from republics and autonomous provinces; and commercial bank credits to enterprises or other entities from republics and autonomous provinces via their commercial banks licensed for external credit relations (obligors under NFA). The division between nonallocated and allocated debt was important because of the linkage to the "payments scheme". Under this scheme funds were provided to service the allocated debt of final beneficiaries from republics and autonomous

^{3/} The New Financing Agreement was signed in 1988 between 10 Yugoslav commercial banks (from each of the six republics and two autonomous provinces) and the National Bank of Yugoslavia as debtors and a syndicate of commercial banks as creditors. SFRY provided a guarantee for this contract. According to this contract, US\$7.3 billion of commercial bank debt was refinanced. By end-January 1991, this amount was reduced to some US\$4.2 billion mainly as a result of debt conversions.

^{4/} SAL I was later divided into the part assigned to two final beneficiaries in Slovenia and to the commercial bank from Serbia/Montenegro which acted in 1983 as agent-borrower.

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provinces that lacked sufficient convertible exports.^{5/} Table 1 provides estimated long-term debt distribution as of end-1991 as reported by central banks of the new republics and information provided by the former federation institutions.

Table 1: Use of IMF Credit and Estimated Long-Term Debt by the Republics and Creditors
(\$US millions, end-1991)

	USE OF IMF CREDIT	TOTAL LONG - TERM DEBT	Public and Publicly Guaranteed				Private Non - Guarant. Long- Term Debt and Others
			Official Creditors			Commerc. Banks NFA	
			Multilateral		Bilateral		
			World Bank	Others			
Bosnia and Herz.		1,925	450	100	415	643	317
Croatia		2,164	169	130	660	880	325
Macedonia		850	157	78	210	195	210
Slovenia		1,765	147	378	358	466	408
Serbia and Montenegro*		5,501	1,212	272	1,509	1,142	1,366
ALLOCATED		12,205	2,135	958	3,152	3,200	2,760
NON-ALLOC.	683	3,100	--	--	1,000	1,000	1,100
TOTAL	683	15,305	2,135	958	4,152	4,300	3,860

Sources: World Debt Tables, National Bank of Yugoslavia, National Bank of Bosnia and Herzegovina, National Bank of Croatia, National Bank of Macedonia, Bank of Slovenia.

* Includes estimated debt of Republic of Serbia, Republic of Montenegro and Autonomous Province of Vojvodina and Autonomous Province of Kosovo.

^{5/} So-called solidarity circles for the collection of funds were established. The first circle included the debtor and his bank, the second all obligors (commercial banks) from the debtor republic, and the third all obligors under NFA and the Federal Government as the final guarantor. This scheme was financed by republics financing the federal budget and original revenues such as customs duties from the federal budget. The foreign exchange needed was provided by obligatory surrender of foreign exchange earnings by all exporters.

III. Principles for Debt Apportionment

10. By end-1991 the former Yugoslavia was de facto dead as war escalated. It also ceased to exist de jure as its constituent republics became politically and economically independent, first: Slovenia and Croatia, then Macedonia, followed in the spring of 1992 by political independence of Bosnia and Herzegovina. Serbia and Montenegro opted to join into one country, the so-called Federal Republic of Yugoslavia (FRY).

11. Although the former Yugoslavia ceased to exist, its external debt (and assets) remained. As the process of economic independence began, so did the apportioning of the debt. Slovenia, Croatia, Macedonia, and Bosnia and Herzegovina adopted either constitutional laws or government commitments to start discussions on this apportionment. The individual proposals of new countries (except Serbia/Montenegro) were in substance similar to the proposal embodied in the Constitutional Law of the Republic of Slovenia, which promulgated that for allocated debt the Republic would, on the basis of an agreement on the legal succession of the Socialistic Federal Republic of Yugoslavia (SFRY), take over both the portion of the SFRY national debt that referred to the Republic of Slovenia as well as the portion of the SFRY-guaranteed debtor obligations whose beneficiaries were legal entities based on the territory of the Republic of Slovenia. With respect to nonallocated debt, the Constitutional Law stipulated that the Republic of Slovenia would take over the corresponding part of the SFRY national debt whose immediate beneficiary was not determined.

12. In order to apportion the debt as the first step in normalizing external financial relations, two sets of issues were to be resolved. The first concerned the successors to the former Yugoslavia: one sole successor or five successor republics (i.e., the succession principle). The second concerned how to apportion the nonallocated debt (i.e., the debt apportionment principle).

A. Succession Principle

13. Establishing this principle was politically difficult and extremely contentious. Under international law, when the territory of a predecessor state is divided and gives rise to new and different states, two general positions can be taken by the international community. The first is to accept the continuation of the state, with secession of some of its territories, and the second is to accept the dissolution of the state. Each position has very different implications for apportionment of the predecessor state's external debt.

14. Four of the new countries of the former Yugoslavia claimed succession rights. Following long political debates, the international community fully accepted that there are five successor countries to the former Yugoslavia. The legal basis for establishing a succession principle for the former Yugoslavia was provided by the work of the UN and the EU-sponsored International Conference on Former Yugoslavia (ICFY) through its special arbitrage commission (the Badinter Commission, known after its president), which issues legal opinions on the questions raised by co-presidents of the Conference.

15. According to the Badinter Commission Opinion No.1 (November 19, 1991) the former Yugoslavia was in the process of falling apart. Opinion No. 8 (July 4, 1992) stated that the former Yugoslavia had ceased to exist and opinion No. 10 (July 4, 1992) that Serbia/Montenegro (the so-called Federal Republic of Yugoslavia) was not the only successor to the former Yugoslavia. In summary those opinions established that Yugoslavia no longer existed and that there were five successor republics, namely, the Republic of Bosnia and Herzegovina, the Republic of Croatia, the (former Yugoslav) Republic of Macedonia, the Republic of Slovenia, and the Federal Republic of Yugoslavia (Serbia/Montenegro).

16. These opinions have never been accepted by the delegation of the Federal Republic of Yugoslavia participating in the ongoing discussions within the framework of the ICFY Succession Group. The delegation continues to deny the legal fact that the former Yugoslavia has ceased to exist and that the Federal Republic of Yugoslavia (Serbia/Montenegro) is only one of several successor states. Moreover, the conflicting views of the delegations from Bosnia and Herzegovina, Croatia, Macedonia and Slovenia on the one hand and the delegation of Serbia/Montenegro on the other have completely blocked the work of the Succession Group. This group was established with the objective of defining the principles concerning succession issues, including the division of assets and liabilities of the former Yugoslavia.

17. The fact that the former Yugoslavia has ceased to exist was confirmed within other international organizations. In particular the UN Security Council, adopted two important resolutions in connection with the succession to the former Yugoslavia. According to Resolution No. 757 of May 20, 1992, the Security Council concluded that the continuity of Serbia/Montenegro (the so-called Federal Republic of Yugoslavia) in the UN as the sole successor of the former Yugoslavia is not generally recognized. At the same time it adopted economic sanctions against Serbia/Montenegro because of its involvement in the war in Bosnia and Herzegovina. According to Resolution No. 777 of September 19, 1992, the Security Council concluded that the former Yugoslavia had ceased to exist and proposed that the so-called Federal Republic of Yugoslavia should request the General Assembly for membership. The General Assembly adopted this proposal by Resolution No. 47/1.

B. Debt Apportionment Principles

18. The framework for defining the apportionment principles for the internally allocated debt and for nonallocated debt was provided by decisions and agreements reached between the IMF and the World Bank and the successor states.

19. For the apportionment principle of the *nonallocated* debt a decision of the IMF Board provided a precedent by establishing *a formula* based on the economic power of the successor republics by which assets and liabilities of the former Yugoslavia to the Fund were distributed among five successor republics. On December 14, 1992, the Executive Board of the International Monetary Fund decided that "the Socialist Federal Republic of Yugoslavia has ceased to exist and has therefore ceased to be a member of the Fund." The Fund decision also established a mechanism under which, once certain conditions^{6/} have been met, each successor republic may succeed to the membership of the former Yugoslavia in the Fund.

20. According to the above-mentioned formula, the shares of the quota (of some US\$600 million) in the IMF and of liabilities to the IMF (also some US\$600 million) were as follows: Bosnia and Herzegovina-13.20%; Croatia-28.49%, Macedonia-5.40%, Slovenia-16.39%; and Serbia/Montenegro-36.52%. This formula was accepted by all successor republics within one month, i.e., by January 14, 1993, and was later applied for the actual succession of Slovenia, Croatia and Macedonia to membership in the IMF. The validity of the IMF offer for the membership of Bosnia and Herzegovina and Serbia/Montenegro was recently prolonged.

21. By the above formula, the first part (debt with IMF) of the nonallocated debt of the former Yugoslavia was apportioned, and the IMF formula was the precedent proposed for the apportionment of the nonallocated debt with other creditors. For example, it was used for the principal agreements reached by Slovenia, Croatia and Macedonia with the Paris Club on the

^{6/} The conditions to be met were defined as follows: (a) the successor republic has notified the Fund within one month of the decision (i.e., January 14, 1993) that it agrees to its share of assets and liabilities of the SFRY to the Fund as determined by the Fund; (b) it has notified the Fund within six months (i.e., June 14, 1993) that it agrees, in accordance with its laws, to succeed to the membership of SFRY in accordance with the decision of the Fund; (c) it has been found by the Fund to be able to meet its obligations under the Fund's Articles of Agreement; and (d) it has no overdue financial obligations towards the Fund or in the Special Drawing Rights Account.

apportionment of nonallocated debt. It was also proposed by Slovenia in its relations with the International Coordinating Committee (ICC). The creditor banks have, however, refused the division of their claims under the NFA (New Financing Agreement) on their allocated and nonallocated part, referring to the joint and several liability of all obligors under the contract.

22. The IMF formula was also applied for apportioning among the five successor republics the shares at the IBRD, IDA, IFC, and EBRD. It is also proposed by four successor republics to be used for apportioning of international reserves of the former Yugoslavia.

23. For the apportionment principle of the *allocated* debt, critical legal agreements and a decision of the World Bank Board provided a precedent by establishing a principle of *final beneficiary* by which IBRD loans were apportioned among successor republics. By this the internal division of Yugoslav allocated debt was confirmed. The whole process started in February 1992 when the Bank entered into agreements on an interim basis with the SFRY (then consisting of the Republics of Serbia, Montenegro, Bosnia and Herzegovina and Macedonia), the Republic of Slovenia and the Republic of Croatia for the service of debt due on the Bank loans *directly benefiting each of them*, subject to the overall guarantee of the SFRY. A similar agreement was concluded in August 1992 with the former Yugoslav Republic of Macedonia.

24. Because of the interim nature of these agreements and because the membership of the SFRY was to terminate at the latest on March 14, 1993 (according to the Articles of Agreement of the Bank any member that ceases to be a member of the IMF shall automatically cease after three months to be a member of the Bank), the Bank sought to replace these agreements with the final ones. The Republics of Croatia, Macedonia and Slovenia have signed agreements confirming the interim agreements. The Federal Republic of Yugoslavia (Serbia and Montenegro) and the Republic of Bosnia and Herzegovina have indicated to the Bank their readiness to enter into such final agreements. On this basis, on February 25, 1993, the Bank's

Board of Executive Directors adopted resolutions terminating the membership of the SFRY in the Bank, IDA and IFC and providing that the republics that are the successors to the SFRY upon succession to membership in the IMF become members of the Bank upon fulfilling certain requirements.^{2/}

IV. Recent Developments and Current Status of the Relationship Between Successor States and Foreign Creditors

25. Following the adoption of succession and apportionment principles, the successor republics began the process of succession to membership in IFIs and towards normalizing relations with other groups of creditors. Because of very different initial economic and political conditions, the successor republics are currently at quite different stages of normalizing their financial relations with creditors. Table 2 shows the status of these relations as of October 1995.

^{2/} Each successor republic shall succeed to the membership of the SFRY in the Bank as of February 25, 1993 provided (a) it has formally accepted the Articles of Agreement and the terms and conditions of succession (shares were distributed according to IMF quota); (b) it has made payments in its currency with respect to the shares of the Bank's capital. In addition, it has to enter into a final agreement with the Bank on the loans made by the Bank to or with the guarantee of the former Yugoslavia which that particular republic assumed and eliminate or agree on a plan to eliminate arrears, if any, in servicing of any Bank loan.

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Table 2: Status of Successor Republics and Creditors, October 1995 ^{8/}

Creditor Country	International Monetary Fund	The World Bank Group	Bilateral Creditors	Commercial Banks
REPUBLIC OF SLOVENIA	Membership achieved.	Membership achieved.	Agreement on principles reached after Slovenia's taking over of whole allocated debt and a share of nonallocated debt according to IMF formula. Follow-up negotiations with individual member countries under way.	Agreement in principle reached after Slovenia's taking over 18% of total NFA debt.
REPUBLIC OF CROATIA	Membership achieved.	Membership achieved.	Agreement on principles reached after Croatia's taking over of whole allocated debt and a share of nonallocated debt according to IMF formula.	No agreement yet.
FORMER YUGOSLAV REPUBLIC OF MACEDONIA	Membership achieved	Membership achieved.	Agreement on principles reached.	No agreement yet.
REPUBLIC OF BOSNIA AND HERZEGOVINA	Membership offered.	Membership offered.	No agreement yet.	No agreement yet.
FEDERAL REPUBLIC OF YUGOSLAVIA	Membership offered.	Membership offered.	No agreement yet.	No agreement yet.

^{8/} Since October 1995 not much has changed except for the achieved membership of Bosnia and Herzegovina in the IMF and World Bank, which goes beyond the scope of this paper.

A. Republic of Slovenia

26. The Republic of Slovenia was the first successor republic that reached political independence, June 1991, and economic independence, in October 1991, when it introduced its own currency. The richest and the least indebted republic with strong exports and supported by a substantially improved external financial position, Slovenia has regularly serviced its obligations on allocated debt. These commitments were based on the Slovenian Government's decisions from the middle of 1992 that Slovenia (a) will take over its whole allocated debt; (b) will take over an agreed, or determined by arbitration, share of nonallocated debt of the former Yugoslavia which has to correspond with the distribution of assets of that country; (c) will do its utmost to ensure that as large a part as possible of the former Yugoslavia's debt will be allocated to individual republics and that, consequently, the volume of nonallocated debt will be as small as possible; (d) does not request new rescheduling of its obligations vis-a-vis foreign creditors and is ready to honor these obligations agreed in previous agreements between the Paris Club and commercial banks on the one hand and the former Yugoslavia on the other; and (e) reserves the right to negotiate equivalent conditions with other successor republics for servicing its portion of nonallocated debt.

27. *Membership in IMF and World Bank Achieved.* Slovenia succeeded to membership in the IMF and the World Bank Group in early 1993 without major problems, and it received its first support from the IBRD through the EFSAL project in the middle of 1993.

28. *Paris Club Negotiations to Be Formalized.* Immediately following IMF membership Slovenia initiated the process of formal regularization of its relationship with Paris Club members. The process consists of both establishing guidelines and negotiations. By June 1993, the first phase was finalized with the following basic agreement: (a) the terms and conditions of the existing bilateral agreements will remain unchanged; (b) bilateral agreements will include

allocated debt (identified final beneficiaries) and 16.39% of the nonallocated debt (IMF formula); (c) Slovenia will take over those debts of Slovenian entities vis-à-vis the Paris Club that have been, by Yugoslav legislation and without the consent of foreign creditors, transferred to the NBY; and (d) in a reasonable period of time, Slovenia will repay all principal arrears on its Paris Club debt (arrears were from the Slovenian pre-independence period when a part of obligations were transferred at the federal level). The second phase-negotiations-with individual Paris Club members started in autumn 1993 and had been completed with most of the countries by the middle of 1995. The procedure for ratification of bilateral agreements by the Slovenian Parliament is currently under way and is expected to be completed in the coming months.

29. *Agreement in Principle with Commercial Banks Reached.* In June 1993, i.e., after reaching agreement on basic guidelines with the Paris Club, Slovenia proposed to the ICC a new separate agreement that would be based on the same principle as used in negotiations with other groups of foreign creditors, i.e., IFIs and bilateral partners. Under this proposal Slovenian obligors would assume some US\$510 million of obligation under the NFA. This amount included some US\$410 million for debt of Slovenian entities as allocated internally plus some US\$170 million as 16.39% of the Yugoslav nonallocated debt with NBY as the obligor minus some US\$70 million of NFA debt purchased (but not extinguished in the NFA agent banks) on the secondary market by Slovenian entities. In addition, Slovenia also expressed its willingness to assume responsibility for some US\$30 million under the second agreement with the ICC in 1988, the so-called Trade and Deposit Facility (TDFA).

30. ICC rejected this proposal, referring to the clause of joint and several liability and shared responsibility of all obligors. An ICC counterproposal suggested that Slovenia assume a much higher amount of US\$1.2 billion, more than double what Slovenia had offered. By some estimates this amount represented the current market value of "former Yugoslavia" debt.

31. In the second half of 1993 several meetings were held with ICC and with individual banks represented in the ICC, but a mutually acceptable solution has not been found. The major issue of disagreement at that point was the amount of debt under NFA to be assumed by the Slovenian obligors. Because of this and as the grace period under NFA expired in December 1993, the Government of the Republic of Slovenia decided to change the modality of servicing its obligations to ICC as of January 1994. Instead of paying directly to ICC's agent, Chemical Bank, payments are made, until final agreement is concluded with the ICC, to the fiduciary account opened by the Bank of Slovenia with the Dresdner Bank Luxembourg SA. To this account the following payments are made: (i) principal and interest due under the Slovenian allocated debt (NFA); (ii) 16.39% of interest due under the nonallocated debt (NBY portion of NFA debt); and (iii) amounts on deposit with Ljubljanska Banka Ltd. (TDFA). The main objective of this decision was not to hamper the negotiations with the ICC but to speed up the dialogue with this group of foreign creditors in order to reach an acceptable solution for both sides.

32. During 1994 and the first half of 1995, negotiations continued on two most contentious issues: the amount of the debt to be assumed and the treatment of debt held by Serbian controlled entities--so-called connected persons. Based on the contractual provisions that former Yugoslavian debt to ICC cannot be treated as two categories of allocated and nonallocated, ICC continued to insist that Slovenia take over a certain percentage of the overall NFA debt and that this percentage be significantly above the 16.39% determined by the IMF. Another issue that has complicated negotiations is the fact that, based upon transactions on the secondary market, the London Club now consists also of the so-called connected persons (i.e., entities from Serbia and Montenegro as well as entities holding NFA credits on their behalf or for their benefit). As at least one part of the NFA debts bought by "connected persons" on the secondary market was financed from former Yugoslavia's foreign exchange reserves, Slovenia has strongly requested that these "persons" be excluded from the final agreement with the London Club.

33. After two years of negotiations, an agreement in principle between Slovenia and the ICC was reached in June 1995. Under this agreement, Slovenia agreed to take over 18 percent of the total obligations under the NFA (principal-matured and unmatured as well as interest arrears on this portion of the debt) and to exchange this portion of the NFA loans for its own bonds. The bonds will be amortized on the same basis as the credits under the NFA (repayment period ends in 2006) and will bear the same interest rate as the credits under the existing contract (LIBOR plus 13/16%). The exchange will be made with all the creditors under the NFA except with those which have been determined to be "connected persons".

34. There are two conditions for the exchange to be implemented. First, creditors holding at least two-thirds of the outstanding NFA debts have to agree with the agreement in principle and to consent to the release of the Slovenian obligors from the NFA and, second, agreement in principle has to be ratified by the Slovenian Parliament. If both conditions are met, the whole procedure for the exchange will be completed in the first months of 1996.

B. Republic of Croatia

35. The Republic of Croatia reached political independence together with Slovenia in June 1991 and economic independence in December 1991. As the second richest republic Croatia would in principle have no major problems with debt servicing if it were not for the war escalating on its territory. The war has resulted in one quarter of its territory being occupied and has negatively affected its economy, especially export-oriented sectors and territory. Nevertheless, the Government is committed to negotiations with IFIs and to normalizing financial relations with bilateral donors and commercial banks. Croatia's initial position was based on the same principles as those of Slovenia in regard to the apportionment of allocated and nonallocated debt.

36. *Membership in IMF and World Bank Achieved.* Croatia succeeded to membership in the IMF and the World Bank Group without major problems in early 1993. It received the first support from the IBRD through an Emergency Reconstruction Project in the middle of 1994 and is about to receive support in the form of an EFSAL project.

37. *Difficult Paris Club Negotiations Finalized.* In parallel with membership in IFIs and as a precondition to achieving a stand-by arrangement with the IMF - a precondition for EFSAL - Croatia initiated the process of formal regularization of its relationship with Paris Club members. Because of the war, Croatia -- in addition to the principles agreed under the membership process in IFIs -- also proposed to the Paris Club a debt reduction and a six years' grace period. These proposals were based on the estimates of war damages, but Croatia's overall economic and external positions were assessed as ineligible for debt reduction. The Paris Club therefore negatively responded to the request for debt reduction, and follow-up discussions that took place in February 1995, Croatia made it clear that it was no longer requesting debt reduction and that it was also ready to relinquish its initial position that it would service only a "symbolic amount" of its share of nonallocated debt (pending resolution of the former Yugoslavia's assets question). Negotiations continued and were successfully finalized in March 1995. Croatia and the Paris Club agreed on a standard rescheduling of the debt for reasonably well-off countries (over 10 years with a 5 year grace period), with arrears of US\$100 million to be repaid in 10 semi-annual installments beginning in 1996..

38. *Potentially Difficult Negotiations with Commercial Banks.* In regard to the negotiations with ICC, Croatia seems to be ready to assume some US\$1.2 billion of obligations under NFA. This amount includes some US\$880 million for debt of Croatian entities as allocated internally in Yugoslavia and some US\$285 million as 28.49% of the Yugoslav nonallocated debt with NBY as the obligor. It is expected that, as in the case of Slovenia, ICC will reject such a proposal, referring again to the joint and several liability clause, and that it will demand that Croatia take

over almost 30% of the overall NFA debt. Actual negotiations are not expected to take place before the agreement in principle reached between Slovenia and ICC is actually implemented.

C. Republic of Macedonia

39. The Republic of Macedonia reached political independence in the fall of 1991, but did not take decisive steps toward economic independence until April 1992. In the first agreement between the World Bank and so-called (Socialist) Federal Republic of Yugoslavia which took place in February 1992, Macedonia's obligations with the Bank were also included. Macedonia, as the poorest of the six republics, faced by lost internal markets and the negative effects of UN economic sanctions, and with almost no foreign exchange reserves, fell into substantial arrears on its debt of some US\$850 million. Arrears appeared in relation to all of its creditors except the IMF and reached almost US\$300 million at the end of 1993, of which US\$107 million was to the IBRD. Once the country became a UN member in the spring of 1993, the Government focused attention on economic issues, including normalizing external financial relations. The Government is committed to normalizing financial relations with all creditors and has a similar position in regard to apportionment of the allocated and nonallocated debt as do Slovenia and Croatia. However, as Macedonia had been declared IDA eligible, it hoped for favorable terms of debt rescheduling with the Paris Club and with commercial banks.

40. *Membership in IMF Achieved Smoothly; For Membership in World Bank -- Plan for Arrears Clearance Prepared.* Macedonia, following admission to the UN, achieved membership in the IMF without any problems. Before it was able to borrow from the IMF, it had to solve the substantial problem of arrears with the IBRD. During 1993 Macedonia underwent the difficult process of agreeing a program with the IMF under the systemic transformation facility (STF) and of normalizing financial relations with the World Bank. This process was linked with the preparation of the first Economic Recovery Loan/Credit (ERL/C) in support of the Government's initial stabilization and structural reform measures. With the assistance of the Support Group, spearheaded by the Netherlands Government, and with the financial support from Mr. George Soros, the funds were assured and Macedonia was able to present to the Bank a financing plan for clearance of arrears. On this basis the Bank's Executive Board declared that the former Yugoslav Republic of Macedonia became a member of the Bank, IDA and IFC on December 30, 1993 (effective February 25, 1993) upon fulfillment of the requirements of succession approved by the Executive Directors, including an agreement with the Bank on a plan to clear Macedonia's arrears to the Bank. On February 8, 1994 the World Bank Board approved ERL/C, and on February 14, 1994, actual arrears clearance took place, followed immediately by ERL/C signing, effectiveness and first disbursement. During 1994 the process of normalizing financial relations with IFIs continued by agreeing on the second tranche of the STF and on a follow-up program with the IMF and preparation of the second credit from IDA resources-Financial Enterprise Structural Adjustment Credit (FESAC).

41. *Paris Club Negotiations Finalized.* When Macedonia achieved membership in the IMF and the World Bank, it began the process of normalizing relations with the Paris Club. It based its initial position in regard to the allocated and nonallocated debt on the same positions as had Slovenia and Croatia, but in addition it wanted to exclude from its debt part of the obligations under the 1989 economic program under which some of Macedonia's Paris Club obligations were transferred at the federal level. The Paris Club's position was that Macedonia first needed

to assure that it would service all of its originally allocated debt, including the debt that was transferred in 1989 at the federal level, as well as a 5.40% share (IMF formula) of nonallocated debt. After months of delay and only after the election victory in the fall of 1994 did the Government agree with the Paris Club position.

42. Negotiations continued and were successfully finalized in July 1995. Macedonia and the Paris Club agreed on a rescheduling of the pre cut-off debt for 15 years with a three year grace period, including interest arrears and payments due up to June 1996 (excluding penalty interest). For post-cut off debt arrears and obligations due up to June 1996 an agreement was reached for obligations to be paid in eight semi-annual installments starting from July 1998.

43. *Preparation for Negotiations with Commercial Banks.* Macedonia is just starting to prepare for negotiations with ICC. Given its economic situation, Macedonia is most likely not going to be saddled with the same type of request from ICC as were Croatia and Slovenia, although formally that would be possible. It is expected that Macedonia will be ready to assume its allocated debt (of some US\$300 million to ICC) as well as an eventual 5.40% share of nonallocated debt.

D. Republic of Bosnia and Herzegovina

44. The Republic of Bosnia and Herzegovina reached its political independence and international recognition in the spring of 1992. Once it was recognized as one of the successors of the former Yugoslavia and was recognized by EU countries and the United States, it became a UN member in May 1992. Because of the escalation of war, it was initially not able to gain economic independence. It issued its own currency in August 1992 and started to collect taxes. However, because of the war its economy collapsed to about 5-10% of pre-war levels.

45. With no foreign reserves, the Republic of Bosnia and Herzegovina fell into substantial arrears on its debt (of some US\$1.9 billion as of end-1991) in relation to all its creditors, including preferred creditors (arrears to the IMF and the IBRD are projected to reach US\$450 million as of end-December 1995). The Government is, however, committed to achieving membership in the IMF and World Bank and to normalizing financial relations with bilateral partners and commercial banks. In this context and within the framework of preparations for peace agreements and for postwar recovery of Bosnia and Herzegovina, a strategy was prepared for normalizing external financial relations.

46. The essence of the strategy^{2/} is that, based on an assessment of the entire external debt situation and economic prospects and the post-war reconstruction and recovery needs, the Government would need to design, jointly with the IMF, the World Bank, and other creditors and donors community, a medium-term balance of payments and external financing plan. Such a plan would help to provide resources for the post-war rehabilitation of the country and enable it to normalize its international financial relations while maintaining an acceptable level of imports and reserves. A plan to clear arrears with the preferred creditors (IMF and World Bank), which is the key to membership, would need to be developed as part of an overall macroeconomic and financing plan that includes debt reduction, debt rescheduling and new assistance from the international community. Because the behavior of each of the creditors and aid-donors is likely to be strongly influenced by the behavior of the other donors, a coordinated simultaneous approach to financial normalization and reconstruction financing is likely to have the best chances of success.

^{2/} Bosnia and Herzegovina, Economic Issues and Priorities, Discussion Paper, Central Europe Department of the World Bank, September 29, 1995, p. 8.

47. Membership in the IMF is a pre-requisite for World Bank membership and hinges upon, *inter alia*, the clearing of Republic of Bosnia and Herzegovina's arrears to the Fund and the Fund's determination that the country is able to meet its obligations as a Fund member. The most important conditions for World Bank membership are for Bosnia and Herzegovina to (a) assume its agreed share of the outstanding Bank loans to SFRY and (b) agree on a plan to eliminate arrears on these loans. The arrears clearance plan would need to be integrated within the medium-term financing plan. Any such overall financing plan is likely to require several elements, including, most importantly, significant debt relief on bilateral debt, with comparable treatment for commercial debt; donor contributions in the form of capital grants from bilateral donors, bridge financing to allow legal membership and, new and mostly concessional, financing from the IFIs and other sources.

E. So-called Federal Republic of Yugoslavia, i.e., Serbia/Montenegro

48. The so-called Federal Republic of Yugoslavia has not taken any decisive steps toward normalizing its relations with international creditors, i.e., first to clear arrears or attain membership in the IMF and the Bank. Contrary to previous agreements it has recently started to question the succession principle applied and has made political recognition of Croatia, the Republic of Bosnia and Herzegovina, and Macedonia conditional on their recognition of Serbia/Montenegro as the sole successor to the former Yugoslavia. This demand has already been openly refused by Slovenia, Croatia, Macedonia and Bosnia and Herzegovina.

V. Conclusions

49. On the basis of the three principles (i) five successor states, (ii) the IMF formula for nonallocated debt apportionment, and (iii) final beneficiary principle for allocated debt apportionment; significant progress has been made in distributing former Yugoslavia's debt among the successor countries and consequently in normalizing their financial relations with foreign creditors. There are, however, large differences between individual successor states.

50. Slovenia and Croatia, for example, have smoothly achieved membership in the IMF, World Bank, and EBRD. Slovenia needs now to ratify bilateral agreements with member states on the basis of the agreement on principles already reached with the Paris Club and to implement agreement in principle reached with commercial banks to get full access to international capital markets. Croatia on the other hand has only recently agreed on the principles of the Paris Club agreement but has yet to agree on issues of debt apportionment with commercial banks.

51. As far as Macedonia is concerned, it smoothly achieved membership in the IMF and EBRD and successfully put together a plan to clear arrears with the IBRD. On that basis it became a member of the World Bank Group and proceeded to clear arrears. Macedonia has also reached agreement in principle with the Paris Club, but has not yet started discussions with commercial banks with which it has substantial arrears.

52. Bosnia and Herzegovina only recently started preparation for the post-war recovery by initiating the process towards membership of the IMF and the World Bank Group. For this it will need to solve the problem of substantial arrears to the IMF and IBRD. It will also need to find a solution for arrears with the Paris Club, IFC and commercial banks and reach new agreements. Given the difficult economic situation, any overall financing plan that would enable

normalization of external financial relations would require several elements, including, most importantly, significant debt relief on bilateral debt with comparable treatment for commercial debt; donor contributions in the form of capital grants from bilateral donors: bridge financing to allow legal membership and new and mostly concessional financing from the IFIs and other sources.

53. Serbia/Montenegro has not taken any of the steps necessary to achieve membership in the IMF and World Bank Group or to solve arrears problems with the IMF, IBRD, Paris Club, IFC and commercial banks. Instead, it is questioning the principles applied, claiming that Serbia/Montenegro is the sole successor to the former Yugoslavia. In the context of Bosnia peace negotiations, Serbia/Montenegro started the process toward normalization of international financial relations, however, it seems that it would take much time.

