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YUGOSLAVIA

MR. McNAMARA'S VISIT TO YUGOSLAVIA

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Mr McNamara's Visit to Yugoslavia

Itinerary

Date and Time	Place	Meeting	Remarks
Oct. 11 (Sunday)	Arrival Belgrade		
" " 16.55	Airport		Statement at airport.
" " ~~17.05~~ 17.15	Departure to Government Villa		
" " ~~18.00~~ 19.00	Villa	Mr Smole	Courtesy visit (Mr Smole, the Minister of Finance and Governor IBRD, is Mr McNamara's official host) Biography 13
" " 19.30	Villa	Unofficial dinner	Mr and Mrs Smole attending
Monday, October 12	Belgrade		
08.00	Federal Executive Council Building	Mr Smole	
~~08.30~~ 8:45	- ditto -	Dr Jelic	Federal Secretary for Economy Biography 6
09.30	- " -	Dr Stajner	Director, Federal Institute of Planning; in charge of preparations for Five Year Plan 1971-75. Biography 14
~~10.00~~ 10:15	- " -	Mr Granfil	Member, Federal Executive Council; in charge of external economic relations. Biography 4
~~11.00~~ 11:15	- " -	Mr Miljanic	Member, Federal Executive Council, in charge of economic affairs. Biography 10
~~11.45~~ 12:00	- " -	Mr Ribicic	Prime Minister; meeting not certain, Mr Ribicic may be in New York at UN. Biography 12
~~12.30~~ 12:45	- " -	Mr Bojanic	President of Exec. Council Serbia Biography 2
~~13.00~~ 13:30	To be determined	Lunch	~~Mr Ribicic or~~ Mr Bojanic

Date and Time	Place	Meeting	Remarks
Monday, October 12			
15.00	Trade Union Headquarters	Pres of Central Council of Fed. of Trade Unions MR. DIZDAREVIC	Briefing on workers' self management. Annex 5a
16.00	Federal Chamber of Economy	Mr Kolak	President, Federal Chamber of Economy; voice of the business community in the planning process. Biography 7.
17.00	Headquarters Yugoslav Bank for Foreign Trade		Meeting with Bankers. Annex 5b
		Mr Lukic	President, Yugoslav Association of Banks; Director General, Belgrade United Bank.
		Mr Ivanovic	Secretary, Yugoslav Association of Banks
		Mr Linhart	General Manager, Yugoslav Bank for Foreign Trade.
		Mr Sebrek	General Manager, Privredna Bank Zagreb; former Director of Croatia office of Investment Bank.
		Mr Miljkovic	General Manager, Yugoslav Investment Bank.
	Separate	Mr Baum	General Manager, Export Credit Fund; former Assistant Secretary for Foreign Trade
		Mr Kavcic	General Manager, Kreditna Banka Ljubljana.
18.00	Headquarters National Bank	Dr Perisin	Governor National Bank of Yugoslavia. Biography 11
	Dinner free at villa.		
Tuesday, October 13	Belgrade, Novi Sad and Skoplje		
0715 ~~07.30~~ leave for DMB			
08.00	D.M.B. (21 May Factory)	Representatives Workers' Council and Management MR. BRKIC " DESPOTOVIC	Mr Rakovic (General Manager, Zastava Automobile Engerprise) to accompany Mr McNamara Annex 9a and b.
09.30	Departure by car to PIK-Beograad		

Rakovic Mgr Zastava

Date and Time	Place	Meeting	Remarks
Tuesday, October 13	0715 0800 DMB where Rep mgt - accom. by 0930 depart		
10.00	PIK Beograd	Mr Zecevich	Agro-industrial Enterprise Annex 8a
11.00	Departure by car to Novi Sad		
12.00	Novi Sad	Mr Bulatovic MR. FILIPOVIC	Tisa-Danube Canal Enterprise. Annex 8b
13.00	Novi Sad	Talks + Official Lunch	VP, EXEC. COUN. VOJVODINA Mr Marusic, President, Executive Council of Vojvodina. Biography 9
14.30	Novi Sad	Mr Sovol	Koproduct (Association of 27 meat exporting enterprises). Annex 8c
15.30	Novi Sad	Dr Savic	Director, Institute for Agricultural Research. Annex 8d
16.30	Departure by car to airport Belgrade		
18.00	Departure by air to ~~Skoplje~~ Ohrid		
~~19.15~~	~~Arrival Skoplje~~		
~~20.00~~	OHRID ~~Skoplje~~	Reception ~~Dinner~~	Dr Bogoev, President Macedonia Biography 1
Wednesday, October 14 - Skoplje, Sarajevo and Dubrovnik			
0730 ~~08.00~~	Begin Ohrid sightseeing ~~Skoplje~~	Urban Renewal Institute	Briefing on rebuilding of Skoplje after 1963 earthquake. Annex 10a
1830	Leave by plane for Skopje		
0930 ~~09.00~~	Tour of Skoplje urban renewal		
10:30 ~~10.00~~	Departure by air to Sarajevo		
11.30	Arrival Sarajevo		
12.00	~~Tour of Sarajevo~~		Sarajevo has a very interesting historic Turkish section.
~~13.30~~	Sarajevo	Talks - Official Lunch + short tour	Mr Kosovac, President, Bosnia-Hercegovina. Biography 8
~~15.00~~	~~Sarajevo~~	~~Mr Kosovac & members of BH Executive Council~~	Discussion on problems of BH, one of the under-developed republics

Date and Time	Place	Meeting	Remarks
~~13:00~~ ~~16.00~~ 15:30	Sarajevo	Industrial-ists	Mr Blum, General Manager, Ernergoinvest. Annex 9c.
	8:30		Mr Tomic, General Manager, Skoplje Steelworks. Annex 9d.
	9:30		
	11:00		Mr Maglajlic, General Manager, Banja Luka Paper Plant. Annex 9e.
	Lunch - Villa		
	3:30 City		Mr Makic, General Manager, Investment Bank Sarajevo.
	4:00 3 or 4 industries		
	5 to 8 reception		
17.30 free	Departure by air to Dubrovnik Accommodation in hotel; free dinner.		

Thursday, October 15 - Dubrovnik and Zagreb

Date and Time	Place	Meeting	Remarks
08.00	Dubrovnik	UNDP Team Mr Lujak MR GEIL met ? A.S. BAM UNDP Rep.	Briefing on South Adriatic Development Program and Babin Kuk Project. Annex 10 b and c.
09.30	Tour of Dubrovnik		
10.30	Departure by car for Hercegnovi (drive along Adriatic Highway, financed by Bank)		
11.15	Arrival Hercegnovi		Discussion with Dr Bulajic, President Montenegro. Biography 2
13:30 ~~12.00~~	~~Departure by car to~~ Leave airport Dubrovnik lunch on plane		
14.30	Arrival Zagreb		
15.00	Zagreb	Mr Haramija	President Croatia Biography 5.
	?	Mr Rajkovic	Director of Planning ?
16.30	Zagreb	Industrial-ists	Mr Markovic, General Manager, Rade Koncar. Annex 9f
			Mr Pavlisko, General Manager, Ingra. Annex 9g.
			Mr Bubanj, General Manager, INA. Annex 9h.
			Mr Marjanovic, General Manager, Jadran Brod. Annex 9i.
			Mr Gasparevic, President Republican Chamber of Economy.

Date and Time	Place	Meeting	Remarks
Thursday, October 15			
18.00	Zagreb	Dr Supek	Rector, Zagreb University (Philosopher, Sociologist, and Member Pugwash Group).
20.00	Zagreb	Official dinner	President of Croatia

Friday, October 16 - Belgrade

President Tito will receive Mr McNamara in his official residence on Friday. It could not yet be ascertained whether the President will wish to have the meeting in the morning or in the afternoon. An official luncheon or dinner will probably be given by President Tito. Biography 15.

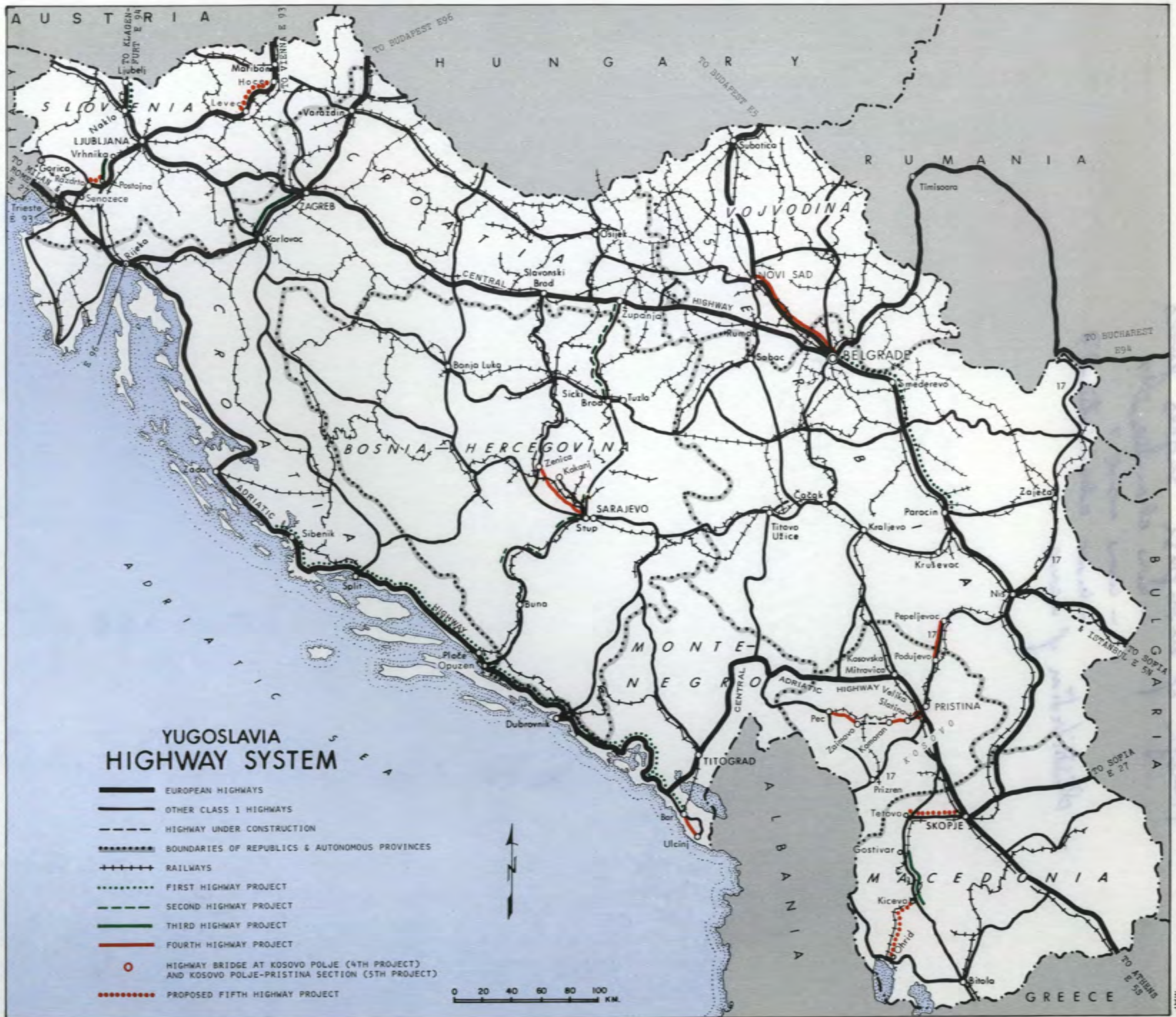
Timing of the remaining meetings in Belgrade can therefore only be fixed later:

	Mr Gligorov	Mr Gligorov	Member, Presidium League of Yugoslav Communists; formerly Member of Federal Executive Council in charge of Economic Affairs. Biography 3.
		Industrialists	Mr Jasic, General Manager, Electronska Industria. Annex 9j.
			Mr Brkovic, General Manager, Sevojno. Annex 9k.
			Mr Mucalov, General Manager, Energoprojekt. Annex 9l.
			Mr Visnjic, General Manager, General Export. Annex 9m.
1800 2000		Mr Smole - Final meeting Reception in the Federal Exec. Council Bldg.	

Saturday, October 17

09.30 Departure Belgrade airport

Editor Privredni Pregled - outspoken econ. weekly



SEPTEMBER 1970

IBRD-3165

McN - participatory management
- regional imbalance
- transfer of enterprise surplus funds
  - how channelled?
  - how used?
  - how administered?
- distribution of income

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YUGOSLAVIA

Briefing Paper for Mr McNamara's Visit
October 11-17, 1970

A. Political Background

Introduction

1. The most important single factor in understanding Yugoslav realities is the principle of decentralization, or, in Yugoslav terms, self-management. This principle implies a division of society into a vast number of social, political and economic units which are alone responsible for their management. Its adoption has been the essence of the change from the early postwar regime, characterized by a complete centralization of decision-making in the hands of the Federal Government, to a decentralized system of decision-making in which the Government often plays a surprisingly small role. In the economic field coordination by informal means, at which the Yugoslavs are masters, and decentralized institutions have replaced the binding central plan.

2. Though the process of decentralization started back in 1950 shortly after the break-away from the Komintern, it gathered momentum very slowly and it was only with the 1965 Economic Reform 1/ that self-management became fully operational. Some remnants of the old attitudes remain, for instance, in the inadequacies of the capital market and banking system, the weakness of financial analysis of projects by banks and enterprises, and the failure of a number of enterprises to make the full shift from the production-oriented to the market-oriented approach.

3. One of the most important forces behind the introduction of self-management, i.e. the decentralization of the political, social and economic life of the country, has been the strong nationalism of the constituent parts of Yugoslavia with roots in century-old cultural, religious and political differences. The peasant in Macedonia and Kosovo, with a per capita income of less than $200 and a Turkish/Islamic heritage is closer to the peasant of other Southern European or Middle Eastern countries than to his countryman in Slovenia or Northern Croatia who, for his part, shares a standard of living and cultural background with his Austrian or Northern Italian neighbours. These differences are so large and are still such an important influence in present day Yugoslavia that their roots have to be briefly described.

Historical Background

4. The division of the Roman Empire in 395 split the territory of Yugoslavia into two cultural zones. Slovenia and Croatia were oriented towards Western Europe and the Roman Catholic religion with all its social and cultural

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1/ See Section B, paragraph 2.

implications. The south-eastern regions became part of the Byzantine Empire and adopted the Orthodox religion. When the Byzantine Empire began to weaken around 1200, the first independent states emerged in the Yugoslav territory of Bosnia and Servia. Their rise, however, was halted by the Turkish penetration into the Balkans. The Ottoman Empire gradually expanded its influence and at the beginning of the 16th century the Yugoslav peoples found themselves again within the frontiers of two great monarchies - Turkey and Austria, with the geographic division being practically the same as a thousand years before. This increased the fundamental differences within the country. Slovenia and Northern Croatia, under Austrian rule, took part in the economic, social and cultural development of Western Europe. The other parts stagnated under Turkish rule.

5. With the weakening of the Turkish Empire parts of Yugoslavia acquired an increasing degree of independence, particularly Serbia and Montenegro. The State of Yugoslavia came into existence in 1918 as the result of the amalgamation of Serbia and Montenegro with certain provinces from the dismembered Austro-Hungarian and Turkish empires. The very name of the new state, "Kingdom of the Serbs, Croats, and Slovenes", points at the divisions that were caused by sharply divergent cultural traditions, religions and ethnic background. The events of the Second World War led to the emergence, for the first time, of a truly national feeling, but to this day the republican capitals of Slovenia and Croatia look with considerable suspicion towards Belgrade, the capital of Serbia and the Federation. Each of the six republics, and two Autonomous Provinces, which constitute present-day Yugoslavia, is determined to preserve its "national" heritage.

6. These deep-rooted differences were probably the main reason why the centralized system was discarded, since the adoption of the self-management principle provided a much greater possibility for regional autonomy. Of course, there were also other reasons. It was felt that economic growth could better be achieved by a more open market-oriented economy relying on the pressures of competition rather than by the autarchic centralized systems followed in the other Eastern European countries. There is, moreover, an element of ideology in the decision to decentralize. The principle of the "withering away of the State" is an important part of communist theory, and the Yugoslavs are proud to point out that they are the only communist country which has followed this course.

7. Political life in Yugoslavia is characterized by two principles: independence from foreign powers on the outside, and independence of republics, institutions and enterprises from central state interference domestically. The latter element is, of course, intimately linked to the idea of self-management. Neither of these two principles could obviously be fully realized in practice. Externally, however, Yugoslavia is fairly close to its ideal since, though a socialist state, it manages to keep its distance from the Eastern Bloc countries and is one of the driving forces behind the non-aligned nation movement. Internally, the result of the policy has been a large degree of regional autonomy through a transfer of Federal power to the Republics and, in some fields such as health and education, from the Republics to the Communes.

Unifying Factors

8. Two main elements seem to unite the country: the Communist Party (now called the League of Communists) and President Tito. The League tries to spread common ideas and policies at all levels but its influence on practical affairs appears to be greatest at the Communal level. Because of its obedience to central directives, it is one of the most cohesive forces in the nation. President Tito remains the strong man of Yugoslavia and has risen to a stature which, together with the legends beginning to form around him, puts him above political or regional strife. Though his participation in the daily affairs of state is small, general policies all have to obtain his approval. He is widely respected and his interventions in economic or political disputes are usually considered a final decision - and this seems to be fully accepted by the great majority of people. Though he was not the prime force behind the decisive move to self-management embodied in the Economic Reform of 1965, he was a steadfast supporter and carefully eliminated all Party opposition to it, including Rankovic, the leader of the conservative forces, in 1967.

Outlook

9. The role of the "League of Communists" has changed significantly over the years but more important has been the change in the form in which it operates. Its influence on Government and daily life has become smaller; and while substantial, is exercised primarily behind the scenes. It is no longer possible for people to hold simultaneously important positions in the League and in the Government but the fact that most Government officials are long time members of the League and have close personal contacts there enable the League to exert effective informal influence. A very beneficial aspect of Yugoslav political life is that no one normally can hold an important position in Government or political life for more than four years, and this rule has on the whole been strictly adhered to. In the last few years a new force has arisen, the managers of enterprises, who since the economic reforms, are less willing to sacrifice economic considerations to political interests and pressures.

10. A great number of the occasions for dispute between Republics were eliminated by the transfer of power from the Federation. The tendencies to secession inherent in regions with such different ethnic, cultural, historical, and economic characteristics have been effectively dampened by this transfer of power. The Czech crisis of August 1968 has also served as a strong reminder of the need for unity. It seems that no Republic is ready or even desirous to break away from the Federation for either short-term or long-term advantage. This, plus the unitary role of the Party and the low posture of the Federal Government, will probably guarantee that following Tito power struggle will not take place for the succession (presently 78). As a further guarantee against the latter, Tito has recently announced a proposal to hand over power to a presidium composed of regional representatives.

B. The Economy

1. Past Economic Performance - Since 1950, income per head in Yugoslavia has increased from about \$200 to over \$600 in constant prices. During the same period industrial output more than quintupled, going from \$700 million to \$3.6 billion (in 1969 prices). This remarkable record of economic growth (implying an average annual 7 percent real growth rate of GNP over 20 years) was accomplished against the background of a war-devastated economy and in the midst of a far-ranging structural evolution from a centrally administered, production-oriented system to a decentralized, market-oriented one.

2. The Economic Reform - Complex political objectives were partly responsible for the 1965 reform. However, it would seem clear that the Yugoslav authorities had also come to the conclusion that further fast economic growth could not be achieved within the existing framework of economic policies and institutions. The economic reform thus included measures designed to achieve three major objectives:

a) To give greater responsibility to enterprises for their production and investment decisions. This required increasing market influences and reducing the role of the Government in the allocation of resources. Enterprise taxes were reduced as was the role of state in investment (See annex on "The Yugoslav Enterprise").

b) To correct long-standing distortions in the pattern of output. This was accomplished through major price adjustments (especially for agricultural products and raw materials) and has abolished some price controls.

c) To integrate more closely the Yugoslav and the world economies especially with the industrialized western countries. This was done by a 40 percent devaluation of the dinar, by halving customs tariff rates, and by liberalizing imports and the foreign exchange regime.

Due to internal pressures, an additional objective was to increase the share of consumption through a lowering of the investment rate (which had stayed for a number of years at over 33 percent of GNP).

3. In addition to creating a market economy, and making enterprises responsible for profits, the decrease of the economic role of the state implied a much more central role for the banks. The banking system was re-organized in order to make them independent, and more responsible for the management of their funds (See annex on "The Banking System").

4. Opening to the West - The economic reform marked an important step in the slow process of opening the economy to greater Western influence. While Yugoslavia has remained non-aligned, politically, its economic relations

with COMECON countries have been decreasing in importance, and its links with Western economies, in particular the EEC, have strengthened. In March 1970, Yugoslavia signed the first trade agreement between the Common Market and a socialist country. Between 1965 and 1970, the share of Yugoslav trade with the convertible currency countries increased from about 40 percent to over 60 percent of the total. In industry, especially, technological and commercial cooperation with Western firms is more and more widespread.

5. Recent Performance - The immediate result of the economic reform and of the stabilization measures that accompanied it, was a recession which lasted through mid-1968. Internal political pressures for reflation then became strong and, since an export-led expansion did not materialize quickly enough, a boom was engineered through an expansion of domestic credit. Results were quick, and the overall growth rate in 1968 was 4 percent, mostly achieved in the second half of the year.

6. Although credit expansion was more moderate in 1969, the growth rate of exports picked up speed, and total internal demand began to exceed supply, creating inflationary pressures and an expanding resource gap. The 1969 growth rate of GNP was over 9 percent, and industrial production increased by 11 - 12 percent while export performance was very good (+ 17 percent) especially to the convertible currency area. However, imports increased by 19 percent, and the trade deficit grew to $660 million. At the same time, internal prices increased by over 8 percent.

7. For 1970, the Yugoslav authorities are forecasting an increase of 6 - 7 percent in the real product. With an industrial output growth of 9.5 percent in the first half of the year, and indications that this may decline somewhat in the second half, there is a good chance that the forecast will be realized. Although the pressure of demand has been eased somewhat (partly due to a decrease in the growth rate of exports) price increases have accelerated to an annual rate of over 10 percent, led by an increase in nominal incomes of about 17 percent.

8. Balance of Payments - The shortage of foreign exchange is one of the main constraints to fast economic growth in Yugoslavia. However, this shortage applies only to convertible currencies, since Yugoslavia has a large surplus in its bilateral balances. Deliberate steps have been taken in recent years to increase the competitiveness of Yugoslav exports in Western markets, particularly the EEC. As a result, convertible currency earnings have risen by about 17 percent a year between 1964 and 1969 - to a level of over $2 billion in the latter year.

9. Because of lower protection levels and heavy dependence on Western equipment and raw materials, imports in hard currencies increased even faster than exports. The increasing discrepancy between exports and imports, though compensated by a very fast growth of net earnings on services (mainly tourism, workers' remittances and transport), made necessary a net capital inflow large enough to create an external debt problem. To maintain its

creditworthiness, Yugoslavia has had to restrict somewhat its exchange and trade systems, and in the future may have to exercise even more control on the amount and terms of its foreign capital inflows.

10. Industry - Industrialization has played a leading role in the economic development of Yugoslavia, and this sector is now the most important one both in terms of production (32 percent of GDP) and exports (84 percent of exports of goods). Structural adjustments provoked by the measures of the Economic Reform slowed down growth considerably between 1965 and 1967, but are an important cause of the present resumption of fast growth (12 percent in 1969) and a sound basis for further expansion. This is seen in the increased competitiveness of industrial exports, which have grown twice as fast as output since 1965.

11. Fast growing branches include shipbuilding, chemicals, electric equipment, non-metal products, and pulp and paper, while traditional branches, such as coal mining, tobacco manufacturing, and textiles grow slowly, with decreasing employment. The recent re-organization has meant a fast rise in productivity (6 percent in 1969) and few new jobs: since 1966, industrial employment has hovered between 1.35 and 1.4 million - about 38 percent of employment in the social sector. While technological and marketing problems have often been solved by cooperation with foreign firms, the influence of the market has not been strong enough to prevent some misallocation of resources and the survival of a number of non-viable enterprises.

12. Agriculture - In terms of persons employed and share of GDP, agriculture is a declining sector. Growth during the sixties averaged 3 - 4 percent a year. However, with a labor force of slightly less than half of total active population, a total value added of close to $2 billion in 1969 (20 percent of GDP) and exports of over $250 million, agriculture still remains an important sector, especially since the main agricultural export - meat and cattle - will benefit markedly from the recent trade agreement with the EEC.

13. Over 80 percent of the available land is privately owned, but individual plots cannot exceed 10 hectares. The land within the socialized sector (2.5 million hectares), produces about 30 percent of total agricultural output and 45 percent of the marketed production. Most of the growth rate since 1960 has taken place in the social sector, even though the share of the social sector in total land area has increased only by 7 percent since 1960. Productivity in socialized agriculture is about twice that of private holdings due to much larger size of farms and mechanization.

14. The development of cooperatives and of contract farming seems to have been successful, and has at the same time prevented a larger percentage of the under-employed agricultural population to migrate to the cities. Further development would seem to lie in this kind of mixed farming, and in large socialized farms doing mainly agro-business and production for exports.

15. Population and employment - There is no overall population problem in Yugoslavia, where the birth rate has declined to less than 20 per thousand, and the net population growth rate is less than one percent per annum. There

is, however, a striking difference between regions: in Croatia (income per head: $725) the population growth rate is 6 per thousand, while it is 28 per thousand in Kosovo (income per head: $180). The state offers some family planning assistance mainly in the poor regions, through mobile clinics and propaganda.

16. Even though the population is not growing fast, the relative decline in agriculture has not been fully compensated by faster growth in the service and industrial sectors and unemployment has been increasing. The unemployment rate in the social sector is 8 - 9 percent, and the problem has been prevented from becoming more acute by the large amount of workers, mainly from the poor regions, who go and work abroad, especially in Germany. The present number of these migrant workers is estimated to be more than 600,000, compared with a total work force in the social sector of about 3.4 million. The size of this external work force is beginning to be viewed with disquiet due to the problems it would create if a large number of these workers had to be suddenly re-absorbed in the economy. A more important problem is that it is the skilled and educated workers that are being lost to the higher-wage Western countries, thus depriving internal industry of needed technicians.

17. The Planning Process - The present planning process is based more on conciliation and informal pressures than on coordinated decision making. The 1971-1975 Plan, which is about to be adopted, is merely indicative, and has no binding power on Republics, Communes, special funds, or individual enterprises. Though it is conceived of as a coordination instrument, in which concepts of growth and diverging strategies have to be publicly discussed and then coordinated, implementation of the plan rests mostly on individual enterprises. These, of course, are subject to pressure by their Communes, producers associations, consumer groups and political parties.

18. The objectives of Yugoslav economic policy for the next five years, as envisaged by the draft plan, are:

a) Fast economic growth. The authorities hope to increase per capita income from the present $600 to about $800.

b) Development of the less developed regions. This will mainly be accomplished by income transfers from the wealthy regions.

c) Closer relations with the world economy.

d) Increased efficiency of Yugoslav enterprises.

e) Convertibility of the Dinar.

19. Potential Growth Rate - There are two main constraints on the growth rate: the mobilization of domestic savings and the possible size of the resource gap i.e. the availability of foreign exchange. While before 1965 the Government was the main "saver" in the economy, its decreasing role since the

economic reform has not been fully replaced by personal or enterprise savings, and domestic savings probably fell as a percentage of domestic product. Fixed investment, as a proportion of social product, has remained at about 25 - 26 percent since 1966, but this is considerably below the pre-reform years. Though this performance is still very good by international standards, more would have to be done if the pressure on resources, created by the desired very high growth rate, is to be alleviated. The development of the banking system, incentives to savings accounts, the development of a stock exchange, and a bond market, together with changes in the taxation system (e.g. in depreciation allowances and taxation of profit) would help increase the level of domestic savings.

In addition to the savings problem, the gap between imports and exports will have to be closed faster if external debt is not to reach unmanageable proportions. External debt is now over $2.5 billion (including private debt) which corresponds to a debt service ratio of over 23 percent, and its structure is deteriorating due to the increasing prevalence of suppliers' credits. Gross foreign reserves ($400 million at the end of 1969) are equivalent to just over two months of imports, and they could not withstand for long large current account deficits. The fast increase in internal prices has had its normal effect on the unit prices of exports, and this unfavorable influence on the competitive situation of Yugoslav exports, especially in the convertible currency area, would have to be quicly arrested if a devaluation is to be avoided.

C. Relations with the Bank

General

1. With total Bank lending to date amounting to $476 million (including $98.5 million in FY 1970), Yugoslavia is the Bank's seventh largest borrower. Relations between Yugoslavia and the Bank have generally been excellent during the past years. The fact that the Bank is Yugoslavia's principal single source of long-term capital is certainly relevant in this respect. But there is no doubt that the Yugoslavs are also genuinely interested in benefiting from the Bank's expertise and experience. Most of the Bank's operations in Yugoslavia are therefore aimed at helping determine policies and, where necessary, achieve structural reforms in major sectors of the economy. Although this approach has met with some difficulties, it has on the whole been successful.

2. Apart from its contribution to Yugoslavia's economic development through its lending program and related activities, the Bank could eventually play a role in helping Yugoslavia to obtain access to capital from other foreign sources. A first step in this direction has been made with the establishment of the International Investment Corporation for Yugoslavia. Recently the Yugoslavs have raised again the question whether the Bank could advise them on attracting capital from abroad by issuing bonds. A preliminary investigation of the possibilities on the European capital markets by Mr. Aldewereld last May led to the conclusion that the chances for a successful issue were slim in the present conditions. Perhaps in a few years, when the situation might have returned to normal, a Yugoslav issue could be contemplated. In that case, the Bank would be prepared to assist Yugoslavia.

Lending Operations

3. The major objectives of the Bank's lending program are:

(a) to alleviate Yugoslavia's shortage of convertible foreign exchange, which is a major constraint to economic growth, by providing a significant portion of the required inflow of external capital and helping to increase export earnings;

(b) to accelerate development in the lesser developed regions of the country;

(c) to promote structural reforms in major sectors of the economy, primarily through better coordination of development efforts.

4. Transport, industry and tourism are the sectors of principal concentration in the lending program because of their crucial importance to future economic growth and their need for assistance beyond the mere providing of finance. In addition, they are the main sources of foreign currency earnings.

Roads

5. The Bank has so far lent $115 million for four road projects and a fifth is being appraised now. (See Map.) The first two projects consisted of the construction of the main East-West transportation axes (Central and Adriatic Highways) and the link between them. The other loans were the first two tranches of a large highway investment program that the Government submitted for Bank financing in October 1968. The proposed Fifth Highway Project will complete this program.

6. The decentralization of the highway administration (a result of the 1965 Economic Reform) in October 1967 transferred virtually all responsibilities with respect to the expansion and maintenance of the highway network from the Federal Government to the Republics. This led, as could be expected, to a number of problems in the field of planning, policy coordination and allocation of resources for investment and maintenance. When the Government submitted the highway investment program for financing, these problems became the subject of intensive consultation between the Bank and the various Yugoslav authorities. In view of its sheer size, as well as the stageof preparation of the various sections, the program was split in three yearly tranches. During the appraisal and negotiation of the first tranche (Third Highway Project) an understanding was reached with the Yugoslavs on the need and measures for improvement in sectoral policies. The appraisal and negotiation of the Fourth Highway Project gave the Bank an opportunity to review the progress made, which proved to be substantial.

7. One of the most important results has been the creation of a mechanism whereby the various independent republic Road Funds now regularly meet to discuss common problems, to establish an agreed-upon consistent program of studies, and to review plans for the construction and improvement of interrepublic highways. During the past few months, the focus has been primarily on the coordination of the republic plans for highways in connection with the new 1971-75 National Plan. In addition, the Bank's insistence that decisions on highway construction and maintenance expenditure should be based on consistently applied economic criteria is already yielding results. Furthermore, project preparation by the Yugoslavs has progressed remarkably since 1968 and the quality of maintenance has improved to the point where it has reached fully adequate standards in three of the six Republics.

Railways

8. Three loans totaling $155 million have been made for railways. Two were for the construction of specific lines (Sarajevo-Ploce and Belgrade-Bar) and the third to assist in the financing of a modernization program of the main lines and marshalling yards.

9. The modernization program (Loan 395 YU of December 1964) has run into major difficulties. The major part of the work started considerably later than expected because of delays in engineering, preparation of tender documents and bidding. The latter was largely due to the devaluation in July 1965. In addition, the transfer of financial responsibilities from the Federal Government to the Republics (resulting from the

Economic Reform) led to severe shortages of funds as the Republics were reluctant to assume fully the heavy financial obligations to the railways previously carried by the Federal Government. This led to a further slowdown in the execution of the program. In November 1969, the Yugoslav authorities requested a postponement of the Closing Date of the loan from December 31, 1969 to March 31, 1973. The Bank then informed the Government that it could consider the postponement only if steps were taken (a) to ensure completion of the project by the new Closing Date, and (b) to prevent a recurrence of the shortages of funds which have plagued the railways since 1966.

10. After prolonged discussions, agreement was reached recently on a plan of action, which provides a sufficient basis for the solution of the railways' immediate and long-term financial problems. A variety of measures has been taken, of which the most important are: a freight rate increase by 9 per cent, new loans by local banks, rescheduling of domestic loans, phasing of the investment program, exemption from a number of taxes, a bond issue, and the recovery of past deficits through budgetary allocations by the Republics. In addition, a yearly review will be undertaken until 1973 of the railways' overall financial situation, and the Federal Government has undertaken to ensure that the railways will have at their disposal the funds required to cover their needs during each ensuing year.

Transport Sector Review Mission

11. Because of the Bank's heavy involvement in the transport sector, the need for a closer look at the sector as a whole has become apparent. Hence, a sector review mission has been organized. Originally scheduled for October 1970, when the necessary documents were to have been ready, the main mission has been postponed at least four months at the request of the Yugoslavs. Political and technical problems have prevented their being prepared. Certain elements of the review had already been started, but the comprehensive mission will have to await resolution of the Yugoslav's problems.

Industry

12. Apart from three loans made between 1949 and 1953 (totaling $60.7 milion), which were in part for industry, the Bank has made three loans since 1967 (amounting to $45 million) for specific industrial projects. The loans were so-called "packages," including respectively seven, ten, and three subprojects. All subprojects were appraised separately by the Bank, which imposed a heavy burden on the staff. Moreover, the relatively small size of the individual projects and their dispersion over several industrial sectors made it difficult to evaluate sectoral policies properly with the exception of the third loan for which a detailed analysis of the automobile sector was made.

13. During the past year the Bank has therefore discussed with the Yugoslavs the adoption of a twofold approach towards lending for industry: (a) a line-of-credit to a development bank for smaller industrial projects, and (b) direct loans for larger projects. The Yugoslav Investment Bank (YIB), which had been the channel for most Bank loans to Yugoslavia since

1961 without, however, preparing and appraising the projects, was evaluated as a development finance company by an appraisal mission in April. The mission concluded that YIB's appraisal techniques and standards were below the standards expected from DFCs and felt that even an extraordinary Bank effort on technical assistance and supervision might not lead to the necessary improvement of performance. There were further questions on the soundness of YIB's portfolio.

14. The Bank's position with respect to YIB caused considerable concern to both YIB and the Government. Early September discussions were held in Washington to find a solution which would still make a line-of-credit possible. Basically, the Bank has suggested two alternatives: the creation of a new institution or the establishment of a "special unit" attached to the Central Bank or the Federal Government. The first alternative was rejected outright by Yugoslavia and a compromise may be found in the form of the second alternative with a number of modifications. Full details on the discussions in Washington as well as an outline of the two alternatives are presented in Annex 7.

15. In the future, industry will most likely play the major role in Yugoslavia's economic development. If this sector is to occupy an important place in future Bank lending, a new and comprehensive approach is called for. The forthcoming economic mission, which will start its work in Belgrade on October 26, will devote special attention to industry and determine in what areas the Bank's assistance would be most useful. Immediately thereafter, a reconnaissance/identification mission from the Industrial Projects Department will visit Yugoslavia so that a pipeline of industrial projects can be built up.

16. However, an emphasis on lending to industry may require in-depth studies of certain subsectors and this could be a difficult path, as our recent experience with a proposed steel study has shown. The appraisal of the Third Industrial Loan led to the conclusion that a review of the steel sector in the context of the 1971-75 Five-Year Plan would be desirable. The Yugoslavs, although having signed a side letter on this subject, kept stalling and postponing the mission. It finally came to light that an intense political fight had developed, led by the major steel producers who feared that the Bank might want to curtail their investment programs in favor of a new plant on the coast. The suspicions about such a-priori conclusions have now been resolved, and a mission will probably visit Yugoslavia towards the end of the year. In contrast to these problems, the automobile sector study mentioned above has met with good cooperation.

Tourism

17. Since 1962, Yugoslavia's earnings from tourism have increased by about 25 percent per year. Gross earnings for 1970 are expected to reach about $300 million, and an annual increase of 15-20 percent can be expected for the next five years. The limited availability of tourist facilities is likely to be the main constraint in the future. The Yugoslav authorities

are promoting the creation of "tourist complexes" (2,000 - 10,000 beds) which are an attempt to organize tourism on an industrial scale. Inasmuch as these large complexes represent a new approach, which has never been applied anywhere in the world, problems in the construction and operation of such complexes can be expected. In order to assist Yugoslavia in the proper planning of these projects, the Bank has presently three such complexes under review. Two projects are part of a regional development program for the South Adriatic Coast, which was recently completed with UNDP technical assistance. The Governement has requested UNDP to undertake a similar program for the North Adriatic coast, in which the third project would be incorporated.

18. You will visit one of these projects, the Babin Kuk complex near Dubrovnik. An appraisal mission visited Babin Kuk in July, but because of problems with management and infrastructure, the appraisal is not yet completed. A mission headed by Mr. Scarisbrick of the Bank Tourism Department will be in Yugoslavia during your visit, working on these matters. Preliminary appraisal of the Portoroz project was also begun in July and there are no major problems with this project. A technical mission will be completing the appraisal work during your visit. Also during this time, a Bank project preparation mission will be visiting Budva to assist in preparing the project.

Lesser Developed Regions

19. While the aggregate economic indicators clearly establish that Yugoslavia is a less developed country, regional disparities are very considerable and have to be taken into account in developing the lending program. The northern and western parts of the country have per capita incomes which approach those of Austria and northern Italy, but the central and south-eastern regions, with per capita incomes in the range of $200 to $400, are at the level of many less developed countries. The Bank, therefore, as part of its lending strategy to Yugoslavia, will devote a special effort to projects located in these areas.

20. The Ibar Multipurpose Water Supply Project is the Bank's first operation specifically directed at an under-developed region (Kosovo). The project consists of the mobilization of the waters of the Ibar river for industry, irrigation on 30,000 ha., domestic water supply, and power. There will also be some benefits from flood control and prevention of siltation. The project works include a storage dam, a regulation dam and two main conduits. In addition, there will be irrigation and drainage works, land levelling and road construction. The total cost of the project is estimated at $90 million. The project is scheduled for this fiscal year and was appraised in July.

21. Some of the Bank-financed roads are located in the lesser developed regions, as well as some of the industrial plants financed under the three loans for industry.

Other projects

22. Apart from the sectors mentioned above, the Bank has financed high priority projects in other sectors such as telecommunications (FY 1970 - $40 million) and two power projects in the early sixties. For fiscal year 1972, a tourism resort complex, a sewerage project (Dubrovnik), and a tourism water supply project have been identified. Subject to the findings of a power sector mission which will visit Yugoslavia this fall, a loan for power is also planned.

23. Lending for industry and transportation will continue to be emphasized, but the identification of specific projects will take place only after completion of the discussions with the Government (industry) and the return of the Transportation Review Mission.

DEPARTMENT OF STATE SEPTEMBER 1970

SOCIALIST FEDERAL REPUBLIC OF YUGOSLAVIA

BACKGROUND NOTES

Population: 20.6 million (1970 est.)
Capital: Belgrade

Yugoslavia, a country about the size of Wyoming, is divided into two general sections. Lowland hills and plains form a rough oval which centers on the Pannonian Plain and fills the northern and eastern third of the country from Zagreb to Nis. Only a few minor mountain ranges interrupt the lowlands, which are an extension of the Middle Danube Plain shared by Yugoslavia with parts of Austria, Hungary, and Romania. The remaining two-thirds of the country consists of mountains which present a rugged border to Austria, Italy, and the Adriatic Sea on the northwest and west, and to Albania, Greece, and Bulgaria around the south and southeast.

The fertile lowlands provide Yugoslavia with the major part of its commercial agricultural land. Because most of the numerous valleys in the mountainous sections are steep, narrow, and isolated, agriculture there is largely of subsistence character. Mineral, metal, and timber exploitation, as well as sheep raising, are important activities in the mountains.

The extensive transportation network of the lowland area is connected to the northwest and southeast by passages through the mountains. The country, therefore, controls the most important land routes from Central and Western Europe to the Aegean Sea and Turkish Straits. It also controls part of the Danube—the most important water route from Central and Western Europe to the Black Sea. The Danube descends from Hungary to the center of the Pannonian Plain, flows down to Belgrade, and eastward to the Carpathians. As it cuts through the Carpathians, it forms the border with Romania. Toward the end of its course through the Carpathians, the Danube cuts through the steep gorge known as the Iron Gate or Djerdap.

The mountains constitute a natural defensive barrier on all sides except the long, exposed northeastern frontier. During World War II they served as the base of operations for resistance forces against the Nazis, Fascists, and their allies. Those forces which had gathered under Marshal Tito created an independent power base for the establishment of Communist rule at Belgrade at the end of the war. This facilitated not only the regime's rise to power but also the early loosening of its ties with the Soviet Union, the dominant power to the east.

Yugoslavia's flag consists of three equal-sized horizontal bands—blue, white, and red from top to bottom—and a large red star edged with yellow in the center of the field.

THE PEOPLE

The population of Yugoslavia has the greatest ethnic and religious diversity in Eastern Europe, an area noted for such diversity.

Yugoslavia came into existence December 1, 1918, after World War I and the dissolution of the Austro-Hungarian Empire. Borders of the new nation—then called the Kingdom of the Serbs, Croats, and Slovenes—enclosed five principal "South Slav" groups and an additional 17 minorities, which are still distinguishable today. The population came both from the former empire and from the independent Kingdoms of Serbia and Montenegro.

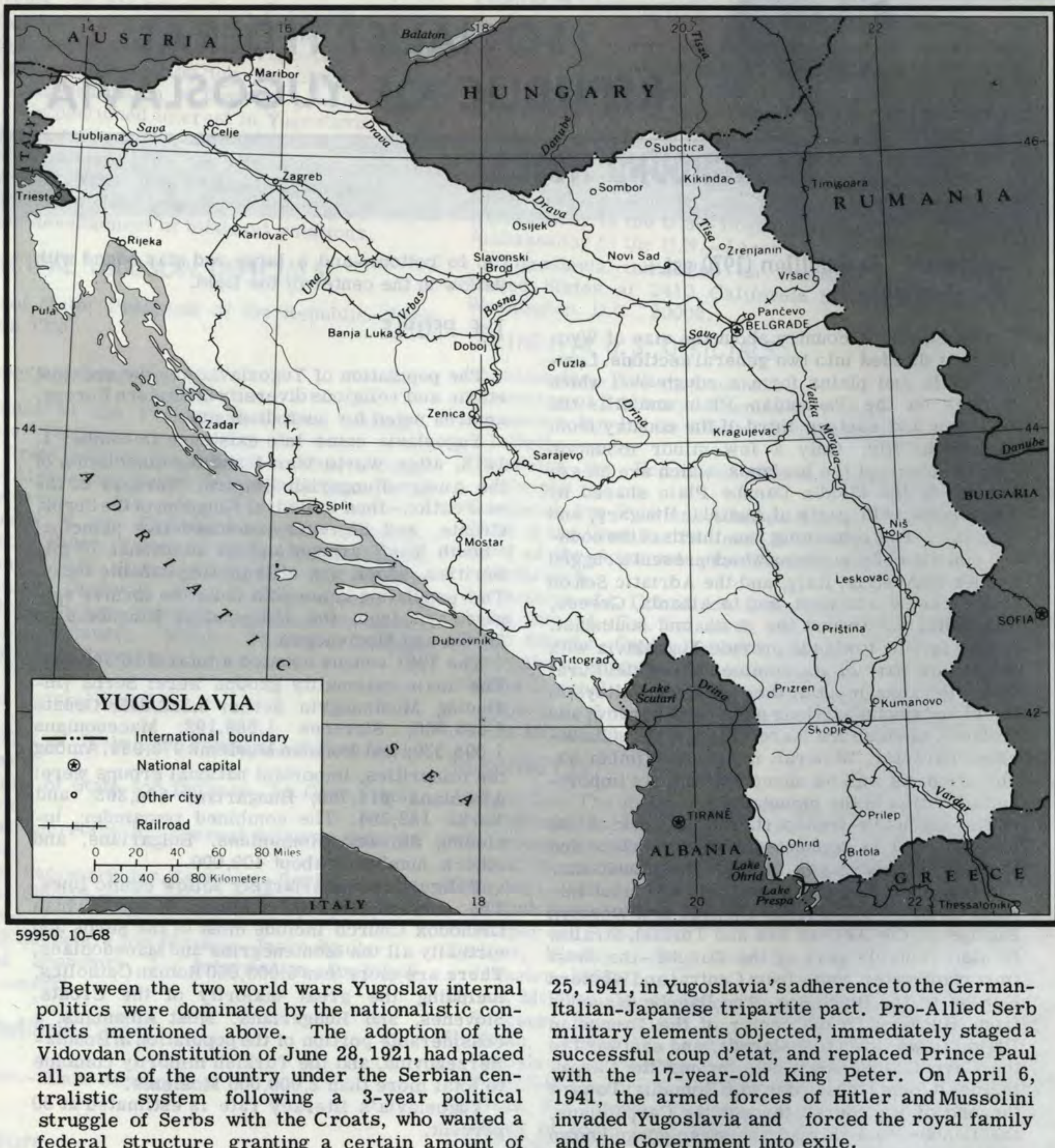
The 1961 census counted a total of 18,549,211. The main nationality groups were: Serbs (including Montenegrin Serbs) 8,320,846; Croats 4,293,860; Slovenes 1,589,192; Macedonians 1,095,330; and Bosnian Moslems 972,954. Among the minorities, important national groups were: Albanians 914,760; Hungarians 504,368; and Turks 182,964. The combined remainder, including Slovaks, Romanians, Bulgarians, and others, numbered about 400,000.

Religious groups largely follow ethnic lines. The some 7,000,000 members of the Serbian Orthodox Church include most of the Serbs and virtually all the Montenegrins and Macedonians. There are more than 5,000,000 Roman Catholics, including the great majority of the Croats, Slovenes, and Hungarians. Most Albanians, a considerable portion of the population in Bosnia-Herzegovina, and the Turkish minority combine to total more than 2,000,000 Moslems.

Yugoslavia's literacy rate is estimated at 80 percent.

HISTORY

The internal history of Yugoslavia between the wars was largely a story of antagonism between the nationalistic Orthodox Serbs, who with their political allies dominated the highly centralized government at Belgrade, and the equally nationalistic Catholic Croats, who originally pressed for a federated Yugoslavia but in the end settled for their own autonomous rights. Ethnic and religious tensions, which came to a climax of internecine strife and reprisals during World War II, have survived under Communist rule despite the party's attempts to moderate them.



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Between the two world wars Yugoslav internal politics were dominated by the nationalistic conflicts mentioned above. The adoption of the Vidovdan Constitution of June 28, 1921, had placed all parts of the country under the Serbian centralistic system following a 3-year political struggle of Serbs with the Croats, who wanted a federal structure granting a certain amount of regional and ethnic autonomy. The struggle erupted violently in 1928 when a Montenegrin Serb stood up in parliament and shot the Croatian leader, Stjepan Radic. The Croats withdrew from the parliament in protest, and King Alexander established a royal dictatorship. The continuing internal struggles finally resulted in 1939, on the eve of World War II, in the granting to Croatia of a considerable degree of autonomy.

The pro-French foreign policy of King Alexander, assassinated by extremists in Marseilles in 1934, was abandoned by his successor, Prince Paul, the Regent, for one which resulted on March 25, 1941, in Yugoslavia's adherence to the German-Italian-Japanese tripartite pact. Pro-Allied Serb military elements objected, immediately staged a successful coup d'etat, and replaced Prince Paul with the 17-year-old King Peter. On April 6, 1941, the armed forces of Hitler and Mussolini invaded Yugoslavia and forced the royal family and the Government into exile.

During the war, resistance forces in Yugoslavia were split into the Yugoslav Army in the Fatherland ("Chetniks"), with close ties to the exile government, and the National Liberation Army (Partisans) led by Tito and the Communist Party. This led to a complicated internal situation which resulted in tragic civil war. The Partisans developed the broader and more active resistance to the invaders and established their own government in late 1943 in the areas they controlled. The Allies recognized the Partisans' effectiveness by sending military missions to Tito's headquarters in mid-1943 and by gradually allocating to his forces rather than to those of Mihajlovic's Chetniks the bulk of Allied supplies and equipment available for the Yugoslav resistance effort. The Partisans' increase in power was facilitated in part by the fact that they acquired control of considerable territory and arms at the time of the surrender of Italian forces to the Allies. Tito's power was further consolidated when Soviet troops aided in driving German troops out of Yugoslavia in late 1944.

Allied pressure induced formation of a coalition government in 1945, but elections in 1945 which were Communist-controlled produced a Provisional Assembly which proclaimed the "Federal People's Republic of Yugoslavia" on November 29. On January 31, 1946, a Soviet-type constitution was adopted, and Yugoslavia officially became a "people's republic."

The Communist rise to power was followed by a foreign policy which in every respect tied Yugoslavia to the Soviet orbit until June 1948 when the U.S.S.R. made public its strong disapproval of policies and practices in Yugoslavia. The issue was whether Yugoslavia could remain in the Soviet bloc while pursuing policies decided upon by its own leaders instead of by Moscow. Stalin decided this degree of independence was unacceptable, and Yugoslavia was expelled from the Soviet-dominated Cominform. This expulsion was followed by an active but unsuccessful Cominform campaign to subvert the Tito government and replace it with a regime subservient to Moscow.

Since 1948 Yugoslavia's effort to maintain its independence has led to a foreign policy characterized by three motifs. First, isolated and under the pressure of Soviet bloc hostility, Yugoslavia developed ties with the United States and other Western countries based on trade, aid, and discussions on the defense of Yugoslavia in the event of aggression by the Soviet bloc. Secondly, its search for an independent base produced efforts to identify itself as a leader of nonaligned nations, eschewing proximity to either the Soviet or the Western military bloc. Its role in organizing the 1961, 1964, and 1970 nonaligned conferences, the Cairo Conference on Economic Development of 1962 and the 1964 U.N. Conference on Trade and Development (UNCTAD), underlined this latter course. Thirdly, following the strengthening of other ties, Yugoslavia has shown interest in approaches made by the Soviet Union provided they have been on Yugoslav terms. Yugoslavia has found it easier to get on with the Soviet Union following the latter's repudiation of many of Stalin's internal and external policies, but relations between the two countries have followed an irregular course, alternately improving and deteriorating. For instance, Belgrade was prompt and forthright in its condemnation of the Soviet-led invasion of Czechoslovakia in August 1968. Subsequent efforts to normalize relations have been marked by Soviet Foreign Minister Gromyko's visit to Belgrade in September 1969 and Yugoslav Prime Minister Ribicic's visit to Moscow in June 1970. The Yugoslavs have made it clear, however, their disapproval of the Soviet doctrine of "limited sovereignty" within the Socialist "commonwealth." Yugoslavia has described the intermingling of these three motifs as the external complement of its search for a distinctive "road to socialism" in internal policies.

Economic and military assistance contributed by the United States and its Western allies after the break in 1948 helped Tito to maintain Yugoslav independence despite the Cominform pressure. The rigid Cominform economic blockade in 1949-53 led to a reorientation of Yugoslav foreign trade toward the West, and during the same period Yugoslavia broadened its contacts with the free world in political and cultural fields as well. Its economic ties with the West have resulted in varying degrees of involvement with ~~Western~~ world economic organizations such as the General Agreement on Tariffs and Trade (GATT), the Organization for Economic Cooperation and Development (OECD), the European Economic Community (EEC), and the European Free Trade Association (EFTA).

Yugoslavia has also become a strong supporter of the United Nations and its specialized agencies and is a member of the International Monetary Fund and the International Bank for Reconstruction and Development (World Bank).

GOVERNMENT

Under the new Constitution, promulgated in April 1963, the official name of Yugoslavia became the Socialist Federal Republic of Yugoslavia. The Socialist Federal Republic of Yugoslavia continued to be composed of six Republics—Serbia, Croatia, Slovenia, Bosnia-Herzegovina, Macedonia, and Montenegro—and two autonomous provinces within Serbia: Kosovo and the Vojvodina. While each area has a mixed population, only Bosnia-Herzegovina does not have a dominant ethnic group. Accordingly, the federal character of the Yugoslav state has a strong base in demographic and historical realities. Each republic has a government apparatus modeled on that of the Federal Republic with a parliament, executive council, administrative agencies, and a judiciary.

The 1963 Constitution provided for a President and a Vice President of the Republic, a Federal Assembly, a Federal Executive Council with broad executive and administrative powers, and a Constitutional Court. The position of Vice President was abolished, however, in 1967.

The President is elected by a majority of all federal deputies to a term of 4 years and may be reelected for one further consecutive term of 4 years. By specific exemption, President Tito's tenure of office is not limited.

Under the 1963 Constitution "the Federal Assembly is the supreme organ of power and the supreme body of social self-government within the framework of federal powers and obligations." It has five Chambers. The Chamber of Nationalities is most senior. It is organized on a federal basis and has 140 members: 20 from each Republic and 10 from each of the two autonomous provinces. Deputies to this Chamber are elected by republican and provincial assemblies. The Federal Assembly's other Chambers are: the Economic Chamber, the Chamber of Education and Culture, the Chamber of Welfare and Health, and the Socio-Political Chamber. Each has 120 deputies elected on the basis of proportional representation. Deputies in the Socio-Political Chamber are directly elected. Those in the specialized Chambers are elected by bodies composed of delegates from local (county) assemblies and organizations in the electoral district whose work category falls within the purview of the Federal Assembly Chamber concerned.

The 19-man Federal Executive Council is the executive arm of the Assembly and "the Government," although its members do not have titles referring to specific portfolios. It is presided over by a president, who, like the other members of the Federal Executive Council, is a deputy in the Federal Assembly and is proposed by the President of the Republic and duly elected by the Federal Assembly. The Constitution states that members shall be elected "with due consideration to national composition." State Secretaries participate in Federal Executive Council work with the same rights and duties as elected members. Federal Secretaries participate on matters within their areas of responsibility.

There are State Secretariats for Foreign Affairs and Defense and Federal Secretariats for Internal Affairs, Economy, Finance, Foreign Trade, and Information.

The Constitutional Court, consisting of a president and 10 members, is an innovation in Yugoslav Communist Government. The members are proposed by the President of the Republic and elected by the Federal Chamber for an 8-year term. One of the court's duties is to rule on disputes between the Federal Government and a republic or between republics.

POLITICAL CONDITIONS

Until 1948 the Communist Party of Yugoslavia outwardly appeared to be as loyal a member of the Moscow-dominated Cominform as any other Communist Party and just as devoted to communization on the Soviet model. In 1948, however, growing differences between Tito and Stalin and their parties culminated in an open break. The Yugoslav Communist Party's position of rejecting domination and control from Moscow and of seeking independence from the Soviet bloc has had far-reaching implications for internal as well as external policies, the combination of which became known as "Titoism."

Since 1948 the Yugoslav leadership has in many important respects moderated the harsher features of a Communist dictatorship while extensively developing its own interpretation of the Marxist-Leninist philosophy. Although refusing to tolerate organized opposition, it has decreased police repression, abandoned forced collectivization and compulsory deliveries in agriculture, and lifted onerous restrictions on religious freedom. It has decentralized government, giving more power to republic and local administrators, and has introduced workers' councils in industry.

The Constitution adopted in April 1963 wrote into law many of the changes that had been accumulating since 1948. Primary emphasis was given to decentralization and self-government with a major effort to broaden popular participation in the country's political life through reorganization of the previously compliant federal and republic parliaments. Since late 1963 genuine debates have taken place in the Federal Assembly. These political changes have paralleled the introduction of some features of a market economy—including decentralization of management, the provision of credit and other facilities for small-scale private enterprise, and the formation of advertising associations. For the agricultural sector there is now a constitutional guarantee of private peasant landholdings of up to 10 hectares (about 25 acres) of arable land. While this figure would appear small by U.S. standards, the average peasant landholding in Yugoslavia has been small traditionally, often only 2 or 3 hectares.

The 1963 Constitution has written into it the principle of rotation of offices. As a result, during recent years, there have been many shifts among occupants of senior positions. Nevertheless, the leadership group, headed by President Tito, has remained essentially intact and cohesive.

Dramatic ousters did occur at the Brioni Plenum of the Party Central Committee in July 1966, when Yugoslav Vice President Aleksandar Rankovic was deposed. At the same time, Secretary of the Interior Svetislav Stefanovic was removed from office. Stefanovic had been Rankovic's chief agent of control over the secret police. Overzealous activities of the secret police were aired in great detail in justification of these ousters. It also was made apparent that Rankovic was an opponent of the programs of economic and political liberalization and decentralization underway in Yugoslavia.

Reflecting the policy of decentralization set forth in the 1963 Constitution, there has been a general movement of power away from central party and state organs. In institutional terms, this trend is best symbolized by reduction of Federal Secretariats (Ministries) from 13 to six in 1967 and by transfer of many federal functions to local levels.

There also has been decentralization of party power. Stress is on the role of republican and local party bodies. There have also been steps to avoid disunity on party objectives. While the Ninth Party Congress in March 1969 abolished the Central Committee, it set up a 52-man Presidium consisting of: Tito, six members from each Republic (36), three from each autonomous province (6), three from the armed forces, and Presidents of the six republican Central Committees (ex officio). From the President's regular members, a 15-man Executive Bureau was chosen, again emphasizing representation on a federal basis. It consists of Tito, two representatives from each Republic (12), and one representative from each autonomous province (2). It meets often and under a rotating chairmanship to provide guidelines of party policy.

Membership in the party is approximately 1 million, or some 5 percent of the population. The principal mass organization, comprising most salaried employees, is the Socialist Alliance of the Working People of Yugoslavia. This organization is a faithful instrument of the party, despite the fact that it shows more independence than similar front organizations in other Communist states.

ECONOMY

Although rich in natural resources (agricultural land, nonferrous metals, timber, hydroelectric power potential, natural gas, and oil) and relatively underpopulated by European standards, Yugoslavia has been held back on the road to economic development by wars and conquest. After World War II, aided by large United Nations Relief and Rehabilitation Administration (UNRRA) grants, the war-devastated economy began reconstruction under a completely Soviet-type command regime. After Yugoslavia's expulsion from the Cominform, the country scaled down its grandiose investment program, which had assumed the receipt of large quantities of aid from the Soviet Union and other Communist countries, and dismantled its economic planning and administrative structure. The United States, the United Kingdom, and France cooperated in an assistance program aimed at keeping Yugoslavia from having to yield to bloc economic pressure and at advancing the country's economic development. Yugoslavia began in 1950 a far-reaching program of experimentation with workers' self-management, decentralization of investment decisions, and freer markets, while retaining social ownership of capital goods. Furthermore, forced collectivization in agriculture was abandoned when it became apparent that much of the mountainous country was not suited to extensive cultivation. Today, however, much of the prime agricultural land remains in the hands of agricultural enterprises which are the successors to state farms.

During the 1950's and early 1960's, Yugoslavia enjoyed a high rate of economic growth, and industrialization of the country proceeded. Neither process, however, solved a nagging balance-of-payments problem or leveled out the sharp regional contrasts, as, for instance, between highly developed Slovenia and Croatia and backward Macedonia and Montenegro. Indeed, many of the investments in the underdeveloped regions were economically dubious. Nor was the economy ever as free in fact of central direction and Communist Party control as it was in theory.

Efforts were begun in the late 1950's to strengthen Yugoslavia's agriculture and to render it less vulnerable to the severe droughts which have struck the country on the average of once every 4 years over the past 100 years. These efforts included measures to increase the availability of fertilizer; to introduce more productive and drought-resistant grain varieties; to improve livestock bloodlines; and to improve agricultural land. These measures have met with success. Today, Yugoslavia, although having a greatly expanded urban population which consumes a large volume of food products from commercial agricultural producers, is largely self-sufficient in agricultural products and is able to export substantial quantities of high-grade fresh and canned meats as well as perishable market crops. While Yugoslavia's grain production remains vulnerable to drought, improved production methods and greater storage facilities have enabled some stockpiling to provide reserves against lean years.

Another area of the economy to which increased attention was turned in the late 1950's was tourism. Today, tourism is one of Yugoslavia's principal sources of hard-currency earnings. Each year millions of visitors come to Yugoslavia from Western Europe and other areas of the world. Yugoslavia's picturesque Adriatic coast, featuring many islands and a Mediterranean climate providing a warm and dry spring, summer, and early fall, is the prime area for tourism.

In 1965 Yugoslavia embarked on a program of economic reform to convert an essentially command-type, centrally controlled economy into a market-type, Western-style economy. The dinar was devalued to 1,250 to U.S. $1.00. Subsequently, a new dinar was established which converted into U.S. dollars at the rate of 12.5 to 1. National policy shifted toward increasing consumption at expense of investment and toward concentration of resources on enterprises which could prove their viability in competition with foreign producers. In this direction, tariffs were lowered and export subsidies abolished; central control of investments was replaced by granting greater authority to local banks; governmental levies on enterprises were reduced. Individual Yugoslav enterprises were enabled to deal directly with foreign concerns without approval of central authorities.

The reform, which in principle called into question the nature and scope of Communist Party as well as governmental control over the operation of the economy, met with considerable opposition which reached a high level within the party. Tito, however, has supported the reform resolutely. At the Ninth Party Congress in March 1969, he reaffirmed his full support for the reform.

Tito has defended the reform in the face of attacks from the Soviet Union. These attacks have reflected Soviet displeasure with Yugoslavia's condemnation of the Soviet invasion of Czechoslovakia as well as Yugoslavia's support for the liberalizing economic reforms begun in Czechoslovakia in January 1968. The Soviets have described the Yugoslav economic reform as out of step with socialism and, therefore, doomed to failure.

Western countries, together with the International Monetary Fund (IMF), have given Yugoslavia considerable support of various types in order to give the recent reform program time to bring the balance of payments out of the red. The assistance has sometimes taken the form of extension of payment periods for Yugoslav debts, and sometimes additional credits have been made available.

The immediate effect of the reform, internally, was a sharp rise in prices and in unemployment. The latter phenomenon, which has plagued Yugoslavia since 1953 in proportion to the amount of freedom given enterprises to lay off surplus labor, has been mitigated by a substantial movement of Yugoslav workers to Western Europe, notably the Federal Republic of Germany, for temporary employment. Externally, the country in 1965 balanced its accounts for the first time since 1946. This was due only, however, to a surplus in trade with the East European Communist countries. The Yugoslav Government has stressed the long-range significance of the reform.

Although balance-of-payments problems with hard-currency areas continue to beset Yugoslavia, there are signs that the initial impact of the reform on Yugoslavia's hard-currency accounts is being met and that balance-of-payments problems will become less in the future. In particular, earnings from tourism and remittances from Yugoslav workers in Western Europe have helped compensate for negative trade balances with hard-currency areas. While industrial production growth slumped to near zero in 1967 due to readjustments brought about by the economic reform, industrial production is again on the upswing, now that the redirection of economic energies into enterprises capable of competing with foreign producers is taking effect. This should further help the balance-of-payments problems.

The transition is not easy from underdeveloped to developed status. The process admittedly is handicapped by natural disasters ranging from recurrent droughts to the earthquakes which devastated Skopje in 1963 and Banja Luka in 1969. But government and party policies have also played their role. The Yugoslavs, although considering themselves "pragmatists" in economic affairs, for a long time in the past followed orthodox Marxist theory in stressing investment in heavy industry, in discriminating against private agriculture, in abolishing private enterprise in industry and commerce except to a degree in service trades, and in running down housing stocks by excessively low rents. These policies have been modified under the current reform program.

Despite the conditions noted above, Yugoslavia has enjoyed a considerably higher standard of consumer welfare than other Communist states, as well as a noticeably higher degree of personal freedom. Per capita gross national product (GNP) is estimated at around $500, but varies widely among the different regions of the country.

Yugoslavia's most important trading partners are in Western Europe, notably Italy and the Federal Republic of Germany. Yugoslavia also has substantial trade with the U.S.S.R. and the East European countries (COMECON), the United States, and countries in Asia, Africa, and Latin America.

In 1969 Yugoslavia's exports totaled $1.5 billion and its imports $2.1 billion. The resulting trade deficit of $660 million was covered in large part by hard-currency earnings from tourism and remittances from Yugoslavs working abroad. The 1969 balance-of-payments deficit was put at some $119 million. GNP during the same year was estimated at $16.8 billion.

During 1969 Yugoslavia's trade with convertible-currency countries rose to 67 percent of total trade from 57.5 percent in 1967. Trade with the COMECON countries fell from 30 percent of total trade in 1967 to 27 percent in 1969.

In 1969 U.S. exports to Yugoslavia were $92.5 million and U.S. imports were $93.5 million. Principal U.S. exports include industrial goods and agricultural machinery. Imports include nonferrous metals, wood products, tobacco, and canned meats.

FOREIGN RELATIONS

Yugoslavia has pursued a vigorous campaign to develop ties with nations generally not clearly identified as allies of the Soviet Union or the United States. These efforts have included several extended trips by President Tito and have resulted in his close association with Nasser, Nehru, Sukarno, and other nonaligned leaders.

Tito traveled to Burma and India in January 1954; to Indonesia, Burma, India, Ceylon, Ethiopia, the Sudan, and the United Arab Republic in the winter of 1958-59; and to several African countries in 1961. The first nonaligned conference was held at Belgrade in 1961, serving to further Yugoslav efforts to identify itself as a leader of nations outside the Western and Soviet alliance systems. A second was held at Cairo in 1964. In 1963 Tito extended his efforts to South America with a trip to Brazil, Bolivia, Chile, and Mexico in search of friends and economic relations. In 1967 and early 1968 Tito visited the U.A.R., Syria, Iraq, Afghanistan, Pakistan, Cambodia, India, Ethiopia, the People's Republic of Southern Yemen, Japan, Mongolia, and Iran. In early 1970 he toured East Africa. In July 1969 a preparatory meeting for the third nonaligned summit was held at Belgrade, and in September 1970 he attended the conference itself at Lusaka, Zambia. Furthermore, Yugoslavia has provided credits and technical assistance to underdeveloped areas.

Tito's identification with the nonaligned world was clear in June 1967 when he reacted strongly to support Nasser at the time of the Arab-Israeli hostilities. Yugoslavia broke diplomatic relations with Israel. Tito was sharp in his condemnation of Israel and his claims that an "imperialist" plot was behind the Israeli actions. Furthermore, he flew to Moscow on June 9, 1967, to urge a gathering of Soviet and other Communist leaders to support the Arabs. Subsequently, Yugoslavia's position on the Near East has moderated, but Yugoslav-Israeli diplomatic relations remain severed.

Changes in Soviet external and internal policies after Stalin's death in 1953 led to friendlier relations between Yugoslavia and the U.S.S.R., beginning with the May 1955 visit of Khrushchev and Bulganin to Belgrade. In June 1956 Tito visited Moscow where Soviet leaders acknowledged the Yugoslav doctrine of "many roads to socialism" and expanded bloc credits. Yugoslavia's attitude toward the Polish and Hungarian outbreaks in 1956, however, cut short the rapprochement and led to "postponement" of the Soviet credits. Efforts during 1957 to patch up the relationship were only partially successful, and a new series of mutual remonstrances finally led to cancellation of Soviet credits in 1958. Although Tito had recognized East Germany in October 1957 following resumption of Soviet credits and a meeting with Khrushchev in Romania, Yugoslav representatives refused to sign the Moscow Declaration of Communist Parties later that year, and in April 1958 the 7th Congress of the League of Communists of Yugoslavia (LCY) adopted a new program reaffirming Yugoslavia's belief in the particular Yugoslav "road to socialism."

Soviet credits were never resumed, but in 1962 the Soviet Union again took the initiative to improve relations with a visit by the then Chief of State Brezhnev, and Foreign Minister Gromyko. In return, Tito went to the Soviet Union in December 1962. Thereafter, bloc criticism of Yugoslav "errors" gradually subsided. Improved relations were symbolized by a series of top-level visits between Yugoslavia and all the bloc countries, highlighted by Khrushchev's August 1963 trip to Yugoslavia, the Khrushchev-Tito meeting at Leningrad of June 1964, and Tito's trip to the U.S.S.R. in June 1965 to see the new Soviet leaders. Exchanges intensified with the maneuvering involved in the Sino-Soviet dispute. The severity of attacks on Tito by the Chinese and their supporters in Albania served to bring Yugoslavia closer to the Soviets in the Sino-Soviet conflict despite Yugoslav opposition to any "excommunication" of the Chinese which might irrevocably split the Communist world.

Yugoslavia sought to maintain leverage with each of the members of the "Soviet bloc" during the evolution of looser relationships between Moscow and East European governments. In September 1964 Yugoslavia accepted limited association with the Communist bloc's Council on Mutual Economic Assistance (CEMA) and inaugurated a Danube River Iron Gate hydroelectric and navigation project in collaboration with the strongest critic of CEMA within the bloc, Romania.

Tito's hurried trip to Moscow at the time of the 1967 Arab-Israeli hostilities and his claims at that time that an "imperialist" plot was underway against "progressive" regimes gave rise to some speculation that Yugoslavia might be changing its course of nonalignment and veering toward closer association and identification with the Soviet world. However, Yugoslavia's subsequent opposition to the Soviet-promoted World Communist Conference and its condemnation of Soviet actions in Czechoslovakia reemphasized Yugoslavia's traditional posture as an independent, nonaligned state. It retains that posture.

Yugoslavia's relations with Western Europe have evolved favorably. In January 1968 Bonn and Belgrade resumed diplomatic relations, which broke in 1957 when Yugoslavia recognized East Germany. Furthermore, Common Market restrictions on agricultural imports which posed a problem in 1968 for Yugoslavia, particularly with regard to meat exports, were lifted in 1970.

U.S.-YUGOSLAV RELATIONS

Since Yugoslavia's expulsion from the Cominform in 1948, United States policy toward Yugoslavia has sought to offer Yugoslavia alternatives to dependence on the Soviet Union and the East European Communist states and to assist Yugoslavia in establishing its independence firmly and irrevocably. In this connection, grant military assistance to the extent of some $700 million was provided Yugoslavia from 1951 to 1959, and economic assistance (including grants, loans, and concessional sales) of about $2 billion was supplied between 1950 and 1967. The final aspect of economic assistance to Yugoslavia came to an end on January 1, 1967, when United States legislative action precluded further concessional sales of surplus agricultural commodities to Yugoslavia because Yugoslav ships traded with Cuba.

The United States seeks to promote economic relations with Yugoslavia, and Yugoslavia enjoys most-favored-nation treatment under United States tariff schedules.

Yugoslavia has on two occasions, in 1948 and 1964, settled outstanding financial claims of U.S. citizens for their nationalized property. It has also reached agreement with the representatives of American holders of pre-war Yugoslav bonds on paying off a portion of its obligation.

In 1964 the United States and Yugoslavia signed a Fulbright Agreement for educational exchange. This remains the only such agreement with a Communist state. It has enabled intensification of educational exchanges.

While United States-Yugoslav relations have developed generally favorably in recent years, Yugoslavia has disagreed, for instance, with United States policies in Indochina, Cuba, and the Dominican Republic. Bombings in January 1967 of the Yugoslav Embassy in Washington, D.C., and of the Yugoslav Consulates General in Chicago, New York, and San Francisco remain unsolved and have been an irritant in bilateral relations.

The Soviet invasion of Czechoslovakia and the U.S.S.R.'s subsequent reassertion of the doctrine of the right of intervention and "limited sovereignty" within the Socialist "commonwealth" have put new emphasis on United States-Yugoslav relations. In this connection, President Johnson, on October 14, 1968, cited the long tradition of United States assistance to Yugoslavia and expressed his admiration for Yugoslavia's people and their dedication to freedom. He also made clear his continued interest in Yugoslavia's independence, sovereignty, and economic development.

In February 1969 the press announced that Presidents Nixon and Tito had exchanged letters expressing mutual interest in meeting and in the further development of bilateral relations.

PRINCIPAL YUGOSLAV OFFICIALS

Head of State; President of the Republic—Josip Broz Tito

Members of Government

President of the Federal Executive Council—Mitja Ribicic

Vice Presidents of the Federal Executive Council—Aleksandar Grlickov, Nikola Miljanic, Miso Pavicevic

Members of the Federal Executive Council—Marco Bulc, Toma Granfil, Miran Mejak, Franjo Nadj, Hakija Pozderac, Ali Sukrija, Dragisa Djokovic, Dusan Gligorijevic, Ivo Jerkic, Mirjana Krstinic, Ljubisav Markovic, Marko Orlandic, Nikola Pavletic, Blagoje Popov, Izet Zubovic

Senior Federal Officials

Secretary of State for Foreign Affairs—Mirko Tepavac

Secretary of State for Defense—Lt. Gen. Nikola Ljubicic

Federal Secretary for Internal Affairs—Radovan Stijacic

Federal Secretary for Economy—Borivoje Jelic

Federal Secretary for Foreign Trade—Muhamid Hadzic

Federal Secretary for Finance—Janko Smole

Federal Secretary for Information—Drajoljub Budimovski

Constitutional Court

President—Blazo Jovanovic

Legislature

President of the Federal Assembly—Milentije Popovic

Vice Presidents of the Federal Assembly—Marijan Brecelj, Dzavid Nimani, Gustav Vlahov, Blazo Djuricic, Peko Dapcevic, Milos Minic

League of Communists of Yugoslavia (LCY)

President of LCY—Josip Broz Tito

Executive Bureau of the Presidium—Vladimir Bakaric, Josip Broz Tito, Krste Crvenkovski, Nijaz Dizdarevic, Stane Dolanc, Stevan Doronjski, Kiro Gligorov, Fadilj Hodza, Edvard Kardelj, Cvijetin Mijatovic, Miroslav Pecujlic, Budislav Soskic, Mijalko Todorovic, Mika Tripalo, Veljko Vlahovic

Ambassador to the U.S.—Bogdan Crnobrnja

Ambassador to the U.N.—Lazar Majsov

Yugoslavia maintains an Embassy in the United States at 2410 California Street, N.W., Washington, D.C. 20008.

PRINCIPAL U. S. OFFICIALS

Ambassador—William Leonhart

Counselor of Embassy—Thomas O. Enders

Counselor for Public Affairs (USIS)—Wallace W. Littell

Counselor for Economic Affairs—Raymond J. Albright

Counselor for Political Affairs—Robert C. Mudd

Chief of the Consular Section—Richard Miles

Chief of the Administrative Section—Dorothy E. Weihrauch

Air Attaché—Lt. Col. Jason J. Carlisle

Army Attaché—Col. Leland G. Fair

Naval Attaché—Cmdr. Robert E. Hunter

Agricultural Attaché—Frank W. Ehman

Consul General, Zagreb—Orme Wilson, Jr.

The U.S. Embassy in Yugoslavia is located at Kneza Milosa 50, Belgrade.

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YUGOSLAVIA

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KEY ECONOMIC INDICATORS: Yugoslavia, March 1970

ITEM	A 1967	B 1968	C 1969	D %Change**
GNP at current prices	9459	10229	11866	+16
GNP at constant 1967 prices	9108	9738	10466	+ 7.5
Per capita GNP, constant prices	456	483	514	+ 6.4
Investment as % current GNP	16.8	20.3	19.6	- 3.5
Savings as % Disposable Income	11.5	13.9	15.3	+10.1
Money Supply	1878.6	2327	2609	+12.1
Domestic Credit Outstanding	3677	4246	5338	+25.7
Commercial	3465.9	3905	4946	+26.7
Consumer	211	341	392	+15.0
Interest Rate, Central Bank	6	6	6	--
Commercial Bank Prime	8	8	8	--
Commercial Bank Average	9	9	9	--
Public Debt Outstanding	2648	N/A	--	N/A
Domestic	1006	N/A	--	N/A
External (Long & Medium Term)	1642	N/A	--	N/A
Gold & Foreign Exchange Reserves	80	132	254	+95
Balance of Payments/Deficit*	- 82	- 109	-119	+9
Production Major Agric., Mining Mfg. Items:				
Cereals (Thousands of metric tons)	13355	12053	13597	+12.8
Non-ferrous metals ore (Thousands tons)	10785	11935	13915	+16.6
Ferrous Metallurgy (Thousands tons)	4364	5026	5363	+ 6.7
Sawn Timber (Thousands of cubic met.)	2904	2989	3043	+ 1.8
Electric Power Cons. (Millions kwh)	18645	20919	23077	+10.3
New Plant & Equipment Investment	1592	2011	2326	+15.7
Construction (Social Sector, by value)	1199	1368	1258	- 8.0
Unemployment Rate (Social Sector monthly avg.)	7.5	8.3	8.3	0
Indices: Base (Previous Year - 100)				
Consumer Price	107	104	107	+ 7
Wholesale Price	102	100	103	+ 3
Ind. Production	100	106	111	+11
Average Ind. Wage	114	110	115	+15
Labor Productivity (1964 - 100)	110	117	125	+ 8
Foreign Trade:				
Total Exports, FOB	1253	1264	1475	+16.7
Exports to US	80	89	93.5	+ 5.0
Total Imports, CIF	1708	1796	2135	+18.8
Imports from US	124	90	92.5	+ 2.8
Imports from other main sources:				
West Germany	286	320	389	+21.5
Italy	228	269	312	+17.8
USSR	164	188	168	- 9.6

* Current Account.
** %Change 1969/1968.

Principal Source: Index No. 2/70.
Statistical Bulletin No. 2/70.
IMF International Financial Statistics.

SUMMARY

The Yugoslav economy continues at full steam with impressive gains in production, productivity, wages, and agricultural production. Accompanying price and cost of living increases have prompted concern about overheating and anti-inflationary measures are under consideration.

The trade deficit has grown, as Yugoslavia imports increasing amounts of Western equipment and semi-manufactures. However thanks to a sizeable growth in invisible receipts, particularly tourism and worker remittances, the convertible area deficit on current accounts has been substantially reduced. The US ran a trade deficit with Yugoslavia for the first time in 1969, as US suppliers failed to keep pace with the overall growth of Yugoslav imports.

As before, best US export opportunities will be found in export-oriented fields, as Yugoslavia continues to gear up its hard currency earning industries. Tourist equipment, food processing, air conditioning, and commercial refrigeration all hold especially good export potential. The rise in industrial integration and the ongoing quest for greater operating efficiency points the way for increased sales of American market and management consulting services. Yugoslavia is seriously trying to attract venture capital and there are real prospects for major equity investments by foreign firms in 1970.

Sharp Production, Price Rises Continue

The Yugoslav economy at the end of 1969 continues to confront the inherent advantages and disadvantages of boom conditions which first appeared during 1968. Industrial production increased at an 11% annual rate (double the increase registered in 1968) with particularly impressive advances in electric power, metal working, chemicals, electrical manufacturing, and steel. Gains in industrial output have been accompanied by a continuing and impressive rise in worker productivity, which now stands 7% above 1968. Workers nominal incomes increased by 15% over 1968 levels and 6% in real wage terms.

Boom conditions also apply to capital investments, which established an increase of 16% in 1969. As in the recent past the bulk of such investments are being undertaken by the increasingly prosperous and aggressive commercial banks. Particularly large investment increases are occurring in tourism, transportation, construction, and agriculture. Surprisingly, despite the substantial total increase in investments, those in industry and mining remained at 1968 levels.

Substantial increases were also noted in the growth of consumer credits, short term industrial credits, savings deposits, money supply.

Hyperactive economic conditions are also reflected in steady and substantial rises in living costs and factory prices. The overall cost of living, led by increases in rent, food, and clothing costs, rose by an overall 8% during

1969. Figures for December, 1969 and January 1970 indicate that living costs at the close of the year were accelerating at a 13-14% rate. Similarly, factory prices, which showed an overall increase of 3% for 1969 have recently quickened to a 6-7% rate of increase, a worrisome situation for the export-minded Yugoslavs.

Concern over soaring prices and other signs of overheating have prompted speculation about new economic measures to dampen inflationary forces and achieve a more tempered growth rate.

The strong increases in production and investments, combined with already existing credit restrictions, have created a liquidity problem for the domestic economy. Some enterprises, faced with credit restrictions, have neglected debts to domestic suppliers, thus creating a cycle of unpaid debts and lack of operating funds. A number of liquidity measures have recently been passed to combat the situation and it is expected that these measures will have a major structural impact as they begin to take effect. The Government faces a difficult balance in monetary policy in order to assure sufficient credit for productive growth while restraining excessive inflation. They have developed a series of liquidity measures for phased implementation during 1970 which are designed to stabilize a slightly slower growth rate, with preference for export industries.

Exports, Imports Show Strong Advances

Although exports grew at a high rate the Yugoslav trade deficit increased to $660 million, or $127 million more than in 1968. During the year exports grew by 17% to $1.475 billion while imports rose by 19% to $2.135 billion.

As has been the case for several years, the largest trade deficit was seen with the convertible area, where an imbalance of $570 million (or 86% of the total deficit) occurred. The convertible area continues to account for two thirds of Yugoslavia's total foreign trade, with the EEC accounting for 36% and EFTA 15%.

Trade with the CEMA nations continues to decrease and during 1969 accounted for only 27% of Yugoslavia's total trade, a new annual low. Yugoslavia continues to run trade deficits with CEMA (1969-$56 million), largely as a result of efforts to reduce its large existing clearing account credit balances (end 1969 about $52 million).

Export performance reflects strong advances (19%) in sales of industrial goods, especially ferrous and non-ferrous metals, electrical machinery, and shipbuilding. Clothing and furniture exports also registered good gains. Yugoslavs were also heartened by an increase of 8% in sales of agricultural products, a remarkable turn-around from the previous year, when a 21% decrease took place. Export declines in field crops, particularly corn, prunes, and tobacco, were more than compensated for by strong gains in sales of livestock and processed meats. Although Yugoslav food exports are still well below pre-1968 levels, the recent 3 year non-preferential agreement with the EEC on beef is expected to make a substantial contribution to this key sector in 1970.

On the import side, purchases of materials for re-manufacture grew substantially to $1.28 billion, 25% over last year. Within this field particularly strong increases were registered in imports of synthetic and artificial textiles and fibers. Equipment imports ($480 million) continued to grow but with a surprisingly modest increase of 6%, seem to be slackening after the rapid annual rises in recent years. Particularly large increases were noted in imports of machinery for the construction, power, and metal working industry. Consumer goods imports rebounded from a decline in 1968 to an all-time high of $376 million.

Despite the substantial 1969 trade deficit, no new import restrictions are foreseen for 1970. However, the previously mentioned liquidity and stabilization measures are expected to slow the import growth rate and permit some reduction in the 1970 trade imbalance.

Yugoslav-US Trade

In 1969 Yugoslavia registered its first-ever trade surplus with the U.S., on imports of $92.5 million and exports of $93.5 million. American suppliers, in registering a sales increase of only 3%, clearly failed to keep pace with Yugoslavia's overall 19% import growth rate. As a result the U.S. slipped to fifth place among Yugoslavia's trading partners (behind West Germany, Italy, the USSR, and the United Kingdom) and the US share of total trade fell from 6% in 1968 to 5.2%. Yugoslavia's 5% growth in exports to the U.S. is largely attributable to large gains in exports of wooden furniture and lead, which more than offset a decline in canned meat sales.

On the U.S. side, exports of oilseeds, computers, electronic calculators, and automated machinery showed substantial increases, while sales of machinery for the chemical industry and coking coal sagged appreciably.

Invisibles, Reserves Increase Substantially

Despite the substantial trade imbalance, record invisible earnings permitted Yugoslavia to achieve close to a balanced current account with convertible countries. 1969 was a boom year for tourism, with total net foreign exchange receipts from tourism estimated at $240 million. Hard currency remittances from emigrants and Yugoslav guest workers in other countries totalled approximately another $200 million, much more than previously anticipated. Transportation and other invisibles added about $100 million more. The $109 million deficit with the convertible area is a clear improvement over the $124 million gap in 1968. Including the non-convertible area the current account deficit was $119 million compared to $109 million in 1968.

According to IMF statistics National Bank reserves in December 1969 reached a new high of $254 million, or $122 million more than in the same month of 1968. Despite heavy debt burdens, Yugoslavia maintains an excellent credit standing with international financial and banking institutions.

Strong growth in both tourist receipts and emigrant and worker remittances is projected to continue in 1970; thus, it appears likely that invisible earnings will continue to cover at least the major part of convertible area trade deficits.

Unemployment Trend Reversed?

1969 figures indicate that the post-reform trend toward steadily increasing non-agricultural unemployment may have been halted, and possibly reversed during 1969. Socialized sector employment increased by 4 percent while the average unemployment rate in this sector (which includes all industries, but excludes most agriculture) remained constant at the 8.3% of registered workers, same as in 1968. Also this overall 1969 unemployment figure does not reveal the distinct improvement registered during the last quarter of the year as compared to 1968. As a percentage of the estimated total work force, the registered jobless represent about 3-4 percent.

As of December, 1969 the lists of unemployed contained an increasingly large proportion of women (45%) and first-time jobseekers, mainly from the "unskilled" category.

Unemployment problems have unquestionably been eased by the striking growth in Yugoslavs employed as "guest workers" in Western countries. At present it is estimated that over 500,000 Yugoslavs are employed in this manner.

1969 - A Good Year for Agriculture

1969 was an outstanding year for Yugoslavia's agriculture and there are indications of even greater success in 1970. Excellent weather conditions prevailing throughout the country for most of 1969 contributed to a field crop production up 12% over the previous year. The wheat crop totalled 4.88 million MT, an all-time record, while the important corn harvest of 7.79 million tons (up 14%), was sufficient for domestic requirements and permitted increased exports. Other crops showing marked increases were sunflowerseed, sugar beets, potatoes, grapes, fruits and vegetables.

Despite lower livestock numbers resulting from weaker prices and export difficulties in 1968, farm meat production and exports held up fairly well during the year. This was due largely to renewed foreign demand especially by Italy but this, in turn, resulted in other severe meat shortages on the home front. The EEC agreement and the proposed establishment of a livestock marketing-coordinating board are both expected to benefit the livestock industry and its exports.

Implications for the US

Yugoslavia's rise as a world import market, and its appetite for the most modern equipment, technology, and know-how, combine to offer American suppliers good present and future sales potential. The Yugoslav drive toward modernization and export-competitiveness continues to generate substantial sales opportunities, not only from individual enterprises, but also for extensive macro-projects, such as road construction, regional tourist expansion, and modernization of telecommunications.

Yugoslavia also hopes to stimulate industrial efficiencies through industrial cooperation and joint investment agreements with Western firms. A substantial and growing number of such arrangements are in effect. In a recent step to further encourage foreign investment the Yugoslav Government has passed legislation permitting foreign investors to utilize at least 33% of the convertible currency earnings from the joint investment for profit repatriation and/or amortization. Steps to ease the compulsory re-investment requirement for foreign investors and broaden investment opportunities in the free trade zones are also being discussed.

In recent months Yugoslavia has further intensified ties with the international banking and financial community. A major step for assisting joint investments in Yugoslavia was the creation in 1969 of the International Investment Corporation for Yugoslavia. This consortium, sponsored by the International Finance Corporation (IFC) and headquartered in London, is comprised of leading US, Western European, Japanese, and Yugoslav banks. It offers commercial banking services to investors in Yugoslavia and to act as a clearinghouse for bringing foreign firms together with prospective Yugoslav partners.

The IFC also has made an $8 million equity investment in the leading Yugoslav automobile manufacturer, as part of an expansion program in which Yugoslav-banks and a foreign industry are also investing.

The World Bank continues to be active in financing Yugoslav projects. The more recent loans have been extended for modernization of telecommunications ($40 million), highway construction ($30 million). Loans for industrial expansion, railroad construction and tourist infrastructure on the South Adriatic coast are pending. Total IBRD participation in Yugoslavia as of March 1, 1970 totalled $427.6 million. These credits offer opportunities for needs for bidding by US firms on the related projects. They also demonstrate continuing confidence by the IBRD in the growth potential of the Yugoslav economy.

Also of longer term significance to the US, including commercial firms and banks, is the continuing close cooperation between Yugoslavia and international economic institutions such as OECD, GATT, International Monetary Fund and the UN Economic Commission for Europe. Moreover, Yugoslavia signed on March 19 a new agreement with the European Economic Community on a new three-year trade arrangement. This supersedes previous bilateral arrangements and establishes a new trade framework based on MFN non-preferential principles. These economic ties should facilitate closer working relations between Western and Yugoslav firms.

The cumulative effect of these growing international links and Yugoslav investment incentives has been to ease greatly approaches by American business to the Yugoslav goods and investment market. Knowledgeable Yugoslavs believe that despite 1969's disappointing trade performance, the time is ripe for a substantial increase in US-Yugoslav commercial-financial relations. The mutual interest in developing these links was highlighted during the December 1969 visit of Commerce Secretary Stans, when concrete steps were discussed with the highest levels of the Yugoslav Government.

A negative indication for American suppliers is 1969's structural shift in import growth from equipment, a field where American firms have traditionally done rather well, to raw materials and semi-manufactures, where the US market share has usually been low. There has also been a levelling off of investments in industry and mining. A continuance of these trends, combined with the hoped-for reduction in import demand through liquidity measures, could result in a lagging US export growth rate again in 1970. These problems are compounded by the growing competition from German, Italian and British suppliers.

Areas of Special Interest

As in the past US suppliers will find their best sales opportunities in the export industries, which under Yugoslav regulations, receive preferential treatment in foreign exchange availability.

Construction of hotels and other tourist facilities is proceeding at an accelerating rate, providing makers of climate control, institutional cooking and laundry, hotel maintenance, and catering equipment with first-rate opportunities. Interest is also extremely high in contacting American tourist consulting firms and in attracting American investment to participate in tourist macro-development projects. It also appears likely that steep increases in the domestic air fleet and passenger traffic (44% in 1969) will create new demands for airport technical, ground maintenance, and passenger service equipment.

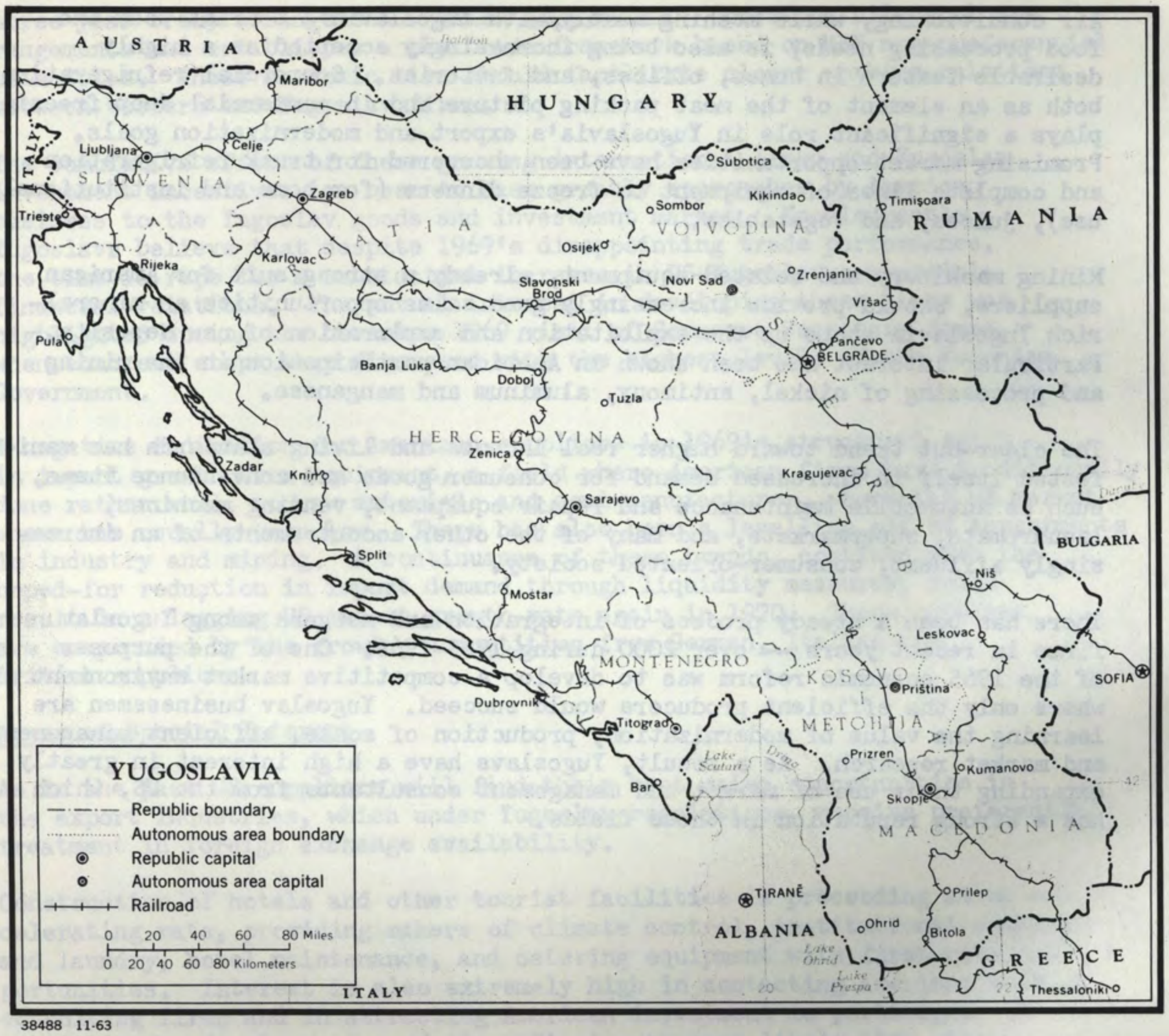
The Yugoslav-EEC agreement permitting increased access for Yugoslav beef to the Italian and other West European markets, plus the increasing influx of foreign visitors, are expected to provide the stimulus for expansion and modernization of Yugoslav food processing. Best prospects appear to lie in complete equipment lines which combine meat processing, deep freezing, weighing, packaging, and labelling.

Air conditioning, while meshing neatly with Yugoslavia's tourist boom and food processing needs, is also being increasingly accepted as a highly desirable feature in homes, offices, and factories. Commercial refrigeration, both as an element of the meat packing picture and in commercial deep freezing, plays a significant role in Yugoslavia's export and modernization goals. Promising market opportunities have been uncovered for truck refrigeration and complete lines of equipment to freeze dinners (for home and institutional use), juices, and vegetables.

Mining machinery and related equipment, already a strong suit for American suppliers, should provide increasingly good sales opportunities as mineral-rich Yugoslavia steps up the exploitation and exploration of new deposits. Particular interest has been shown in American participation in the mining and processing of nickel, antimony, aluminum and manganese.

The clear-cut trend toward higher real incomes and living standards has manifested itself in increased demand for consumer goods and convenience items, such as automobile maintenance and repair equipment, vending machines, laundromats, supermarkets, and many of the other accoutrements of an increasingly affluent, consumer-oriented society.

There has been a steady process of integration and mergers among Yugoslav firms in recent years -- over 2000 during 1965-1968. One of the purposes of the 1965 economic reform was to develop a competitive market environment where only the efficient producers would succeed. Yugoslav businessmen are learning the value of modernization, production of scale, efficient management, and market research. As a result, Yugoslavs have a high interest in greatly expanding their use of market and management consultants from the US, which has a strong reputation in these fields.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Zenica
Zadar
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Split
Niš
Mostar
Leskovac
SOFIA
Priština
Dubrovnik
Titograd
Prizren
Kumanovo
Lake Scutari
Bar
Skopje
TIRANË
Prilep
Ohrid
Bitola
Lake Ohrid
Lake Prespa
Thessaloniki
YUGOSLAVIA
Republic boundary
Autonomous area boundary
Republic capital
Autonomous area capital
Railroad
0 20 40 60 80 Miles
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38488 11-63

Economic Trends
ET 70–34

3

Annex II

Mr. McNamara's Visit to Yugoslavia

List of Personalities

President of the SFR of Yugoslavia

Marshall Tito

Prime Minister

Mr. Mitja Ribicic

Federal Executive Council

s Mr. Toma Granfil, Member
s Mr. Nikola Miljanic, Member
Mrs. Vojna Milovanovic, Adviser
Mr. Branko Mikasinovic, Adviser

Federal Secretariat for Finance

Mr. Janko Smole, Federal Secretary
Mr. Ante Zelic, Deputy Federal Secretary
Mr. R. D. Dodic, Senior Adviser
Mr. M. Zekanovic, Economist
Mrs. B. Jojic, Translator

Federal Secretariat for Economy

Mr. Borivoje Jelic, Federal Secretary

State Secretariat for Foreign Affairs

Mr. Momcilo Peles, Head of Department
Mr. G. Popovic, Assistant Head of Department

Federal Planning Institute

Dr. Rikard Stajner, Director

Executive Council of the SR of Serbia

Mr. Milenko Bojanic, President
Mr. Ikonic, Vice President
Mr. T. Vlaskalic, Member of the Executive Council
Mr. V. Gajinovic, Secretary of the Foreign Relations Committee

Central Council of the Federation of Trade Unions of Yugoslavia

Mr. Marijan Rozic, Secretary
Mr. Rajf Dizdarevic, Secretary

Association of Yugoslav Banks

Mr. Ljubisa Lukic, President of the Association and General Manager of the Beograd United Bank
Mr. Milan Ivanovic, Secretary General of the Association
Mr. Dragan Miljkovic, General Manager of the Yugoslav Investment Bank
Mr. Bozidar Linhart, General Manager of the Yugoslav Bank for Foreign Affairs
Mr. Sreten Cvijovic, General Manager of the Economic Bank, Beograd
Mr. Dragutin Sebrek, General Manager of the Economic Bank, Zagreb
Mr. Niko Kavcic, General Manager of the Bank of Ljubljana, Ljubljana

Export Credit Insurance Fund

Mr. Slavko Baum, General Manager

International Investment Corporation for Yugoslavia (IICY)

Mr. Zoran Zagar, Vice President

Federal Chamber of Economy

Mr. Rudi Kolak, President

National Bank of Yugoslavia

Mr. Ivo Perisin, Governor
Mr. Bramko Colanovic, Vice President
Mr. A. Bogoev, General Manager
Mr. M. Mermolja, Senior Adviser
Mrs. Nada Zivanovic, Director
Mrs. D. Filipovic, Translator

"21 Maj" Motor Factory (DMB)

Mr. Dusan Pudja, General Manager of UMI
Mr. Djordje Brkic, General Manager of DMB
Mr. R. Barisic, Director of DMB
Mr. R. Colic, Director of DMB
Mr. V. Despotovic, Chairman of the Workers' Council
Mr. Lj. Nikolic, Chairman of the Managing Board

"Beograd", Agro-Industrial Combine, Padinska Skela

Mr. Petar Zecevic, Managing Director
Mr. A. Pavlovic, Deputy Managing Director
Mr. M. Milosavljavic, Director
Mr. V. Ciric, Director of the Research Institute

Executive Council of the SAP of Vojvodina

Mr. Sava Filipovic, Vice President
Mr. Z. Cosic, Member of the Council
Mr. Milan Janjetovic, Secretary of Agriculture
Mr. D. Vlatkovic, Secretary of Finance
Mr. V. Probac, Secretary of Information

Dunav-Tisa-Dunav Canal Enterprise, Novi Sad

Mr. V. Bulatovic, General Manager

"Koprodukt", Trade Association of Livestock Producers and Meat Products Manufacturers, Novi Sad

Mr. T. Birovljev, General Manager
Mr. Lj. Kasikovic, Deputy General Manager
Mr. S. Zvekic, Chairman of the Workers' Council

Agricultural Institute, Novi Sad

Mr. T. Vrebalov, Director

Faculty of Agriculture of Novi Sad University

Prof. R. Savic
Prof. S. Reljin

Executive Council of the SR of Macedonia

Mr. K. Bogoev, President
Mr. K. Crvenkovski, Member
Mr. N. Uzunov, Member
Mr. S. Hristov, Chairman of the Economic Chamber of the Assembly of Macedonia
Mr. A. Makraduli, Secretary of Finance
Mr. M. Balevski, President of the Assembly of the City of Ohrid
Mr. T. Ivanovski, General Manager of the Investment Bank, Skoplje
Mr. K. Janevski, Director of the Road Fund of the SR of Macedonia
Mr. S. Moris, Vice President of the Chamber of Economy of Macedonia
Mr. A. Arsov, General Manager of the Chemical Industry OHIS, Skoplje
Mr. G. Petrovski, General Manager of the Agricultural Combine "Pelagonija", Bitola

Assembly of the City of Skoplje

Mr. D. Stavrev, President
Mr. T. Papes, Vice President
Mr. A. Manevski, Vice President
Mr. V. Muratovski, General Manager, Department for Reconstruction and Development of Skoplje
Mr. K. Kitanovski, Director, Department for Regulation of River Vardar

Executive Council of the SR of Bosnia and Hercegovina

Mr. D. Kosovac, President
Mr. S. Lopandic, Vice President
Mr. Dz. Muminagic, President of the Assembly of the City of Sarajevo
Mr. Dj. Peklic, Secretary of Finance
Mr. N. Stojanovic, Director of Republican Institute for Social Planning
Mr. R. Makic, General Manager of the Investment Bank, Sarajevo

"Energoinvest", Sarajevo

Mr. E. Blum, General Manager
Mr. R. Selmanagic, Deputy General Manager
Mr. H. Pitic, Financial Manager
Mr. I. Papo, Assistant General Manager

Republican Chamber of Economy, and Industrialists (Bosnia-Hercegovina)

Mr. H. Numic, Vice President of the Republican Chamber of Economy
Mr. S. Tomic, General Manager of the Mining and Metallurgy Combine, Zenica
Mr. F. Gorski, General Manager of Chemical and Oil Industry HENA, Sarajevo
Mr. Lj. Grupkovic, General Manager of ELEKTROPRENOS, Sarajevo
Mr. R. Krunic, Assistant General Manager, Cellulose Factory, Banja Luka

Meeting in Dubrovnik on South Adriatic Project and Babin Kuk Project

Mr. Nikola Gril, Member of the Executive Council of the SR of Croatia
Mr. A. Vetma, President of the Assembly of the City of Dubrovnik
Mr. R. Lujak, General Manager of the Enterprise "Minceta"
Mr. I. Bautovic, Director of the Enterprise "Minceta"
Mr. V. Betica, President of the Tourist Federation
Mr. N. Vusovic, Coordinator of the South Adriatic Project
Mr. A. Marinovic, Department Head of the Urban Planning Institute

Executive Council of the SR of Montenegro

Mr. Z. Bulajic, President
Mr. Z. Dragovic, Secretary of Economy
Mr. Drecun, Secretary of Finance
Mr. V. Knezevic, President of the Committee for International Relations
Mr. P. Stijepcic, President of the Assembly of the City of Hercegnovi
Mr. M. Cemovic, General Manager of the Investment Bank, Titograd
Mr. D. Grupkovic, Director of the Republican Institute for Social Planning
Mr. J. Sapuric, Director of the catering enterprise "Boka"

Executive Council of the SR of Croatia

Mr. D. Haramija, President
Mr. D. Reljic, Vice President
Mr. E. Nonveiller, Member
Mr. N. Gril, Member
Mr. I. Bukovic, President of the Economic Chamber of the Republican Assembly

Republican Chamber of Economy, and Industrialists (Croatia)

Mr. V. Gasparovic, President of the Chamber of Economy of the SR of Croatia
Mr. Ante Markovic, General Manager of "Rade Koncar"
Mr. B. Prikril, for the Port of Rijeka
Mr. I. Marjanovic, General Manager of the Association of Shipbuilding Enterprises "Jadranbrod"
Mr. I. Spika, General Manager of the Agro-Industrial Combine, Osijek
Mr. M. Basic, Vice President of the Chamber of Economy of the SR of Croatia
Mr. I. Pavlisko, General Manager of "INGRA"
Mr. M. Cuculic, General Manager of "OKO"
Mr. P. Gazi, General Manager of "Podravka"
Mr. N. Veber, General Manager of Steelworks Sisak

Meeting at the Reception given by the President of the Executive Council of the SR of Croatia, Mr. D. Haramija

Mr. Ivo Supek, Rector of Zagreb University
Mr. J. Kolar, President of the Assembly of the City of Zagreb
Mr. V. Gasparovic, President of the Chamber of Economy of the SR of Croatia
Mr. V. Rajkovic, General Manager of the Republican Institute for Social Planning
Mr. Z. Moric, Adviser in the Republican Executive Council

"Crvena Zastava" Automobile Factory

Mr. P. Rakovic, General Manager

Industrialists (Serbia)

Mr. Z. Mucalov, General Manager of "Energoprojekt"
Mr. L. Ljubisa, General Manager of the Community of Yugoslav Electric Power Enterprises
Mr. V. Aksin, Deputy General Manager of "Naftagas"
Mr. P. Marjanovic, Director of Refinery Pancevo
Mr. B. Rmandic, Assistant General Manager of Refinery Pancevo
Mr. R. Sutic, Director, Copper Rolling Factory, Sevojno
Mr. M. Savicevic, Director, "Generalexport"
Mr. Dj. Lezimirac, Director, "Generalexport"
Mr. B. Markovic, Director, "Generalexport"

League of Communists of Yugoslavia

Mr. Kiro Gligorov, Member Presidium

Federal Fund for Developing Regions

Mr. Aleksandr Radevic, Director

4

Population: 19.9 m
GNP Per Cap: $570

IVa. YUGOSLAVIA - 5 YEAR LENDING PROGRAM

		($ millions)							
		Fiscal Year						Total	Total
		1971	1972	1973	1974	1975	1976	1964-68	1969-73
Forestry II	IBRD			10.0					
DFC - YIB I	IBRD		20.0						
DFC II	IBRD			25.0					
DFC III	IBRD					30.0			
Industry Modern. IV	IBRD				20.0				
Power	IBRD		20.0						
Tourism I - Portoroz	IBRD	8.0							
Tourism II- Babin Kuk	IBRD	10.0							
Tourism III	IBRD		15.0						
Tourism IV	IBRD				15.0				
Roads V	IBRD	40.0							
Roads VI	IBRD			30.0					
Roads VII	IBRD				30.0				
Railways	IBRD					30.0			
Water Supply - Multipurpose I	IBRD	34.0							
Water Supply - Multipurpose II	IBRD			25.0					
Unallocated I	IBRD		20.0						
Unallocated II	IBRD			10.0					
Unallocated III	IBRD				10.0				
Unallocated IV	IBRD					15.0			
	IBRD	92.0	75.0	100.0	75.0	75.0		175.5	411.5
	No.	4	4	5	4	3		5	18

P & B 10/2/70

UNDP (Special Fund Projects for Yugoslavia)

Symbol	Project	Agency	Approved by Governing Council	Project duration *(years)*	Project costs *(US dollar equivalent)* Total	Governing Council earmarkings 1/	Government counterpart contribution 1/
	YUGOSLAVIA						
YUG 1	Instructor Training Centres	ILO	May 1959 (Oct. 1963)*	4	7,453,487	985,987 2/	6,467,500
YUG 2	Pilot Land Reclamation Project on the Lower Neretva	FAO	Dec. 1960	7½	3,932,100	1,037,100	2,895,000
YUG 3	Nuclear Research and Training in Agriculture	IAEA	May 1962 (Dec. 1966)*	3	1,752,400	546,400 2/	1,206,000
YUG 4	Skopje Urban Plan	UN	June 1964 (June 1966)*	1	4,847,400	1,475,400 2/	3,372,000
YUG 5	Training Centre for Building Construction Personnel, Skopje	ILO	June 1964 (Oct. 1967)*	3	1,146,600	485,600 2/	661,000
YUG 6	Studies on the Regulation and Control of the Vardar River	UN	June 1965 (July 1969)*	2½	6,102,300	1,479,300	4,623,000
YUG 7	Regulation and Management of the Sava River	UN	June 1966	2	1,571,800	1,061,800	510,000
YUG 8	Physical Development Plan for the South Adriatic Region	UN	Jan. 1967	3⅓	2,979,400	1,114,400	1,865,000
YUG 9	Land Reclamation and Development in the Sava River Basin	FAO	June 1968	3½	1,655,000	600,000	1,055,000
YUG 10	Development of Forestry and Forest Industries	FAO	Jan. 1969	3	2,314,200	983,200	1,331,000
YUG 11	Centre for Industrial Organization and Development	UNIDO	Jan. 1970	3	2,357,100	932,100	1,425,000
YUG 13	Physical Development Plan for the Northern Adriatic Region	UN	June 1970	2	2,961,300	394,300	2,567,000

* Date of completion of field work.

1/ See footnote 3/, page 3.

2/ Final earmarking.

BANK LENDING TO YUGOSLAVIA BY REPUBLICS AND PROVINCES

($ million)

Loan No.	Year	Purpose	Total Amount	Serbia	Slovenia	Crotia	Bosnia and Hercegovina	Montenegro	Macedonia	Kosovo /1	Vojvodina /1
20	1949	Industry (imports of timber working machinery)	2.7	0.3	0.3	0.9	1.0	0.1	0.1	-	-
51	1951	Multipurpose (industry, agriculture, power, transport, forestry, fishery)	28.0	10.4	1.8	4.4	11.2	-	0.2	-	-
73	1953	Multipurpose (see above)	30.0	6.0	7.4	2.8	12.4	0.2	0.1	-	1.1
277	1961	Power (Senj)	30.0	4.0	0.7	20.4	3.3	1.6	-	-	-
318	1962	Power (Bajina Basta)	30.0	22.0	3.0	3.0	-	2.0	-	-	-
344	1963	Roads (Adriatic and Central Highways)	35.0	7.0	3.0	20.0	-	5.0	-	-	-
361	1963	Rail (Sarajevo-Ploce)	35.0	-	-	3.0	32.0	-	-	-	-
395	1964	Rail (modernization program) /2	70.0	26.7	10.1	18.7	7.0	-	7.5	-	-
485	1967	Roads (Zupanja-Opuzen)	10.0	-	-	1.0	9.0	-	-	-	-
504	1967	Industry (7 projects)	10.5	-	4.3	1.0	2.4	-	1.6	-	1.2
531	1968	Rail (Belgrade-Bar)	50.0	30.0	-	-	-	20.0	-	-	-
554	1968	Industry (10 projects)	16.0	11.0	4.6	0.4	-	-	-	-	-
608	1969	Roads (Zagreb-Karlovac, Croatia; Gostiva-Kicevo, Macedonia; Vrnhika-Postojna, Slovena	30.0	-	16.2	10.2	-	-	3.6	-	-
654	1970	Industry (3 projects)	18.5	12.3	-	6.2	-	-	-	-	-
657	1970	Telecommunications	40.0	19.3	2.2	8.9	4.5	1.7	1.1	0.6	1.7
678	1970	Roads (Sarajevo-Zenica, Bosnia/Herecegovina; Bar-Ulcinj, Montenegro; Belgrade-Novi Sad, Vojvodina; Pec-Pristina-Nis, Kosovo)	40.0	4.4	-	-	16.5	4.6	-	2.5	12.0
1.		Total loans	475.7	153.4	53.6	100.9	99.3	35.2	14.2	3.1	16.0
		of which (since 1965)	(215.0)	(77.0)	(27.3)	(27.7)	(32.4)	(26.3)	(6.3)	(3.1)	(14.9)
2.		Per capita: loans	$23	$30 /3	$32	$23	$26	$65	$9	$3	$8
		GNP /4	$580	$610	$1,090	$725	$360	$390	$380	$184	$620
3.		Distribution of:									
		a. total loans	100%	32	11	21	21	8	3	1	3
		b. loans since 1965	100%	36	13	13	15	12	3	1	7
		c. population 1969 total = 20,351,000 =	100%	25	8	22	19	3	8	6	9
		d. GNP 1969 /4 total = $11.8 billion =	100%	26	16	27	12	2	5	2	10

/1 Some sub projects involving Kosovo and Vojvodina may be included under Serbia.
/2 Based on the location of the borrowing enterprise.
/3 For Greater Serbia - Serbia plus Kosovo and Vojvodina - per capita IBRD loans is $20.93. See /1 above.
/4 IBRD estimate.

Bank Lending by Sectors since 1961

Transportation: Roads ($115 million)

344-YU	June 1963	$35 million (fully disbursed)	Central and Adriatic Highways
485-YU	February 1967	$10 million ($1.3 million undisbursed)	Zupanja-Opuzen (link between Central and Adriatic Highways)
608-YU	June 1969	$30 million ($25.2 million undisbursed)	Zagreb-Karlovac (Croatia) Gostivar-Kicevo (Macedonia) Vrhnika-Postojna (Slovenia)
678-YU	May 1970	$40 million (construction to start shortly)	Sarajevo-Zenica (Bosnia and Hercegovina) Bar-Ulcinj (Montenegro) Belgrade-Novi Sad (Serbia and Autonomous Province of Vojvodina) 3 Sections of Nis-Pristina-Pec (Serbia and Autonomous Province of Kosovo)

The Proposed Fifth Highway Project (amount $40 million) will consist of:

Pristina-Kosovo Polje (Kosovo)
Skopje-Tetovo (Macedonia)
Kicevo-Ohrid (Macedonia)
Hoce-Levec (Slovenia)
Postojna-Razdrto (Slovenia)

Transportation: Railways ($155 million)

361-YU	October 1963	$35 million (fully disbursed)	Sarajevo-Ploce line
395-YU	December 1964	$70 million ($16.9 million undisbursed)	Modernization of main lines
531-YU	March 1968	$50 million ($36.3 million undisbursed)	Belgrade-Bar line

Industry ($45 million)

504-YU	July 1967	$10.5 million ($2.6 million undisbursed)	Seven subprojects: Kikinda - Iron foundry Lignosper - Plywood Ohis - Acrylic fibre Pretis - Ball bearings Sisak - Steel tubes Sladki - Paper and board Tam - Trucks
554-YU	August 1968	$16 million ($9.4 million undisbursed)	Ten subprojects: Brest - Furniture DMB - Automotive engines E.I. Nis - Electronics Elan - Sports equipment MTT - Textiles Novoles - Woodworking Sevojno - Copper mill Stol - Furniture Trepca - Lead Combine Victor Lenac - Shipyard
654-YU	January 1970	$18.5 million ($18.5 million undisbursed)	Three subprojects: Zastava - Automobiles Sisak - Steel tubes Zmaj - Wheels and agricultural machinery

Power ($60 million)

277-YU	February 1961	$30 million (fully disbursed)	Senj Power Plant and Transmission Lines
318-YU	July 1962	$30 million (fully disbursed)	Bajina Basta Power Plant and Transmission Lines

Telecommunications ($40 million)

657-YU	February 1970	$40 million (Bidding to start soon)	Main long-distance transit and international telecommunications systems

Smole 10/12

Agr. WW II 200
↓
now 600 = 1200
200 (+1 dep.) → 35% of total pop.

3% of GNP transferred to 35% of pop. (by Gov. influence)
→ a. direct budget allocations
b. Special Fund financed by enterprises (legal requirement)

Flows: 210 billion d. Gov.

140 " d non Gov. flow (enterprises)

Without dom. resources mobil. ext. cap. cannot be used well.

Agr. work force: 75% of total at WW II
48% now.

Defense exp. not now in budget 6% of N.I.

IBRD GROUP:
1. IFC direct invest important. Joint ventures welcome
2. Domestic sav. mobil.
3. ~~Joint ventures welcome~~ Bk help to guarantee Y. bonds abroad
4. Export of capital goods in Y. – Credit arrangem.
200 mill

~~[illegible]~~:

JELIĆ (Secr. of Econ.)

Secretariat involved in subsidy schemes: interest rate, fertilizer, power etc.
Perhaps Y. banking hampered by too low interest rate (8% limit)
Bankers use other means to get deposits – deposits now before loans in future.
Much inflexibility inside economy.
No limitation on mergers.
40% of prices in industry is fixed. Rest is free
Little control on prices in agriculture.

In transportation: freight rates are controlled, passenger rates are not.

9.30 Dr Stojaner: | - Pace of growth of develop. + ldc region same now.
| - Spec. Fund set up for ld regions.

10.15 GRANFIL:

~~[illegible]~~ 1968 17% Δ in exports - hope 15% in 1970

Org. of cap. mkts most important

- Business savings - transferred in form of bonds.
- Part of workers salaries adm. by Workers Councils.

They decide how to invest or otherwise use these funds

⇒ McN: - interested to help Y. develop a capital mkts | see what we can do |

- more projects in pipeline (3:2)
- direct BK invest in industry possible.

11.15 Miljanek:

Profit not the only motivating force between income growth.

Market oriented economy

~~Main~~ tools → monetary + credit policies

a) selective credit policies.

for agriculture.

" exports.

b) subsidized interest ~~[illegible]~~ rates.

sp. in tourism

a) below mkt rate

b) in advance

c) state direct power and influence (mainly infrastructure)
α - road construction
- power devel.

d) differential tax rates (at Federal level)
largely used in tourism

e) conditions for allowing to take up credits abroad.

3.15 Trade Union leaders:
Problems of central planning interference
" resistance to new technology
" funds destribution

3.5 mill members - communal, Republic national level
and by trade

4.05 Kolak, Chamber of Economy (Pres.)
All enterprises ~~are members~~ / Chambers
Represents business pt. of view.
Representative on Econ Council - 70% been members of Chamber
- [Nat'l law requires rail rates approved by Chamber
- [Econ. Council dominated by consumers.
so rates were not approved.
but Gov can take action on its own, but
only rarely and reluctantly.

Gligorov 10/16:

Party no direct State function
more educational -

1. To preserve Y strength - important to let Republics feel that they are part of that org.
2. Further devel of democratic institutions to replace role of single
President.

Party membership - open to anybody - free election within party
Inverse relationship between level of profession and Z membership.
Problem that not enough workers in Party, but most are members
of the Socialist Alliance.
With decentralization the role of fiscal policies must be widened.
The philosophical basis for an incomes policy must be found.

CONFIDENTIAL

EC/O/70-25/1

COUNTRY PROGRAM PAPER
EUROPE, MIDDLE EAST AND NORTH AFRICA DEPARTMENT

YUGOSLAVIA

	Bank Lending ($ million)		
	1964-68	1969-73	1971-75
1969 population: 20.4 million			
1969 per capita GNP: $570			
Current population growth rate: 1% p.a.			
Current exchange rate: US $1 = 12.5 dinars	175.5	394.5	430.0

A. Country Objectives

1. Background - Yugoslavia is a federal state, fragmented by numerous mountain ranges, three official languages and three religious traditions. Six Republics and two autonomous regions in the Federation provide outlets for strong regional loyalties inherited from earlier political divisions and great economic disparities. While the northern and western parts of the country are fairly advanced due to their close present economic and past political links with Central Europe (Austro-Hungarian empire), the central and southern parts, under Turkish influence till the beginning of this century, are still largely underdeveloped.

2. After the second World War, the Eastern European communist system was introduced, but has evolved since into an extremely original socio-economic system characterized by the interplay of the concept of "workers' self-management" and market-economy principles. The socialized sector comprises the modern part of the economy including industrial enterprises, large farms, banks, trading firms and most service establishments. In this sector, society owns the means of production but the workers manage the enterprise in which they work and share its profits. More than half of the population is still in the private sector, which includes traditional occupations, mainly small farmers, but also, within limits, handicrafts, services and professions. The unique nature of the Yugoslav system prevents direct application of economic methods and systems proven in different environments.

3. In its foreign policy, Yugoslavia has adopted a position of non-alignment although leanings to and relationship with the West, arising largely from economic reasons, have become stronger in the recent past. The country identifies itself with the Third World (it participated in the Algiers Conference where the "Group of 77" was formed), refused to become a member of Comecon, joined the GATT in 1966, participates actively in the OECD, and is contemplating association with the EEC.

4. While the Bank has close contacts with the Yugoslav administration and economic circles, the scarcity of contacts at the political level and the on-going transfers of power away from the Federation make predictions about political developments difficult. As far as can be judged, the three main unifying factors are Marshall Tito, the League of Communists and the Socialist Alliance, while the power of the Federal Government has become relatively small. Tito (now 78) is widely respected and his interventions are usually considered final decisions: whether this is due to his strong political position and immense personal prestige, or to his skill in supporting decisions already endorsed by a majority, is not altogether clear.

5. The League of Communists has a limited membership (about 5 percent of the population) and has no power to pass or even introduce laws: these functions are performed solely by the Parliament, whose members are all elected from the ranks of the Socialist Alliance, the only mass party (with over 8 million members). The League makes its influence felt through its members, who occupy the most important positions in the Alliance. Both the League and the Alliance try to spread common objectives and policies and their influence on the implementation of decisions is great at all levels, especially in the Communes. Although both are attached to the Marxist ideology, they are very pragmatic in its application. They have evolved the present original social system, and have dampened the tendencies to secession by transferring power from the Federation to the Republics. The succession process is provided for in the Constitution and there is no specific reason to expect major policy changes after Tito's departure.

6. Recent Economic Development - The 1965 Economic Reform restructured the economy by considerably reducing central administration of resources and establishing a market-oriented economy including profit-consciousness. During the period of consolidation of the reform, growth was slow, as had been expected, but in 1968 the Government decided to promote more rapid growth by expanding credit.

7. The economy reacted quickly and entered a phase of vigorous expansion. Gross Domestic Product at constant prices, which had increased by less than 1 percent in 1967, rose by about 4 percent in 1968 and by over 8 percent in 1969. Demand, particularly for investment, which had experienced a setback during 1967, expanded quickly and, despite the considerable rise in production, it soon outstripped supply. Prices, which had been fairly stable during most of 1968, began to increase at a faster rate towards the end of the year. This created a growing threat to the country's internal financial stability causing the Government to revert again to a restrictive monetary

policy. However the impact of credit restrictions was delayed partly because of excess liquidity created in 1968, but also because they were not adequately supported by similar measures in the fields of fiscal and income policies. Economic activity therefore continued to expand and prices continued to rise in 1969 (the cost of living index rose by 8 percent). On the external side, limitations to rapid growth also became apparent. Even though foreign exchange earnings have developed exceptionally well, rising by 16 percent in 1969, they were not able to keep pace with imports which rose by 19 percent. The current account deficit increased to a level that could probably not be sustained without creating a serious debt problem. However, the Government expects that continued monetary restraint will be sufficient to slow down the rate of economic growth and of import demand and thus to keep the balance of payments under control.

8. Structural Changes and Adjustment Problems - Recent economic developments have clearly demonstrated that the reform measures started in 1965 have been successful. The decentralization of responsibilities for economic management, together with internal price adjustments, a reduction of taxes and some import liberalization, have encouraged enterprises to become more efficient. Stiffer competition both from within the country and from abroad led to mergers and other forms of cooperation among enterprises with the aim of reducing costs through large-scale production and specialization. Greater efficiency and quality improvements increased the international competitiveness of Yugoslav enterprises and stimulated exports particularly to the convertible area. Rising foreign exchange earnings together with credits obtained in the industrialized countries permitted larger imports of modern equipment and capital goods from the West.

9. On the other hand, the rapid growth experienced since 1968 and the stability problems associated with it brought into the open some structural weaknesses of the Yugoslav economy. Fundamentally, they reflect the fact that enterprises and banks which now carry the main responsibility for economic decisions have only limited experience with a market-oriented economy while the legal and institutional framework within which they operate and through which their actions are coordinated, needs further improvement. Financial control and discipline within enterprises and the banking system are still weak and the creditors have difficulty in enforcing their rights. Economic planning has been decentralized to an extent where sectoral and national coordination is becoming increasingly difficult. Economic management instruments such as monetary, fiscal and income policy need further strengthening while financial markets are still in a rudimentary stage of development. In short, while production has responded very favorably to the economic reforms, the necessary adjustments on the financial side and in economic policy instruments are lagging behind.

10. The Government is aware of these deficiencies and has initiated new legislation to enforce adequate financing arrangements for new investment projects, to strengthen the rights of creditors, and to facilitate the improvement or elimination of enterprises which make losses. The laws were passed by the National Assembly in December 1969, and can be expected to have a considerable impact on the financial discipline of enterprises and banks. Moreover, discussions are presently under way between the Government and representatives of banks and business associations to promote the development of money and capital markets, to reduce price controls further, and to strengthen fiscal and income policies.

11. Further action and decisions are required particularly in the current year during which the next Five-Year Plan (1971-75) will be approved. Given the recent fragmentation in economic planning there is a need for country wide development plans for basic infrastructure activities such as water, power, railways and roads, covering the next five years and, if possible, a longer period, together with the phasing of such investments. This would require the creation of adequate coordinating mechanisms to ensure that the projects to be developed would be both profitable and also fit into the overall requirements of the national economy. Related to this is the question of financing large-scale infrastructure projects which may become difficult after 1970 when tax resources for such purposes are planned to be reduced except for projects in the less developed regions. There is need to review the problems connected with this change in financing including the question of price control on energy and railway freight tariffs: removal of price control would allow a higher proportion of investment to be undertaken directly by the enterprises concerned. The review might also consider the desirability of requiring banks to provide for infrastructure in their lending program.

12. The recent economic legislation passed by the National Assembly has created some incentives for the floating of bonds. But the major obstacle to the formation of broad and effective financial markets, the ceiling for interest rates which at present stands at 8 percent, has not been removed. This makes it very difficult to create attractive financial assets in an economy where the opportunity costs of capital are certainly higher than this interest ceiling.

13. One further result of the increased efficiency brought about by the 1965 reforms, was a rise in unemployment. The statistically high rate of unemployment in the socialized sector (9 percent), however, somewhat overstates the immediate urgency of this problem. In fact, less than one-fourth of the registered unemployed are without any occupation or earned income. Most of the others are either small farmers or members of agricultural households who have applied for employment elsewhere

to improve their economic position. This, of course, indicates that unemployment and particularly under-employment are still serious structural problems in rural areas, especially in the economically less developed regions where the small size of the modern sector and the higher rate of population growth tend to aggravate the situation.

14. Solutions to the problems referred to in the preceding paragraphs will often not be easy since they have to take into account the particular characteristics of the Yugoslav social and political system as well as the need for careful balance between the necessary degree of central direction and coordination on the one hand and strong regional and local interests on the other. This means that solutions found in other countries can hardly be copied. As in the past, they will have to be developed to fit the specific Yugoslav conditions.

15. Development Objectives and Prospects - Since the 1965 Economic Reform the Government's development objectives have remained unchanged: to increase economic efficiency through improved resource allocation, relying on market forces rather than central administration; to promote foreign exchange earnings, especially from the convertible currency area, as a basis for future economic expansion; and to reduce inequalities in economic development between different regions of the country. Although the next Five-Year Plan for 1971-75 is still under preparation, it can be assumed that it will reflect this development strategy.

Medium-Term Macro-Economic Targets /1

	Unit	Current level (1969)	1975 Bank Projection Absolute	1975 Bank Projection Growth Rate
GNP (at 1969 market prices)	$ bln.	11.8	16.7	6%
Population	mln.	20.4	21.7	1%
GNP per capita (1969 prices)	$	570	760	5%
Investment ratio	% of GNP	28	28	-
Exports of goods	$ mln.	1,450	2,330	8.2%
Imports of goods	$ mln.	2,100	3,290	7.8%
Net invisible receipts	$ mln.	460	870	11.2%
Net medium and long-term capital inflow	$ mln.	200	150	-
Export credits, net	$ mln.	-50	-80	-
Debt-service ratio		23	21	

/1 There are no official targets available at present. The next Five-Year Plan (1971-75) is under preparation and will be approved later in the year.

16. Prospects that these objectives can be successfully pursued in the future, are on the whole favorable. The skill and industriousness of the Yugoslav people, the country's considerable natural resources and the proximity to the European industrial nations should guarantee a sustained impetus for expansion. There is a pressing need for further modernization and expansion of production facilities and infrastructure. Enterprises and government bodies have sizeable investment programs which they will carry out as soon as sufficient funds become available. However, overall economic growth will be limited by the availability of foreign exchange since investment and current production depend to a considerable extent on imports of equipment, components and raw materials particularly from the hard currency area.

17. Between 1969 and 1975, gross earnings of convertible foreign exchange could rise at an average rate of 11 to 12 percent a year taking into account the fast rising trend of invisible earnings, especially from tourism (with 1969 earnings of $200 million) and workers remittances (where 1969 receipts of $160 million are expected to grow up to $400 million by 1975). Exports to bilateral countries, on the other hand, are unlikely to grow at more than 5 percent a year, mainly because of difficulties of expanding imports from that area. Total earnings of convertible and non-convertible exchange could therefore rise at some 9 percent a year. Assuming a moderate net inflow of loan capital in the order of $100 million a year, and taking into account the need for export financing and some accumulation of reserves, this would permit imports from the convertible currency area to grow at about 9 percent a year, and total imports at approximately 8 percent. Such an increase of imports would be consistent with a 6 percent growth rate of GDP. As the population is rising by only about 1 percent a year, prospects for further improvement in the standard of living and, to a lesser extent, of employment, are quite favorable.

18. The 6 percent rise in GDP could be achieved with a lower investment rate in the directly productive sectors than in the past. Rapid and unselective expansion of production facilities would add strongly to import demand which if not satisfied could lead to unused capacities and a less favorable cost structure. This would be particularly the case if new capacities were established in heavily import-dependent industries catering for the domestic market. On the other hand, there is still a great need for infrastructure investments which would strengthen the country's competitive position in the longer run without immediately creating new production capacities. Overall investment rates should continue to be high and priority should be given to export industries and the development of Yugoslavia's infrastructure.

19. A high level of investment is likely to create considerable pressure on available resources, and economic management will have to guard constantly against the danger of an over-heated economy. Any build-up of excess demand will be reflected in rising prices and will lead to spill-over into imports with serious implications for the balance of payments. The growth of consumption will therefore have to be contained to maintain reasonable price stability and an adequate rate of national savings.

20. In order to bring the per capita income of less developed regions more in line with the rest of the nation, the Government has created a Special Fund through which resources are transferred from the more advanced northern Republics to the poorer areas in the Center and South. The Fund is financed by taxation, its annual resources being equal to 1.85 percent of the national income, and the allocation to Republics is determined by the Federal Assembly on the basis of a number of criteria of which the most important is the level of per capita income. The allocation of the Fund's resources within each underdeveloped region is left to the respective regional governments which usually channel them through local investment banks. As this Fund may well be the main instrument of state economic intervention in the next Plan period, it would be advantageous for the Government to undertake a detailed review of its operations to ensure that resources are devoted to the more important projects.

21. Summing up, the following policy objectives are considered of primary importance to deal with Yugoslavia's development problems:

(a) Continuing efforts to increase foreign exchange earnings from the convertible currency area through further improvements in the international competitiveness of Yugoslav goods and services.

(b) Careful management of the balance of payments and external debt obligations, in order to avoid liquidity crises harmful to sustained economic growth; encouragement of foreign private capital inflow.

(c) Effective fiscal, monetary and incomes policy measures to contain internal inflationary pressures.

(d) Increased emphasis on infrastructure development to strengthen the country's long-term growth potential.

(e) Special efforts to deal with the problems of less developed regions.

(f) Improvement of overall investment planning and intrasectoral coordination and policies.

(g) Improvement of financing mechanisms, particularly to help channel investible funds into priority sectors and projects.

B. Economic Sectors

Sectoral Targets

	Unit	1969	1975 - Bank Projections 1/ Absolute	Growth Rate
Manufacturing and Mining				
Value added	($ mln.)	3,300	5,500	8
Exports	($ mln.)	1,170	1,910	8.5
Power				
Total production	(mln. of kwh.)	23,100	45,600	12
Agriculture				
Value added	($ mln.)	2,060	2,450	3
Exports	($ mln.)	280	420	7
Transport				
Railways:				
Freight	(mln. ton/km)	17,500	22,000	4
Passengers	(mln. passenger/km)	10,100	10,100	0
Highways:				
Freight	(mln. ton/km)	16,680	40,000	16
Passengers	(mln. passenger/km)	27,000	54,000	12
Tourism				
Number of nights	('000)	22,500	44,325	12
Gross foreign exchange earnings	($ mln.)	240	525	14

1/ In the absence of an up-to-date Plan, these targets are very tentative. The next Plan (1971-75) will be ready by the end of the year.

22. Industry - Yugoslav development strategy has given industrialization a leading role since the Second World War and the industrial sector, which was relatively small before the war, is now the most important one both in terms of production and exports. In 1968, it accounted for 31 percent of GDP and 80 percent of commodity exports. Industry also provides by far the largest share of employment in the socialized modern sector (close to 40 percent) although - due to the large labor reserves in agriculture - it employs only about 15 percent of the country's active population.

23. Industrial policies since the mid 1960's have been designed to improve the efficiency of enterprises and the quality of their products. As a result of these policies and measures, the international competitiveness of Yugoslav enterprises has improved, and exports, especially of components, semi-finished products and consumer goods, have risen remarkably. Foreign firms provided technical assistance, market outlets, credit and in some instances even risk capital.

24. As in the past, industry will have to make a major contribution to Yugoslavia's future economic growth. Since investment decisions are largely taken by existing firms and regional banks, resource allocation will essentially be left to market forces, and the more profitable enterprises, which also have the highest credit standing with local banks, will tend to expand faster than others. This implies that industrial growth will be concentrated in the more developed northern parts of the country. But the Government is making a special effort - through the Fund for Underdeveloped Regions - to promote industrialization in the poorer areas. Since manpower appears to be a less critical bottleneck than imports, Government policy will have to focus on synchronizing industrial expansion with the balance of payments constraint. Export industries will require continued encouragement to broaden the foreign exchange base as fast as possible. In a market-oriented economy this implies that a realistic exchange rate (the present one may be slightly over-valued with regard to industrial exports) has to be maintained. In addition, exports could be supported by credits especially from the Federal Export Credit Fund which, so far, has had insufficient resources to satisfy Yugoslav exporters' demands. Cooperation with foreign firms should be expanded in order to introduce more advanced technology and to provide further access to foreign markets. Conditions to attract direct foreign investment need to be improved. This will require clarification of legal rights of foreign investors and more generous guarantees for profit transfers. Joint ventures to establish import-based industries such as assembly operations should not be encouraged unless the agreement provides that imports of parts will be offset by exports of locally manufactured components. As exports expand there will be more scope for import liberalization. This would not only improve the supply of foreign equipment and raw materials but also increase competition in Yugoslav markets.

25. Power - As a result of rationalization measures introduced in the past few years, tariffs are presently set at levels which should permit adequate internal cash generation, and regional associations of enterprises are emerging as the new economic and technical units in the sector, thus over-

coming the proliferation of enterprises in the past. A 12 percent annual growth rate target over the period 1971-1975 would seem warranted and attainable. The right balance has yet to be found between the presently emphasized regional autonomy and optimal national development: difficulties may result for investments in some areas (e.g. Macedonia) and nationwide planning of new facilities (especially transmission lines across Republican borders).

26. Agriculture - In 1968, agriculture still employed about 50 percent of economically active persons, produced some 19 percent of GDP, and supplied 16 percent of the total value of commodity exports. Agricultural production expanded at an average of about 3 to 4 percent annually during the 1960's. It has now reached a level where the country is self-sufficient in most foodstuffs. Further increases in output will be limited by the growth of domestic demand and by export possibilities. Local demand for staple foods will rise only slowly, due to low population growth. Demand for livestock products and other high value foodstuffs is likely to increase faster because of the rising GNP per capita and the growing number of tourists.

27. The main agricultural export is beef, most of which is sold to Italy. Meat exports grew rapidly until 1968, when they fell due to a large increase of protective duties by the EEC. The Government is presently negotiating with the EEC for a reduction of import duties. There are indications that these discussions will be successful. In this case, Yugoslav meat exports to the EEC would increase again in the early 1970's. The outlook for other agricultural exports is varied. There are good prospects for exporting more processed fruit and vegetables to the European market, provided production and processing facilities can be expanded. Corn, the country's largest grain crop, has already become an important export to European markets but the competitive position of Yugoslav producers is weak and in Italy, the major EEC market for corn, Yugoslavia is at a disadvantage due to special levy regulations.

28. The saturation of local markets with basic staple food, the continuing urbanization of the population, expanding tourism and the sophisticated requirements of the export market will place considerable strain on the distribution system and processing facilities and may pose a more formidable task than output expansion. Requirements of the market will also determine, to a much greater degree than in the past, production patterns and plans.

29. The fact that two of the country's principal export commodities, beef and corn, have run into foreign market problems will affect the rural economy adversely unless the current negotiations with the EEC are successful. Internally, producers find themselves in a cost-price squeeze since minimum and guaranteed prices have not been raised in the last two to three years while costs increased considerably. Hence, the outlook for agriculture is somewhat uncertain. As prices are unlikely to be raised in the near future, measures will have to be taken further to improve production efficiency and to expand investment in processing and marketing facilities. Such a policy will be difficult to implement at a time when profits are declining, and pressures for increasing Government assistance for the agricultural sector are likely to build up.

30. Transport - The substantial growth and the liberalization of the Yugoslav economy in the past decade have generated a substantial increase and a structural change in the demand for transport, characterized by a rapid growth in road transport and a shift away from almost complete reliance upon the railways. Improvements to the transportation network have been insufficient because of shortage of funds and institutional changes. The decentralization introduced by the Economic Reform has shifted responsibility for the maintenance and development of the road and rail networks from the Federal Government to the Republics and the transport enterprises, without ensuring that new institutions could take over these tasks financially and operationally. The Federal administration staff is now inadequate to handle efficiently policy issues and to provide the support and supervision needed for the preparation and implementation of major investment projects. The Bank has urged the Government that the Federal staff be re-strengthened.

31. To face current needs and the high rate of future traffic increase, the roads require considerable investment and maintenance expenditures. Furthermore, decentralization has caused problems, mainly in the areas of staffing and coordination. The regional Road Funds and Road Councils have made progress during the past year in strengthening their staffs. Some measures have also been taken to improve coordination, but more needs to be done to reduce duplication and increase standards in highway research. In this connection, the authorities are considering the feasibility of establishing a "Community of Road Funds", or a similar alternative, as a central bureau for data collection and highway research. The Bank is advising the Government on these matters.

32. The railways have experienced a decline in net revenue and, in three of the Republics, are faced with major financial difficulties which are delaying by about three years the modernization of the main lines, which the Bank is helping to finance through a loan made in 1964. There is a clear need for the railways to strengthen central management, adjust tariffs and obtain funds for capital investment from the Federal and Regional governments.

33. Tourism - Since 1962, Yugoslavia's earnings from tourism have expanded at approximately 25 percent per year. Continued expansion at 15-20 percent per annum for the next five years can be expected. The bulk of foreign tourism is concentrated in the seaside resorts along the Adriatic and most of the expansion expected in the future will still take place there. However, several studies have been undertaken to examine the possibilities of diversifying tourism through the development of mountaineering, winter sports and health resorts. Both the Federal and Republican governments are giving high priority to the development of this sector.

34. Limited availability of tourist facilities is likely to be the main constraint. The increase in accommodation, though large, has not kept pace with the expansion in tourist demand. Substantial investment to provide suitable accommodation (hotels, motels, autocamps) together with catering, entertainment and other facilities (roads, water supply and sewerage) will be necessary. The Yugoslav authorities seem inclined to promote the creation

of "tourist complexes" where a planned and coordinated investment program can be developed to provide all necessary facilities. These large complexes (2,000-10,000 beds) represent an attempt to organize tourism on an industrial scale and are particularly suited to foreign financing. The Bank has presently three such complexes under review.

C. External Aid

35. Decline in Official Aid - The net inflow of medium and long term capital averaged $150-$200 million over the last five years. During this time there has been a significant shift in the sources of foreign capital. Long-term official loans, which played a dominant role until 1967, have since become less important. To a large extent this was due to the discontinuation of PL 480 loans which became superfluous after the country reached self-sufficiency in basic foodstuffs. Repayments on official loans are now about equal to new disbursements and the outstanding obligations show little change. The emerging gap has largely been filled by medium-term credits from suppliers and foreign banks which have become the main source of financing Yugoslavia's external capital requirements. In 1968, such credits accounted for over 70 percent of total net capital inflows, and in 1969 their share was probably even higher.

Net Inflow of Medium and Long-term Foreign Capital
(U.S. $ million)

	1965	1966	1967	1968
Official capital	121	120	66	39
USA	107	116	33	25
Other Western countries	-10	-3	13	-13
Eastern countries	-10	-12	9	11
International organizations	34	19	11	16
Private capital	42	84	85	102
Total capital	163	204	151	141

36. The drastic shift in the sources of foreign capital from long-term official loans to medium-term suppliers' credit has led to a fast increase in Yugoslavia's external debt service obligations, placing a heavy burden on her balance of payments despite rapidly rising external earnings. At the end of 1968, more than half of the total external debt with the convertible currency area - $2 billion 1/ - was medium-term debt. Service payments, particularly for amortization, are therefore high, having reached some 19 percent of convertible exchange earnings in 1968, and an estimated 23 percent in 1969.

37. Future Sources of Aid - For the next few years, there is little prospect that Yugoslavia will obtain bilateral aid on a significant scale. Some loans

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1/ There were also some debts with bilateral countries which, however, are neglected in this context, as Yugoslavia's trading position with the non-convertible currency area is strong, and servicing of these debts does not raise problems.

may be made by Germany and to a lesser extent Italy. But such aid is unlikely to reach more than a fraction of the amounts available to the country some years ago despite strong efforts made by the Yugoslav Government to obtain more bilateral loans. In addition, the Yugoslav Government has, in present circumstances, little hope to be able to float bonds on the major western capital markets. The main source for official long-term capital will therefore be the IBRD. According to the lending program, the Bank will commit about $530 million during 1970-75; net disbursements are expected to reach some $340 million in this period compared to $139 million during 1964-69. But even the expected increase in disbursements from Bank loans will do little more than offset the net repayments of bilateral loans ($270 million during 1970-75). Given this situation and assuming an average net inflow of loan capital of about $600 million between 1970 and 1975, which under the circumstances will have to be financed mainly by suppliers' credits ($530 million), the country's debt structure will become even more unfavorable in the future, and debt service payments can be expected to rise faster than the total amount of debt. Thus, even with fast growing exchange earnings, the debt service ratio is likely to remain above 20 percent by 1975.

38. On the above assumptions, Yugoslavia's external net loan capital inflow would average $100 million per year. As repayment obligations are high, gross disbursements from foreign loans would have to rise from some $400 million in 1970 to about $600 million in the mid 1970's. Total gross disbursements would thus add up to $2.9 billion for the six years 1970-75 of which the Bank would contribute some $400 million (14 percent), and bilateral aid about $180 million (9 percent). The remaining $2.3 billion (77 percent) would have to be raised through suppliers' credits and commercial bank loans.

39. One possibility of obtaining additional long-term capital on terms less burdensome to the balance of payments would be to attract foreign private investment on a larger scale. The Government has encouraged such capital flows by special legislation enacted in 1967, and foreign companies have shown considerable interest in establishing themselves in the fast growing Yugoslav market. But actual investments have been disappointing so far; by the end of 1969 only 14 joint ventures had been signed between foreign and local enterprises committing the former to invest $43 million. The main reason for the reluctance of foreign private firms to invest on a larger scale is that the present Yugoslav law regulating such investments is still considered by foreign investors to be too restrictive on questions of management control and transfer of profits. There is also a general lack of understanding of Yugoslav economic and social conditions on the part of foreign private firms which makes them reluctant to place risk capital in a socialist country. In order to familiarize potential foreign investors with the situation in Yugoslavia and to advise the Yugoslav authorities on improvements in the foreign investment legislation, a promoting agency, the International Investment Corporation for Yugoslavia, was recently established

by a group of Yugoslav and foreign banks and IFC, to act as an intermediary for direct foreign investments.

40. Creditworthiness - Yugoslavia's past debt servicing record has been satisfactory although some rescheduling was required in 1965 and 1968. Recent decentralization measures have somewhat weakened the Government's control over external debts, and present arrangements to regulate the expansion of debt obligations have yet to be tried in a difficult situation. On the basis of our assumptions - gross Bank lending of $430 million during 1971-75 and a net inflow of foreign loans not exceeding $100 million a year - the debt service ratio would be slightly lower in 1975 (21 percent) than in 1969 (23 percent). The amount of Bank loans outstanding would increase from $330 million to $750 million during this period and their share in total debt would rise from 16 percent to 25 percent (see Table below). However, due to the favorable conditions of Bank loans, service payments for such loans would account for only about 8 percent of the total service payments in 1975 (6 percent in 1969). The country should therefore have no difficulty servicing Bank loans in the future. Considering, in addition, the success of recent economic reforms and the favorable growth prospects, particularly for export earnings, Yugoslavia is held creditworthy for further Bank lending.

External Debt Projections

($ million; convertible currencies only)

	1969	1975
Total debt outstanding (including undisbursed)	2,109	3,034
Publicly held debt	909	1,034
of which IBRD	(303)	(750)
Privately held debt	1,200	2,000
Bank's share in total	16	25
Bank's share in service payments	6	8

D. The Bank Plan

41. General - The major objectives of the Bank's lending program are (a) to alleviate Yugoslavia's shortage of convertible foreign exchange, which is the major constraint to economic growth, by providing a significant portion of the required inflow of external capital and helping to increase export earnings; (b) to accelerate development in the lesser developed regions of the country; and (c) to promote structural reforms in major sectors of the economy primarily through better coordination of development efforts.

42. Given the encouraging progress made with the Economic Reform, and the difficulty of raising funds on favorable terms from other external sources, the Bank should be, at least over the medium-run, the major external contributor of capital. At a later stage, Yugoslavia should be able to substitute increasingly other long-term sources of capital. The present Bank lending program envisages a participation in average annual amounts of around $90 million. Lending of this order of magnitude would contribute substantially to a more balanced structure of Yugoslavia's debt. A major assumption underlying the program is that a reasonable proportion of local currency financing will continue to be justified. The foreign exchange component, particularly for infrastructure projects and tourism, is relatively low. Yugoslav contractors are becoming increasingly competitive and even sucessfully participate in international bidding for projects in various other developing countries. To limit lending to foreign expenditures would lower the Bank's participation in infrastructure and tourism projects to about 15-20 percent which would give the Bank too little leverage to exercise the required influence on project implementation and sector policies. In addition, if the Bank were to confine its lending merely to the financing of foreign expenditures, the size and the impact of our lending would result in endangering the objective stated under (a) in paragraph 41 above.

43. Inasmuch as shortage of foreign exchange is one of the main constraints to fast economic growth in Yugoslavia, all possibilities of increasing export earnings should be explored. At present, Yugoslav manufacturers have to forego export opportunities because they are not able to provide credit terms as favorable as their competitors', and more adequate credit facilities could have a considerable impact on the country's export performance. In addition, such credit as Yugoslavia is able to give to its exports is straining the balance of payments. The Yugoslavs have asked whether the Bank could consider financing export credits. We expect to receive an informal exposé on this question but the Yugoslavs are aware that this raises difficult issues of principle in the Bank.

44. Less Developed Areas - The trend towards the building up of the "Fund for Lesser Developed Regions and Republics" (cf. paragraph 20) as a regional development institution, acting on the basis of economic priorities, could be asserted by Bank guidance and financial assistance. At the same time, the existence of an efficiently managed regional development institution would help us to select those projects for which the Bank would be most useful. The Fund is financed by taxation, its annual resources being equal to about 1.9 percent of GNP, and the allocation to regions is determined mainly on the basis of per capita income. After 1970, public funds for infrastructure development and for modernization of industry in the less developed regions are expected to be channeled mainly through the Fund and direct budgetary allocations, from federal as well as republic sources for specific projects would gradually be phased out.

45. The multi-purpose project scheduled for FY 1971 is being prepared by Yugoslav consultants with FAO assistance. It will provide an opportunity to examine the Fund as a possible channel for financing projects in the less developed regions. In the fall of this year, when the new Five-Year Plan (1971-75) will be ready, the Government's policy towards these areas will be defined, and it should be possible to determine whether the Bank could finance further projects in the less developed regions.

46. To provide for the possibility of financing projects in less developed areas and of lending to assist exports, either through loans to export-oriented industries or in other ways, the program includes one unallocated operation in each of the fiscal years 1972-1975. No difficulty is expected in finding suitable projects.

47. Coordination and Sectoral Policy - The need for structural reforms in major sectors of the economy arises out of the Government's decentralization policy discussed earlier. The Bank can play a significant role in ensuring that proper measures for country-wide coordination are gradually taken and sectoral policies improved in conjunction with its lending for transport, industry and tourism. These are the sectors of principal concentration in the lending program, since they are considered pivotal to future economic growth and most in need of assistance beyond the mere providing of finance.

48. Transport - Transportation, particularly roads, is increasingly inadequate both as to physical facilities and policies. The Bank's insistence on necessary reforms on the occasion of the Third and proposed Fourth Highway Projects is, however, already showing results. In particular, progress has been made in the field of project preparation. In order to maintain the momentum, further lending for roads has been included in the lending program. The loan scheduled for FY 1970 would be the second tranche of a large program, submitted by the Government in 1968. The first tranche was financed in FY 1969, and the third is scheduled for FY 1971. Since the

implementation of the road projects financed in FY 1969-71 will impose heavy burdens on the budget of the various Republics, the next loan for roads is scheduled for FY 1973 to be followed by a further operation in FY 1974, both for an amount of $30 million.

49. Lending for railways has been postponed till FY 1975, since the execution of the railway modernization program has run into difficulties and is not expected to be completed until 1973. However, new funds, mainly for rolling stock, will be needed as early as 1972, and if performance improves, we would be ready to consider advancing by two or three years the loan proposed for 1975. In that case, we would make necessary adjustments in the rest of the lending program for the respective years.

50. Considering past and planned Bank lending for the transport sector and its importance for the development of the economy, it would be desirable to complete our knowledge, particularly as to the effects of the recent decentralization process on all modes of transport. If staff is available, this would be undertaken by a sector mission, early this summer, before the draft of the new Five-Year Plan (1971-75) is submitted to the Federal Assembly. The mission would also be able to review the investment targets for the transport sector, the proposed means of improving coordination and to make suggestions to the Government with respect to sector policies.

51. Industry - Industry has become the major economic activity over the past two decades and will be spearheading development in the future. Large investments with a high import component have to be made to permit further expansion, modernization, and specialization. The main elements of the Bank's strategy for industry are: (a) loans to a development finance company; (b) direct loans for large industrial projects; and (c) industrial subsector studies. The development finance company is probably the Yugoslav Investment Bank, which the Bank would assist in developing the proper appraisal techniques, follow-up procedures and supervision. Lending to that institution should perhaps be earmarked for specific subsectors and linked with specific policy improvements. The large industrial project provided for in the lending program (FY 1974) must still be identified. It could emerge from the study of the steel industry which will be carried out by the Government perhaps with the help of consultants. The studies of other subsectors must still be discussed with the Government.

52. Power - The Bank could perform a useful role in encouraging the authorities to improve further the institutional set-up of this by and large well planned and administered sector. The entire sector is being re-examined by the Yugoslavs, and the Bank, through a review of the sector in early FY 1971, will help them formulate new sector policies as a prelude to a power project anticipated for FY 1972 but still unidentified.

53. Tourism - Tourism has considerable further potential and will be of particular importance during the coming years to help cover the deficit in the trade balance with the convertible currency area. The program includes three projects, which are already identified. These projects represent comparatively small amounts, but most of the Bank lending for roads will also benefit the development of tourism since these roads will open up important tourist areas.

54. An additional long-term objective of the Bank's lending program would be to help the Government strengthen its macro-economic management. The size of the program will enable the Bank to encourage the Government to proceed with the policies recommended in paragraph 21. Some of these matters can best be raised at the occasion of specific lending operations, e.g. the interest rate question in connection with the DFC lending and questions of investment planning and sectoral policies in connection with lending for highways.

55. If more Bank resources could be devoted to Yugoslavia, lending for foreign currency requirements of industry could be increased without great difficulty. Another way would be to raise the amounts set aside for transportation and tourism, but this would imply an increase in local currency financing. If the amounts under "Unallocated", which are tentatively set aside for assisting export industries and less developed regions, could not be utilized for those purposes, lending for the development finance company and industry could be increased.

56. Being presently the main source of external long-term capital for Yugoslavia,the Bank has a clear interest in exploring the possibilities of opening up other sources of external finance. The Bank Group will work closely with the recently established International Investment Corporation for Yugoslavia. We shall also assist the Yugoslavs in exploring the possibility of a private bond issue, possibly simultaneously with a Bank loan to Yugoslavia. Finally, the possibility of other forms of joint financing will be examined in appropriate cases.

Attachments: 1 - Yugoslavia - Actual and Proposed Lending Through FY 1975
2 - 5-Year Economic Development Program.

Europe, Middle East and North Africa Department
February 20, 1970

Population: 20.4 million
Per Cap. GNP: $570

YUGOSLAVIA - ACTUAL AND PROPOSED LENDING THROUGH FY 1975
($ million)

Projects	through 1963	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975	Total 1964-68	Total 1969-73	Total 1971-75
Forestry - IBRD I - II	2.7										5.0					
Communications								40.0								
DFC I (Yug. Inv. Bank)									20.0							
DFC II											25.0					
DFC III													30.0			
Industry Modern. I						10.5										
Industry Modern. II							16.0									
Industry Modern. III								18.5								
Industry Modern. IV												20.0				
Power I - II	60.0															
Power III										20.0						
Tourism I									10.0							
Tourism II										10.0						
Tourism III												15.0				
Roads I (Adriatic Hwy)	35.0															
Roads II (Central Hwy)					10.0											
Roads III							30.0									
Roads IV								40.0								
Roads V									30.0							
Roads VI											30.0					
Roads VII												30.0				
Railways I (Sarajevo-Ploce)		35.0														
Railways II (Mod. Program)			70.0													
Railways III (Belgrade-Bar)						50.0										
Railways IV													30.0			
Multipurpose I									25.0							
Multipurpose II										25.0						
General Development I and II	58.0															
Unallocated I *										25.0						
Unallocated II *											25.0					
Unallocated III *												25.0				
Unallocated IV *													30.0			
TOTAL (all IBRD)	155.7	35.0	70.0	-	10.0	60.5	46.0	98.5	85.0	80.0	85.0	90.0	90.0	175.5	394.5	430.0
No.	6	1	1		1	2	2	3	4	4	4	4	3	5	17	19
IBRD loans outstanding																
- incl. undisbursed	138	170	237	233	248	307	330	420	500	545	610	685	750			
- excl. undisbursed	64	114	149	155	178	194	216	260	314	378	440	500	560			

* Lending for Export-oriented Industries and Projects in Underdeveloped Regions

Attachment 2

5-YEAR ECONOMIC DEVELOPMENT PROGRAM /a

Yugoslavia

			Actual Data						Projected Data						Period Growth Rates	
			1964	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975	1964-68	1971-75
Population - growth rate	%	1	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	0.9	0.9	0.9	1.0	0.9
birth rate	per 1000	2	20.8	20.9	20.3	19.7	19.0	18.4								
Price Change - c.o.l. index	%	3	12.5	33.3	23.6	6.7	5.3	8.0							15.8	
exchange rate (dinar)	per US$	4	7.5	12.5	12.5	12.5	12.5	12.5	12.5							
Means of Payment - change	%	5	12.8	21.5	15.2	5.6	17.1	10.0							14.3	
GNP at factor cost; 1964 prices - Total	$ mil.	6	8,211	8,310	8,733	8,812	9,129	9,905	10,499	11,129	11,797	12,504	13,255	14,050		
per capita	$	7	425	426	443	443	452	486	510	532	559	587	617	647		
GNP at constant market prices /b - real growth rate	%	8		1.2	5.1	0.9	3.6	8.5	6.0	6.0	6.0	6.0	6.0	6.0	3.9/c	6.0
GDP at current market prices - Total	$ mil.	9	5,342	6,914	8,594	9,260	10,320	11,971								
Production Growth (real) - agriculture	%	10	5.9	-8.8	15.8	-0.8	-3.8	8.7	3.0	3.0	3.0	3.0	3.0	3.0	1.3	3.0
food per capita	%	11														
manufacturing	%	12	16.0	7.8	4.8	-0.8	6.9	12.2	8.0	8.0	8.0	8.0	8.0	8.0	6.8	8.0
GDP by Branch - agriculture	%	13	24.2	24.9	25.7	23.3	19.8	19.9	19.4	18.8	18.3	17.8	17.3	16.8		
mining	%	14														
manufacturing /d	%	15	31.7	31.2	30.6	29.4	31.1	32.1	32.7	33.3	33.9	34.6	35.2	35.9		
construction	%	16	10.1	9.4	9.7	10.7	11.1	10.9								
transport & communication	%	17	7.2	7.3	6.9	7.1	7.2	7.1								
public admin. & defense	%	18	5.1	5.3	4.9	5.1	5.2	5.0								
other branches	%	19	21.6	21.9	22.1	24.4	25.6	25.0	47.9	47.9	47.8	47.6	47.5	47.3		
Resource Gap	% of GDP	20	2.9	0.1	1.2	1.9	2.1	2.2	2.0	1.9	1.8	1.6	1.5	1.3		
Net Factor Payments	% of GDP	21	0.2	0.3	0.1	-0.2	-0.4	-0.5	-0.5	-0.6	-0.6	-0.7	-0.7	-0.8		
National Saving - private	% of GDP	22														
public	% of GDP	23														
Total	% of GDP	24	34.0	31.7	31.6	27.4	27.3	26.5	26.5	26.7	26.8	27.1	27.2	27.5		
Marginal Saving Rate		25														
Consumption - private	% of GDP	26	48.5	50.8	51.8	55.4	55.5	55.9	55.9	56.0	56.0	56.0	56.0	56.0		
public	% of GDP	27	17.3	17.2	16.5	17.4	17.6	18.2	18.1	17.9	17.7	17.6	17.5	17.3		
Total	% of GDP	28	65.8	68.0	68.3	72.8	73.1	74.1	74.0	73.9	73.7	73.6	73.5	73.3		
Exports of Goods and Services	$ mil.	29	1,196	1,457	1,679	1,771	1,828	2,095	2,280	2,486	2,709	2,953	3,219	3,504	11.7	9.0
Imports of Goods and Services	$ mil.	30	1,446	1,440	1,767	1,907	2,026	2,348	2,540	2,743	2,963	3,200	3,456	3,738	11.4	8.0
Net Goods and Services	$ mil.	31	-250	17	-88	-136	-198	-253	-260	-257	-254	-247	-237	-234		
Interest on Public Debt, Gross: Outflow (-)	$ mil.	32														
Other Factor Income, Net: Outflow (-) /e	$ mil.	33	-17	-21	-6	22	42	63	78	90	105	120	133	144		
Net Factor Income: Outflow (-) /e	$ mil.	34	-17	-21	-6	22	42	63	78	90	105	120	133	144		
CURRENT SURPLUS(+) DEFICIT(-)	$ mil.	35	-267	-4	-94	-114	-156	-190	-182	-167	-149	-127	-104	-90		
Net Transfers			68	77	59	32	38	40	50	50	50	50	50	50		
Long Term Private Capital, Net inflow	$ mil.	36	48	42	84	85	102	149	103	108	118	128	138	138		
Long Term Public Capital, Gross inflow	$ mil.	37	173	179	171	150	119	118	71	94	106	105	152	110		
less: amortization	$ mil.	38	32	58	51	84	80	77	86	103	70	73	131	69		
Net long term pub. cap. inflow	$ mil.	39	141	121	120	66	39	41	-15	-9	36	32	-21	41		
Short Term Capital, Net inflow	$ mil.	40						37								
Other Capital, Net Inflow (incl. errors & om.)	$ mil.	41	22	-126	-99	31	45	10	129	108	40	17	42	-29		
Export Credits			-33	-44	-39	-39	-46	-50	-55	-60	-65	-70	-75	-80		
NET BALANCE	$ mil.	42	-21	66	31	61	22	37	30	30	30	30	30	30		
IMF Drawings(+) Repayments(-)	$ mil.	43	-30	35	2	33	-18	-37								
Foreign Exchange Reserves, Inc.(+) Dec.(-)	$ mil.	44	-51	101	33	94	4	0	30	30	30	30	30	30		
Foreign Exchange Reserves, Net - Total	$ mil.	45														
Foreign Exch. Reserves, Gross /f - govt. entities	$ mil.	46	74	104	115	80	132	254								
comm. banks	$ mil.	47	32	111	11	57	52	66								
Total	$ mil.	48	106	115	126	137	184	320								
External Debt	$ mil.	49	1331	1813	1856	1727	1757									
Debt Service Ratio /g	%	50					19	23						21		
Export Price Index	%	51	5.7	6.5	3.1	0.1	-2.0	2.0								
Central Government - Current revenue	% of GDP	52				32.8	34.0	32.2	33.4	34.7						
Current expenditure	% of GDP	53				24.5	25.6	24.2	25.2	26.2						
Saving	% of GDP	54				8.3	8.4	8.0	8.2	8.5						
Capital revenue	% of GDP	55														
Capital expenditure	% of GDP	56				9.4	9.6	8.7	8.5	8.3						
Surplus(+) Deficit(-)	% of GDP	57				-1.1	-1.2	-0.7	-0.3	-0.2						
Military expenditure	% of GDP	58				4.6	5.0	5.0	5.0	5.0						
Education - expenditure (general government)	% of GDP	59				3.4	3.4	3.6	4.0	4.0						
school enrol., primary & second.	%	60														
literacy rate, adult	%	61														
Tax Revenue (general government)	% of GDP	62				24.8	25.5	24.2	25.1	26.1						
Public Saving (% of public fixed investment)	%	63														
Gross Investment - private fixed	% of GDP	64														
public fixed /h	% of GDP	65	30.5	25.2	24.7	26.1	26.6	26.2	26.2	26.2	26.2	26.2	26.2	26.2		
increase in stocks	% of GDP	66	6.6	6.8	8.1	2.9	2.4	1.9	1.8	1.8	1.8	1.8	1.8	1.8		
Total	% of GDP	67	37.1	32.0	32.8	29.0	29.0	28.1	28.0	28.0	28.0	28.0	28.0	28.0		
Finance of Investment - National saving	%	68	91.8	98.9	96.1	94.2	94.0	94.1	94.6	95.3	95.7	96.8	97.1	98.2		
Foreign capital	%	69														
private	%	70														
public	%	71														
Total	%	72	5.7	5.7	5.0	9.2	6.1	5.9	6.2	5.5	5.1	3.9	3.6	2.4		
Change in reserves	%	73	2.5	-4.6	-1.1	-3.4	-0.1	--	-0.8	-0.8	-0.8	-0.7	-0.7	-0.6		
Public Investment by Sector - agriculture /i	%	74	10.2	9.4	9.6	8.9	7.9									
industry /j	%	75	35.6	36.4	39.2	40.2	40.1									
power	%	76														
housing /k	%	77	21.0	24.1	21.0	18.1	18.5									
transportation /m	%	78	12.9	11.6	12.5	12.1	12.7									
telecommun.	%	79														
education	%	80														
health	%	81														
other	%	82	20.3	18.5	17.7	20.7	20.8									

/a Figures for 1969 are estimates. /b GDP at constant factor cost. /c 1965-69. /d Includes mining. /e Includes workers' remittances. /f Convertible only. /g Ratio to convertible earnings. /h Includes private fixed investment. /i Includes forestry and fishing. /j Industry and power. /k Includes public utilities. /m Includes telecommunications.

February 19, 1970

5

THE YUGOSLAV ENTERPRISE

1. The Yugoslav desire to achieve political independence from the Soviet world has been accompanied from the beginning of the postwar period by a tendency to experiment with new economic and political institutions. The growing trend to emphasize local administration and to decrease the power of the state was introduced partly, it appears, to serve as an ideological weapon against the Stalinist central monopoly of power. The Marxist theme of the "withering away of the state" has been stressed and skilfully exploited. It is stated that the primary unit of self-government is the commune (roughly comparable to a municipality and only remotely related to the Chinese concept of a commune). The people who live and work within the boundaries of the commune are responsible for making the decisions on economic, educational, health, recreational, and other matters for the area. Only when the local commune is unable to solve a problem are bodies covering larger territorial units to be called upon: district, republican, and finally federal assemblies.

2. To underline the decreasing role of the state, enterprises are defined not as state property, but as social property. This, at first sight, may seem a semantic difference, but it is a real one to the Yugoslavs. State property implies a direct control by the State as a legal and administrative entity, while social property means that the Yugoslav people as a whole own the means of production over which the State has no control. In the Constitution it is stated that "the working collective shall manage the people's property, and in the name of society, the factories, mines, means of communication, means of transportation, and commercial, agricultural, forest, communal and other socially owned economic enterprises". It should be noted that the law says that the workers are entitled to "manage" the enterprise, but not to own it.

3. The basic organizational structure of a Yugoslav enterprise consists of four layers: the Workers' Assembly (which includes all workers), the Workers' Council, the Managing Board and the Director. The Workers' Council is composed of representatives, elected by all workers, and is, in theory and law, responsible for the full conduct of the affairs of the enterprise. It aprroves production, and marketing policies and plans, the annual financial statement, distribution of income 1/, employment and dismissal of workers (including the director).

4. The Workers' Council usually leaves current affairs to the Managing Board, an executive body elected from among its members. The Managing Board's duties are more specific than those of the Workers' Council. Up to a certain point the Board can dispose of financial matters without waiting for the approval of the Council. The Board handles personnel problems, specifies production norms, and establishes the monthly plan of

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1/ According to the Yugoslav concept, wages do not exist, the workers "share in the net income of the enterprise" as determined by the Workers' Council.

the enterprise. The Chairman of the Managing Board is elected by the Workers' Council members. The duties of the Director are somewhat vaguely defined as work organization, the implementation of decisions taken by the Workers' Council, and the observation and enforcement of the legal norms. The Director is an ex-officio member of the Managing Board, he also represents the enterprise in relation to other enterprises and governmental bodies.

5. The fact that the Workers' Council, by law, controls the distribution of income and therefore the wage-level has led some observers to conclude that in this system an effective overall wage policy would be impossible. In practice, however, the scale and level of income are limited by a number of rather effective constraints. The ratio between the income of the manager and that of an unskilled worker is often as low as 4:1, due to the influence of the Council. The share of net revenue which accrues to income-earners is, almost as a rule, around 70 percent. Many reasons are at work to prevent a Workers' Council from distributing more than this 70 percent share of net revenue as workers' income. First, when considering lending, the banks look very unfavorably upon enterprises that pay out more, and usually ask for at least 30 percent of the needed investment funds to be provided by the enterprise. Second, the communes may refuse to help an enterprise in financial difficulty if the Workers' Council has abused its right on income by distributing too much of it. Third, the Chambers of Economy, the Trade Association and the Party try to discourage disproportions in earnings among groups of workers to prevent social jealousy. Fourth, with the new market-orientation of the economy, the fear of the competitive consequences of lack of investment seem to exert a considerable restraining influence. As a consequence, overall income inequality is very small compared to most other countries.

6. The Commune, although it owns the assets of the enterprise, has no power to meddle in the administration of these assets except in one important case: when the enterprise is losing money. As mentioned above, the distributable income of the enterprise is shared in a 70/30 proportion between personal income and enterprise funds. When the workers' incomes would, following this rule, fall below a "generally acceptable" level, or when the growth rate of income would, in recent years, fall below 5 - 6 percent per year, the 70/30 rule is broken and the share of personal incomes in total distributable income increases. At this stage, some restraints on income growth begin to be exercised. Once the distributable fund has been exhausted by personal income, the depreciation fund is drawn down for this purpose. There is, however, a legal minimum for depreciation rates, and when this point is reached, salaries may be restricted to 80 percent of their previous year's level.

7. If disposable income falls still further (in some cases, even earlier), the Commune becomes involved in the administration of the enterprise. A temporary director may be named, sometimes taxes are reduced and measures to reduce costs (e.g. lower employment) may be taken. Salaries, however,

usually stay at the 80 percent level mentioned above. If the enterprise income is not enough to pay these salaries, the Republic and Commune pay for them out of a Special Fund created for this purpose from contributions by all enterprises. Further measures (mergers, re-organizations, new bank funds) may be taken if thought helpful to get the enterprise back into a healthier position.

8. If everything else fails, the enterprise assets (excepting land, which belongs to society) are sold to pay the various claims against the enterprise (in a preferential order fixed by law), and the enterprise is dissolved. The enterprise's assets remaining after meeting its obligations are transferred to the commune on the territory of which the enterprise is located.

The Banking System

1. The Banking System prior to the Economic Reform. Up to 1955 there was, in effect, only one bank, the National Bank, which acted as a central bank and provided short-term credits. Investment resources were channeled through governmental budgets directly to enterprises and allocated without repayment obligation up to 1954, when the one-bank system was dismantled. In 1955 the majority of the offices of the National Bank were turned into municipal banks (some 400) to administer the investment funds of the Municipalities. Subsequently, separate Federal Government banks were set up to specialize in financing foreign trade (Yugoslav Bank for Foreign Trade), infrastructure and industry (Yugoslav Investment Bank), and agriculture (Yugoslav Agricultural Bank). The funds of the Federal General Investment Fund were distributed among these three banks. In 1962 Republican banks were established to administer Republican funds and act as investment banks to Republics. While all banks remained under some type of Government control (Federal, Republican or Municipal), raised most of their funds via these governmental bodies and carried out specific governmental initiatives, they were not under centralized control. However, they were not competitive in the sense that there were clear separations in the type of financing provided by different banks and in the geographic area they served. While there was some consolidation of small local banks (at the time of the Banking Law the number of banks had declined to 200), the structure remained largely unchanged up to the Banking Law in March 1965.

2. The Law on Banks and Credit Operations, March 1965. The 1965 law aimed at an improvement in the allocation of resources through the freeing of banks from political and governmental control and introducing competition among the banks. The de-etatization of the banks has depended on two extremely basic shifts in banking practices. Firstly, governmental units' "ownership" and control of banks has been reduced. Banks in Yugoslavia have founders which contribute the banks' permanent, equity-like capital (credit fund). This capital is entitled to dividends and has voting power in determining the course of a bank's operations. Previously governmental units controlled the bulk of these funds but since the 1965 Banking Law these units, like all individual founders, have been limited to 10 percent of the voting power in a bank. Moreover, governmental founders are withdrawing their "shares" in banks and banks now look to economic enterprises for the expansion of their permanent capital. The second basic shift is the banks' new role of collecting savings and allocating them according to their own policies to borrowing enterprises. The banks in Yugoslavia no longer receive the bulk of their new resources from governmental sources; they must compete in the market for deposits.

3. At present the only purely governmental bank is the National Bank of Yugoslavia, Yugoslavia's central bank. Other banks are referred to as business banks and are divided into investment, commercial, and savings banks, according to the services they provide. A business bank's founders

may be enterprises, organizations (e.g. organizations of enterprises), and "social-political communities" (the Federal Government, the Republics and Municipalities) but not individuals. Another major change in comparison to the previous system is that banks may now carry out business all over Yugoslavia. In short, the 1965 Banking Law created the basis for a banking system working under the influence of market forces.

4. Developments Since 1965. Since 1965 the process of decentralization and consolidation of the banking system has increased in pace and the banks have become more competitive. This competition has led to a number of mergers of banks and at present there are 60 banks, 19 of which are authorized to deal in foreign exchange. Recently attempts have been made to form groups of banks. Members of such groups retain their independence but the group establishes common credit policies and participates in joint financings. A few such groups have been established; one such group consists of the YIB and commercial banks in Montenegro and Vojvodina. Mergers and groupings are likely to continue as the number of banks is still large relative to the size of the Yugoslav economy. Nine of the 19 banks mentioned above are classified as investment banks, but while some banks are predominantly long-term lenders (investment banks) or predominantly short-term commercial type banks, most banks undertake a mix of long- and short-term lending.

5. A large part of total banking assets is concentrated in a few banks: twelve banks possess roughly 70 percent of the total assets of all banks and the nineteen banks authorized to deal in foreign exchange account for close to 90 percent of the total. By and large banks still operate on a regional basis. YIB is the only investment bank which, to a significant extent, has operations over the whole territory of Yugoslavia, although even the YIB has a Serbian orientation. However, some banks have begun to open offices outside their home districts.

6. The ultimate role and organization of the banks in Yugoslavia is still not entirely clear. It is no doubt true that in some cases the banks are still subject to governmental influence and direction. This is probably particularly the case for the smaller banks. There are also outstanding questions concerning the relative power of bank's founders and its workers, i.e. the principle of ownership management versus worker self-management. Such problems are inevitable as it has been in the banking system that the principle of non-worker "ownership" has first been tried.

The Banks and Industrial Finance

7. The role of the Government in financing of industrial investment has greatly diminished since 1964, when taxes on, and subsidies paid to, enterprises were reduced. Between 1964 and 1968 approximately 15 percent of fixed investment in industry was financed directly out of Government resources. The role of Government funds in industrial financing was, however, larger than the above percentage indicates, as a considerable part of bank resources - an estimated 40 to 50 percent - originated from public funds. Government's role in financing investments is expected to

decline further with exception of the Fund for Development of Underdeveloped Republics and Regions which was established for financing projects in the Republics of Bosnia-Her egovina, Macedonia and Montenegro, and the autonomous region of Kosovo. This fund receives 1.85 percent per year of the national income (an estimated US $150 million equivalent per year during the next few years). A sizeable part of these funds is expected to be allocated to industry, primarily to the ferrous and non-ferrous metallurgy and chemical industries.

8. The Reform envisaged that the banks would play an important role in channelling resources for investment and the operations of banks have accelerated. Prior to the Reform, the banks financed about 10 percent of fixed investment; now their share is running at about 50 percent. Investment credits to enterprises (industry and others) totalled ND 75 billion in September 1969, an increase of 150 percent since the beginning of 1965. While Government funds are still important to many Yugoslav banks, the banks have also succeeded in mobilizing savings from enterprises and households which have been used for investment financing. Time deposits rose from ND 3.2 billion in 1964 to ND 22.3 billion in September 1969. The banks have also received lines of credit from financial institutions in Western Europe and the United States, but these have been relatively less important than these banks' mobilization of domestic resources.

9. In the period since the Reform about 30 percent of industrial investments have been financed from the enterprises' own resources. Another source has been credits from foreign suppliers. While direct foreign investment has been small, given the likely further liberalization of the rules on foreign investments and the work of the newly established International Investment Corporation for Yugoslavia, joint venture operations are likely to become more common and thus foreign-finance a more important source of funds for industry. Financial markets outside the banks have up to now been largely non-existent in Yugoslavia. However, a few bond issues have been floated with banks as intermediaries and a recent amendment of the law enables enterprises to issue bonds at 8 percent plus an additional profit-participating interest. A constraint on this form of financing is that there is, as yet, no secondary market for bonds. Given the dramatic changes in the basic structure of the Yugoslav economy in such a short time span it is unrealistic to expect that a flourishing securities market could also soon be established. Many problems of practice and principle have to be dealt with in moving in this direction, yet there is a conscious effort being made to deal with these problems and a committee is currently studying the matter of securities legislation.

10. At present the demand for funds for investment, especially for foreign exchange funds, by far exceeds the supply; credit is tight. Although the enterprises' possibilities for self-financing and deposits channeled through banks will increase, the medium-term outlook is for a continuation of the tight credit market.

11. Interest rates in Yugoslavia today do not reflect the cost of capital. The maximum lending rate for banks is 8 percent. Despite this low ceiling, banks often lend at lower rates. The interest rates for governmental funds and some bilateral credits, channeled through banks, have been determined by the Government; they have often been as low as 2-3 percent. Interest rate levels have been, and still are in many instances, viewed as a subsidy device rather than as a cost for a scarce resource. Banks are operating with very narrow spreads, usually 0.5-1 percent. To compensate for the narrow spreads on borrowed funds banks regularly now require compensating balances when making loans. Recently the rigid 8 percent ceiling has been modified to the extent that it is now possible for borrowers to issue bonds at 8 percent plus an additional profit participating interest. The Yugoslav authorities and bankers generally agree that the interest ceiling should be raised if not eliminated, while the idea, naturally, is still resented in the business community. While interest rates may be eventually modified to reflect market conditions no changes are likely in the immediate future. Government funds for underdeveloped regions will continue to be lent at subsidized rates. However, the banks relending these funds will be compensated by the Government for differences between the maximum interest rate and actual relending rates.

Performance

12. While on the whole the larger Yugoslav industrial enterprises have made great strides in adapting themselves to the requirements of a market-oriented economy, the banking system has been decidedly less flexible in this respect. To a large extent, its procedures still reflect a system in which decisions in favor or against particular investment projects were taken outside the banking system. The banks served to implement these decisions and since enterprises were not allowed to fail very often under the previous system, the banks lost no money. The changing economic system in Yugoslavia, which is leading to more competition both internally and internationally, will require the banks to pay more attention to the long run commercial prospects of the companies they are financing. But the banks appear to be some distance away from achieving these objectives.

6

IFC ACTIVITIES IN YUGOSLAVIA

I. Completed Investments

1. International Investment Corporation for Yugoslavia (IICY)

Investment: $2.0 million in equity approved September 30, 1969, of which $1.0 million has been disbursed.

Purpose: New investment institution to put together joint ventures involving foreign companies and Yugoslav enterprises.

Share Capital: $12.0 million of which $6.0 million has been disbursed by shareholders.

Ownership: IFC is largest single shareholder with 16.67% of capital. Fifteen Yugoslav banks hold 25% in total with remainder of shares held by 39 European, American and Japanese banks.

Management: Mr. Anthony Solomon, President, and Mr. Zoran Zagar, former IBRD Alternate Executive Director for Yugoslavia, Executive Vice-President.

IFC is represented on the Board by Messrs. Gaud, Paterson, Wishart, and Davidson (replacing R.B.J. Richards). A Directors Meeting was held on October 1 in Dubrovnik and Messrs. Gaud and Paterson attended this meeting.

2. Zavodi Crvena Zastava/FIAT Joint Venture

Investment: $8.0 million in Nominal Capital Account (equity) approved January 27, 1970, and fully disbursed.

Purpose: Expansion to produce 100,000 cars per year of new "128" model of modified FIAT design and thereby bring total plant capacity to 193,000 vehicles per year.

Project Cost: $105.8 million.

Ownership: Varies depending on reinvested amounts into Nominal Capital Account; forecast 1974 (full capacity) ownership ZCZ 69%, FIAT 15%, Generalexport 7%, Yugoslav Investment Bank 2%, and IFC 7%.

Management: Mr. Prvoslav Rakovic, General Manager since 1955, engineer, member of Parliament.

II. Projects Under Consideration

1. TAM/Deutz Joint Venture

The International Investment Corporation for Yugoslavia has requested IFC to enter into a joint financing operation to provide a total of up to $5 million to the proposed TAM/Deutz venture.

The project is to increase Tovarna Automobilow in Mortorjeb's present production of commercial vehicles, mainly light and medium trucks, from 6,600 to 13,000 units per annum. In addition, the joint venture is to produce 5,000 engines for export to Kloeckner-Humboldt-Deutz. The total cost of the investment, including working capital, is estimated at $52.3 million.

A joint appraisal mission with IICY to look into the merits of the project and the basis on which an investment could be made is being discussed with Mr. Solomon.

III. Outstanding Issues

1. Direct Investments in Yugoslavia

The Yugoslav authorities have been pressing IFC to make direct investments in Yugoslavia. IFC can continue to make investments on the joint venture basis used in the Zavodi Crvena Zastava/FIAT investment, but the possibility of direct investment is not excluded although it raises difficult questions in terms of IFC's Articles and Policies.

2. Babin Kuk Tourism Project

IFC has had an exchange of correspondence and IICY has met with Minceta, the leading Yugoslav sponsor of the 5,000-bed Babin Kuk Tourism project. The IBRD Tourism Department has appraised this project (report in preparation). Depending on the conclusions of the IBRD study and whether a private foreign partner is necessary and can be interested in an equity investment, IFC may consider an equity investment.

3. Other Projects

IFC has also been approached on a number of other projects which are not progressing rapidly due to difficulties such as finding foreign partners, financing the project, and being assured of sufficient foreign exchange to repay foreign debts. These projects include the PKB food combinat, which wishes to establish a ready-made foods factory outside Belgrade. It also includes the Pancevo Petrochemical project, which consists of a $258 million naphtha cracker and includes related down-stream plants. IFC is keeping in close contact with IICY on these and other projects.

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Mr. Lowes

INTERNATIONAL DEVELOPMENT ASSOCIATION | INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT | INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara

DATE: October 6, 1970

FROM: William Diamond

SUBJECT: YUGOSLAVIA: Yugoslav Investment Bank (YIB)

1. When you visit Yugoslavia, the question of our relations with, and lending to, the Yugoslav Investment Bank (YIB) is likely to be raised. This memo is to brief you on the subject.

2. A history of our relations with YIB is given in Attachment 1.

3. Bank loans for industry in Yugoslavia have been channeled through YIB. However, they have not been lines of credit to help finance YIB's business (in the usual manner of loans to development finance companies); they have been, instead, loans for specific groups of projects, appraised in advance by the Bank staff.

4. Both the Yugoslavs and we have wanted to shift to the line of credit basis: we, because of the burden of having to appraise a group of projects for a loan; YIB and the Government, because of the non-confidence implicit to dealing with YIB with less confidence than we deal with financial institutions in Korea, Nigeria, Colombia, etc.; both of us, because the "package" loan approach is not workable in dealing with medium-sized enterprises.

5. At first (in 1966) we could not deal with YIB on a line-of-credit basis because YIB was considered a "Government bank" and the Bank would not lend to such institutions. After June 1968, when our policy changed, we began to lay the basis for a line-of-credit. The first issue before us was: who should our borrower be? For, by 1968, there were more than a dozen investment banks in Yugoslavia. We told the Yugoslavs they must choose: YIB, or one or two of the other banks (but not more), or a new institution created by all the existing investment banks. After a year of discussion in Belgrade, the decision was to use YIB as the channel. The second issue then was, was YIB creditworthy and could it use capital effectively?

6. Our reaction to this second issue has been that we cannot recommend YIB as a Bank borrower; we do not feel sufficiently confident of its ability to use capital effectively to justify a recommendation to our Board to delegate to YIB decision-making authority on individual loans using Bank funds; and there are doubts about its creditworthiness.

7. I have discussed the YIB situation with several Yugoslavs, in the past three months, both officially and unofficially. Included was a conversation with the Finance Secretary. It is interesting that no one other than the management of YIB itself has questioned our conclusion and no one seemed to find it surprising; to the contrary, it seems to have been expected.

8. Having reached this conclusion, we invited YIB and the Government to discuss alternatives in Washington, in early September. The result of that discussion appears in Attachment 2. As you will see, we suggested two alternatives to lending to YIB. One is the creation of a new development bank formed by all of the investment banks now operating in Yugoslavia. This alternative has been abandoned as unrealistic in the near future, although, I am told by some Yugoslavs, this is in principle the desirable alternative and might be achieved in the fullness of time. The second alternative is the establishment of a competent appraisal unit, under independent and experienced management, associated with some institution of the Federal Government. (I suggested the National Bank.) This unit would be the recipient of a Bank loan and would use it for financing projects presented to it by any of the Yugoslav investment banks, including the YIB itself. This proposal is now under study in Belgrade. We have reason to believe that it has been received with at least interest and probably with favor by all interested parties except the YIB. In my conversation with the Finance Secretary discussion focused, not on the merits of the proposal, but only on the choice of an institutional instrument; he seemed not to question the merits.

9. There is no way of knowing how long it will take to establish a mechanism for providing a line of credit to Yugoslav industry. Meanwhile, the Bank has said, it will be prepared to continue to lend for industrial projects; and an industrial sector mission will visit Yugoslavia toward the end of the year, among other things, to try to identify industrial sectors and projects where the Bank can lend directly for sizeable investments.

10. I think we are on the right track in Yugoslavia. If nothing comes of the alternative we have proposed, I think it will be, not because of the merits of the proposal, but because of political pulling and hauling in Belgrade. I believe, however, that something will come of the proposal; and then our principal problem will be the more difficult one of agreeing on an independent and competent manager and on assuring a technically qualified staff for the appraisal unit.

Attachments (3)

WDiamond:bda

Bank Relations With Yugoslav Investment Bank

YIB was established in 1955 as a Federal institution to specialize in the term financing of infrastructure projects and industry. It has been the channel through which Federal funds were channelled for development projects. While it assembled a technical staff to advise on projects, it received all its funds from the Federal Government and its "decision-making" consisted largely of carrying out the decisions of Government. During this time it was involved in implementing both loan and grant schemes. At the time of the 1965 Banking Reform, when a process was started whereby the banks were to be freed from political bodies, the assets of YIB had grown to almost US$2 billion. In many respects the YIB was, therefore, a special institution and when the banks were "set free" and began to be competitive in the developing market system, other banks in Yugoslavia became somewhat suspicious and jealous of YIB's advantageous position because of its size, its close relationship with the Federal Government, and its foreign connections. The problem of regional rivalries was also present because, while YIB's funds came as from the Federal Government and it operated all over Yugoslavia, non-Serbian institutions have considered it a Serbian bank.

Of all the Yugoslav financial institutions, YIB had, by 1965, established the closest contact with the Bank. At that time it had signed five loan agreements totalling US$200 million for highway, railway and power projects. Its role in such loans was largely legal and administrative. Bank staff directly appraised the projects. YIB provided administrative support during appraisal missions but did not contribute to the appraisal work as such. Perhaps the most active role taken by YIB in the whole process was during the disbursement period at which time the YIB was involved in the paper work relating to disbursements. The YIB was, however, the signatory for the loans because the Federal Government designated it as the borrower for reasons relating to Yugoslav customs and procedures.

Shortly after the 1965 Banking Reform Bill, the Bank and Yugoslavia became interested in using Bank funds in the industrial sector. It was natural to think in terms of a line of credit, as with other development banks, and thought was given to using YIB as the intermediary. For the first time the Bank began to look at YIB as an institution in its own right, and in the fall of 1966 Mr. Diamond made an exploratory visit to YIB. Following this visit, it was decided, for reasons related to Bank policy at that time, that the Bank would not pursue the line of credit approach but that an effort would be made to assemble a "package" of industrial projects, for direct appraisal by Bank staff. The Yugoslavs submitted lists of companies they thought worthy of Bank finance; these lists were then reduced to a manageable number of prospective clients; and IFC staff appraised the enterprises directly. Here again YIB was the borrower; sub-agreements were signed between YIB and the borrowing enterprises. There have now been three "package" loans: US$ 10.5 million for 7 firms in 1967, US$ 16 million for 10 firms in 1968 and US$ 18.5 million for 3 firms in 1970.

These operations gave IFC staff a more intimate exposure to YIB in that some of the selected enterprises were YIB clients and, moreover, YIB had been requested to give its views and judgments on all the projects. However, in the end, YIB's contribution to the appraisal effort was negligible; this was disappointing, for the Bank and IFC had hoped that this institution could contribute substantively to the effort and that, in time, the Bank could rely on YIB's own appraisals.

Early on in the "package" loan operation, it became obvious to all concerned (the Bank, IFC, the firms, the Yugoslav Government and the Yugoslav banks) that for medium-sized loans the "package" approach was inefficient and the idea of a line of credit was revived.

In the meantime, IFC arranged the visit and program for a group of about 10 general managers of leading Yugoslav banks (commercial cum investment banks). The managers visited financial institutions and industrial enterprises in New York, Washington, Pittsburgh, Chicago and Mexico. The management of YIB was not represented in the group. When this group was in Washington, they made a strong plea for a line of credit for financing industry in Yugoslavia. However, each banker thought his institution a qualified borrower and they had to be told that the World Bank could not lend small sums to 5 or 10 development finance companies in Yugoslavia. They were asked to consider solutions.

In March 1969, Mr. Lejeune met with the Bankers Association in Belgrade and reviewed the problems and prospects of Bank lending. The bankers agreed to try to formulate a proposal for a line-of-credit approach. Shortly thereafter they proposed that the YIB be the intermediary institution and in June a pre-appraisal mission went to Yugoslavia to talk to the bankers about their decision and to start the process of appraising YIB. That mission concluded that the bankers' proposal needed reconsideration (for example, YIB would not be responsible for taking decisions; decisions were to be taken by a board of 19 bank managers, which would probably make decisions on the basis of geographic trade-offs) and that the operational competence, policies and financial position of the YIB were questionable. However, the mission felt these matters were worth persuing.

After much internal argument among the Yugoslav bankers in the months following this mission, they agreed to give YIB, the proposed borrower, decision-making responsibility on sub-projects. With this hurdle crossed, an appraisal mission was mounted in March 1970. The conclusions of that mission were disappointing. In short, they were that: (i) YIB was an extremely complex and cumbersome institution that found it nearly impossible to articulate in clear terms the details of its operations, decision-making criteria and process, procedures and methodologies; (ii) its appraisal and follow-up procedures were seriously deficient by Bank standards: (iii) in spite of long exposure to World Bank appraisal work, YIB's staff, in the main, had not assimilated much and this raised questions about the basic abilities of YIB's staff and their capabilities for change; and (iv) YIB's portfolio and some of the risks to which it was apparently exposed were very difficult to evaluate. Overlaying these problems was the realization that YIB had a long history and experience and that it was probably as good an investment bank as could be found operating on the national scene in Yugoslavia.

After discussion within the Bank, it was decided that the risks and costs of trying to proceed with a line of credit to the YIB outweighed the potential benefits, particularly in view of the fact that other more commendable alternatives, from the Bank point of view, existed.

On July 16, 1970, Mr. Diamond informed the YIB of the Bank's conclusions and invited representatives of the YIB, and the Federal Government to Washington to discuss the Bank's findings and possible alternatives. Mr. Miljkovic, General Manager of YIB, Mr. Trumbic (Head of YIB's Foreign Department) and Mr. Zelic, Deputy Financial Secretary (Government) came to Washington for these discussions during the first week in September. They asked for, and were given, a note on alternatives. The first alternative suggested was the establishment of a new bank by existing institutions, with a hand-picked staff that would concern itself only with long-term industrial finance. This was rejected by YIB as being impractical. The second alternative was to create an appraisal unit, with a director and board approved by the Bank, that would evaluate projects submitted to it by an agreed list of banks in Yugoslavia. This unit could be attached to the National Bank (central bank) and would relend the proceeds of the loan to the Yugoslav banks to finance approved projects.

The YIB found the Bank's conclusions difficult to swallow and took the position that they would do anything in terms of staff or organization asked of them. It pushed for moving along the lines of setting up a separate department in the YIB to handle the proposed Bank line of credit. There was no resolution of the problem but an aide memoire setting out the main points of discussion was prepared. Attachment 2.

Subsequently, the Federal Secretary of Finance, Mr. Smole, requested an appointment with Mr. Diamond in Copenhagen. At that meeting Mr. Smole said that he understood and sympathized with the Bank's position. He said that he and other Yugoslavs needed time to consider the various alternatives that might work for channelling World Bank funds to Yugoslav industry. He promised to be in touch with the Bank on this matter in due course. (A note on the Smole-Diamond meeting is attached as item 3.)

DFC
October 5, 1970

Memorandum on Discussions with the Yugoslav Investment Bank[1/]

1. The first part of the discussions were devoted to reviewing in detail: (a) the quality of YIB's appraisal methods and decision-making procedures and (b) the financial position and strength of YIB as an independent financial institution.

2. As the basis for a line of credit, the Bank must have a borrower which it can be confident will, in all areas of its business, make investment decisions only on the basis of sound economic and financial criteria, and which can borrow on its own credit rather than on credit derived from its government support.

3. The Bank suggested two alternatives to lending for medium-sized industry in Yugoslavia: first, the creation of a new investment bank with a specially selected and trained staff and with its own capital structure; secondly, the establishment of a special Fund, administered by a qualified manager and staff and located in the National Bank of Yugoslavia which would relend the proceeds of the loan to eligible investment banks in Yugoslavia (including YIB) after careful examination of the merits of the projects submitted by the eligible banks. (A note on each of these alternatives is attached.)

4. The discussions this week helped each side understand the position of the other. The YIB for its part, now better appreciates the nature of the Bank's concerns about its decision-making process and financial position. The Bank, for its part, has understood that it is not feasible at this time to establish a new financial institution and consequently, consideration of the first alternative mentioned in paragraph 1 was not pursued. Moreover, the Bank has understood that every possibility of using YIB as borrower for a line of credit should be made before an alternative was adopted which involved a borrower other than YIB. Consequently, the second part of the discussion concentrated on the second alternative above, and on the possibility of applying it within the framework of YIB.

5. YIB was prepared to accept the principle of alternative two if it could be brought about with YIB rather than outside it. Regarding the specific matters mentioned under the alternative in the attachment, YIB could readily accept most. There remains, however, two aspects--which, while few in number, are of critical importance--on which there is no agreement yet.

6. The first of these aspects concerns the autonomy in investment decision-making of the group that would be set up in YIB under alternative two. YIB considers that, if YIB is the borrower, it is not

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1/ This note was prepared upon conclusion of discussions held August 30 - September 4, 1970 between the Bank and representatives of YIB and the Government.

possible to have an autonomous decision-making body within YIB, even for making decisions with respect to lending particular resources, and consequently concludes that the existing management and board must continue to have the ultimate responsibility. The Bank appreciates this point. The Bank, however, considers that the most important basis for a loan is confidence in the competence of appraisal staff and in the objective wisdom of the decision-making body and considers that this can be best accomplished by a separate staff and a separate Board. YIB appreciates this point. The clear question therefore that remains for consideration by both parties is how to reconcile the need for autonomy with the need for responsibility by YIB's own Board, commensurate with YIB's obligation to repay the Bank.

7. The second aspect concerns the financial strength of YIB. The question here is not the confidence of the Bank that its loan will be repaid; although the financial structure of YIB is evolving rapidly, it is not likely that the position will be reached when the Yugoslav Government will allow YIB to fail; moreover, there would remain the Government guarantee to the Bank on which to fall back. The question, therefore, is not repayment to the Bank, but YIB's financial integrity. In the course of evaluation of Yugoslav financial institutions, YIB is becoming an institution which even now is supposed to stand financially on its own feet, and to be able to attract credit on the basis of its own performance and financial position; and the future evolution of financial instutions is likely to enhance this position. Moreover, the Bank's own approach to a financial institution to which it considers a line of credit is to justify a loan to it in terms of its own credit. Consequently, it is difficult to avoid looking to the "creditworthiness" of YIB.

8. There are some questions about YIB's "creditworthiness" in present circumstances. For instance, a substantial part of YIB's portfolio still consists of projects made at the bequest of the government and, since YIB itself may not have made some of those investments, there is doubt about their quality. Of course, the situation is much better now than it was some years ago because many investments of this type have been removed from YIB's balance sheet, but enough remain to cast doubt on the portfolio.

9. Another example concerns the credits from Eastern European countries; there is considerable doubt about their status. Third, not only they, but other foreign credits to YIB have been relent in a manner which at best leaves the exchange risk question in the air. Fourthly, the possibility of YIB's carrying the exchange risk is a potentially serious factor in weighing the debt/equity ratio. Here again there has been considerable improvement in the capital structure of YIB and the debt/equity ratio has now reached manageable proportions, but only if there is no doubt about the value at which YIB carries foreign exchange on its books. Other questions exist, too, which a creditor must consider.

10. The Bank is aware of the fact that YIB is different from the conventional development finance company in other countries. It cannot apply to YIB all the same standards which might legitimately be applied to other financial institutions elsewhere. On the other hand, the present and future position of YIB, and the Bank's general policies toward development finance companies are such that the Bank cannot abandon such standards entirely. The problem, therefore, is to find a satisfactory middleway between a conventional examination of creditworthiness and the minimum acceptable in YIB's circumstances.

11. Summing up, the question of reconciling and decision-making autonomy of a unit in YIB with ultimate responsibility by YIB's Board, is one principal problem, to which both the YIB and the Bank should address themselves in the next few weeks. The question of YIB's financial integrity, which is the second principal matter requiring resolution, should also be concentrated on by the Bank and YIB. Everyone prefers that these problems should, if possible, be resolved. If they cannot be, then the alternative would be to set up the unit in and make the loan to the National Bank as originally suggested in alternative two.

Addendum:

12. One possible resolution of both issues simultaneously might be for YIB to establish a new company--a subsidiary to whose credit fund YIB would be the sole contributor.

a. The Bank would lend to the subsidiary on the basis entirely of its own financial structure, position and prospects, without regard to YIB itself.

b. YIB's Board could name a separate and independent board to head the subsidiary, which board would appoint a manager.

13. A second possible resolution of both issues simultaneously, while retaining YIB as borrower, might be for the Government to find a means by which the Government could relieve YIB of every vestige of risk that might fall on it; and, if YIB has no risk stemming from the loan, its present board and management apparatus need ask no responsibility in the matter.

14. Each of the foregoing possibilities has advantages and disadvantages and needs to be more carefully explored by both sides. Nevertheless, in either of these or any other alternative, the Bank will expect to be in a position to approve:

a. The composition of the committee or board which heads the appraisal or decision-making unit;

b. The person of the manager of the decision-making unit.

DFC
October 5, 1970

ATTACHMENT

Alternative I

This alternative would mean the establishment of a new bank that would focus on industrial and perhaps tourism lending. It could have the following characteristics:

(a) Its founders would comprise representation from all regions in Yugoslavia; perhaps one or two banks from each Republic could establish the new bank. IICY might also be asked to participate.

(b) It would focus its attention on long-term lending to medium-sized enterprises. (It would not be the medium through which Yugoslavia's large firms would secure finance.) It would also serve a function as a broker for mergers and consolidations.

(c) While attempting to finance projects throughout Yugoslavia, its lending criteria would focus on the commercial prospects of the project, within the constraints of international competitiveness.

(d) It would not become active in the short-term credit field and hence would not compete with existing institutions for deposits and commercial business.

(e) The new institution would have a fairly small staff.

(f) Its Executive Board would be broad-based. It would not be limited to bankers or industrialists but would draw on other professions to the extent that they could contribute to the institution's effectiveness as a national, long-term financing institution.

(g) For foreign exchange resources, it would borrow from the IBRD and other foreign public institutions and, if possible, from private sources as well.

(h) Dinar resources could be mobilized through the banking system and, perhaps at a later stage, through direct bond issues to the public. The funds to be obtained from the banking system could possibly be provided on the basis of term loans from banks in proportion to the expansion of deposits of the system as a whole or to the expansion of the founders' deposits. The availability of these resources might also be tied to the success the institution has in mobilizing foreign exchange. Profits would accrue to founders in relation to the proportion of the bank's total resources provided by respective founders.

(i) The new institution would make a determined effort, early, to recruit and train (abroad, if necessary) an able staff. This is central to the future of the institution. Resident foreign assistance in developing appraisal procedures might also be desirable in the initial years.

(j) Detailed thinking and planning for the project could be undertaken by a fairly small group of men familiar with Yugoslavia's banking and industrial sectors and who might serve as the nucleus of the institution's first Executive Board.

Alternative II

The essence of this alternative is to make use of the existing investment banking system for the channeling of Bank funds to Yugoslav industry. The principal features of this alternative would be the following:

1. The World Bank would make a loan for medium- and small-sized enterprises to, say the National Bank of Yugoslavia. For this purpose, the National Bank might establish a special Industrial Development Fund, which could receive the proceeds of the World Bank loan as well as any other funds, foreign or domestic, which it might be deemed appropriate to place through this system.

2. Eligible investment banks in Yugoslavia (including the Yugoslavia Investment Bank) would come to the National Bank to obtain term financing for specific projects which they wish to finance. Eligibility would be determined on the basis of simple, generally applicable criteria, in the same way in which a central bank normally sets the criteria for eligibility for rediscounting commercial paper. The criteria would be linked primarily to the creditworthiness and liquidity of the investment banks.

3. The projects brought by eligible institutions to the National Bank (in the form of well-developed appraisals of projects) would be evaluated (and revised, as needed) by a specially constituted group of qualified persons trained in the techniques of financial and economic evaluation. Decisions on financing a project, based on a positive recommendation by this appraising unit, would be made by a "committee" constituted of people with experience in investment and industry, on the basis only of financial and economic merit.

4. If a project is approved by the "committee", the National Bank would make a loan from the Fund to the investment bank which brought the project to it; and that investment bank would, in turn, relend the amount, under an appropriate loan agreement, to the ultimate user of the capital. That loan agreement would give the investment bank responsibility for supervision of the project. The National Bank would, of course, require in its agreement with the investment bank, that the latter would obtain for the National Bank such rights as would be appropriate to assure adequate information about, and inspection of, the ultimate borrower and the project.

5. The appraisal unit in the National Bank could consist of staff members of the National Bank (especially recruited for project appraisal). The cost of operating the system (both administrative costs and provision for possible losses) would be covered by a part of the spread between the interest rate at which the National Bank receives its loans and the interest rate at which it lends to a financial institution. (The National Bank might also wish to leave the remainder of the spread, if any, in the Fund.)

6. The staff of the appraisal unit would be small, concerned entirely with project appraisal and follow up, in order to insure effective use of the Fund. In due course, if the Fund became large in volume and its users become large in number, the National Bank might wish to establish field representatives, at least to participate in follow-up, but perhaps also to do appraisals and make decisions for smaller size projects.

The World Bank would have to be satisfied that the "committee" of the Fund is composed of competent and experienced people. More importantly, it would wish to be completely satisfied with the competence of the person who heads the appraisal unit and with his responsibility in the appraisal and decision-making process. Thirdly, it would want to assure itself that the small staff of the unit is well selected and either has, or will be given, adequate training in fields relevant to investment decision-making and to project appraisal.

In making a decision to lend within this framework, the Bank would not be concerned with the creditworthiness of the Fund; it would lend on the strength of the National Bank itself, which has the strength of the Government. The Bank's principal concern would be the capacity of the appraisal unit to make sound investment decisions. A second concern would be that the Fund at least pay its own way. Finally, the Bank would also be concerned that the terms and conditions (including the cost) of the loan to the ultimate borrowers are satisfactory.

The Bank would be prepared to assist in training the staff of the appraisal unit and would expect to work with the head of that unit in developing procedures and criteria for effective appraisal. This could be done in part by receiving appropriate staff at the bank for extended periods of time and also, if it should be desired, by finding people who would be prepared to work with the unit in Yugoslavia.

One of the collateral benefits of this procedure should be dissemination of effective appraisal methods among all the eligible investment banks. For, they would be expected to present to the appraisal unit evaluations of projects they want financed, in a form and content satisfactory to that unit; and in the course of time their continuing experience with the appraisal unit should result in raising their level of investment appraisal.

Files September 30, 1970

William Diamond

YUGOSLAVIA (YIB) - Discussions with Mr. Smole, Federal Secretary of Finance

1. Mr. Smole visited me Thursday, September 24. He said that he had been fully briefed by Mr. Zelic on the discussions in Washington concerning the proposed line of credit to Yugoslavia. He said he understood and sympathized with our position and that he and the other Yugoslav authorities needed time to consider the various alternatives that might be used as a channel for World Bank funds to Yugoslav industry.

2. Meanwhile he had the following three points to make:

(a) He would like to have from us as detailed a statement as we could prepare on the criticisms that we had regarding the appraisal methods and criteria of the Yugoslav Investment Bank. He felt that this would be very helpful to him in bringing about improvements in the work of the YIB and in that of other investment banks in Yugoslavia. He said he had made a similar request of other departments in the Bank concerning appraisal methods in other sectors. (Note: Mr. Smole did not question our criticism of YIB. Nor did he suggest we consider YIB as a channel. I inferred that our critique was not a surprise, and that our conclusion was not unwelcome--at least it was sufficiently acceptable to produce no counter-attack. One reason may be the fact that use of the YIB would run contrary to the present drift of institutional development in Yugoslavia. See (c) below.)

(b) He asked whether we could help organize a training program in industrial appraisal for the YIB and other investment institutions. (Note: this is to be pursued with EDI *et al*.)

(c) He said, with respect to a recipient of a Bank line of credit, that he did not think the National Bank was appropriate. I explained to him that our reason for suggesting the National Bank as a possibility was that the proposal we had made was somewhat analogous to the rediscounting of commercial paper. Mr. Smole said he planned to give further thought to this, but doubted the feasibility of the proposal, given the role of the National Bank at present and the continuing stress on diminishing the role of federal institutions.

3. Meanwhile, however, he had in mind the possibility of using another institution in Yugoslavia, a Fund which was concerned with providing credits to Yugoslav industry for export. The name of the institution is Fond za Kreditiranie i Usiguranje Izvoznih Poslova. Its manager is a Mr. Baum (Croatia) who, Mr. Smole said, is a very competent person who has at his disposal a technically qualified staff. The Board of Directors of the Fund consists of representatives of the National Bank, the Finance Ministry, the Bankers' Association, etc. Mr. Smole said he would send me, after his return, papers on the organization and activities of this Fund--which, incidentally, has capital of its own provided by the Finance Ministry. In any event,

he wanted to think more about this possibility and about other alternatives. (Note: From other sources I've learned that Mr. Baum is an able administrator, but that his staff is probably mediocre. Moreover, use of the Fund for our purpose would call for a major revision of its purpose and activity. This is not to say the Fund is not the best base to build on.)

4. I told Mr. Smole that Mr. Miljkovic had suggested that I should stop in Belgrade for a few days after the meeting in Copenhagen. I told him that at best I could spend only a day or two in Belgrade but I felt, from this conversation with Mr. Smole, that such a visit would be premature and that it would be better to resume discussion after the Government had had more opportunity to consider the situation. Mr. Smole agreed. He said that my memorandum of early September had only just been translated when he left Belgrade, he thought a meeting in Belgrade would be more fruitful in November and he hoped I could visit Belgrade in November or December. I told him November was impossible but that I might be able to pass through Belgrade in December, if that was important.

5. Mr. Smole said it was very important to him that we should continue the dialogue on industrial financing institutions so that we would in due course work out an effective and satisfactory mechanism for lending to that sector.

cc:

DFC
October 5, 1970

8

PIK - BEOGRAD

Mr. Peter Zecevich, General Manager.

PIK-Beograd is a large vertically integrated agricultural industrial "kombinat", and a successful example of the socialized part of the agricultural sector. Socialized agriculture in Yugoslavia is small in terms of land ownership, but large in terms of production, and the trend since 1960, although recently slackening, has been towards more land in the socialized sector, and larger units within that sector. Socialized agriculture now produces about 30 percent of total agricultural output, and 45 percent of the marketed production.

PIK is in the forefront of this trend to largeness. Employing about 8,000 persons, the enterprise farms 47,000 hectares of which 35,000 are arable. Of the latter, 15,000 are irrigated. In addition to its own land, PIK organizes the farming of about 3,000 private units in the area with another 20,000 hectares of land. The main lines of production of the enterprise are milk, beef and sausages, wine, and flowers.

Yugoslavia has a very low per capita consumption of milk, one of the main reasons being the inadequacy of processing and marketing facilities. PIK-Beograd's 18,000 high quality cows are a major supplier of milk to Belgrade urban market. The techniques of the kombinat thus represent a potential solution to a national problem.

Beef and sausages are produced both for local consumption and export. Recent meat export problems with the EEC, which undoubtedly affected PIK, have now been partly solved by the March 1970 Yugoslavia-EEC agreement.

The management of PIK-Beograd is considered very progressive: field studies are undertaken, a large number of specialists employed, and the enterprise has its own Institute of Applied Technology and Economics. It recently has gone into the tourist business as a way of marketing its high quality agricultural products.

Annex 8 b

THE TISA-DANUBE HYDROSYSTEM

Mr. Vojislav Bulatović, General Manager.

The Tisa-Danube Hydrosystem is a very large water supply development covering a good part of the Republic of Vojvodina. As of the end of 1969, about $80 million had been invested, 110 million cubic meters of earth excavated, a 400 km canal completed, and about 40,000 hectares of land were under cultivation. The main remaining problem is the construction of feeder canals.

The project has a number of objectives: a) controling the drainage of about 1.2 million hectares of land; b) the irrigation of about 400,000 hectares; c) the water supply of about 100 industrial enterprises; d) the provision of water transport for the region; and e) the development of fisheries and recreation facilities. The importance of the project can be appreciated from the fact that of the last 100 years, 51 were drought years, 32 were flood years, and only 17 years were normal. Some feel for the magnitude of the undertaking can be gained from the fact that by 1972, when the main canal is finished, the earth excavated will be more than one and a half times that excavated in the building of the Suez Canal.

KOPRODUKT

Mr. N. Sovol, General Manager.

Koprodukt is a business association of 27 livestock producers. It is typical for a producers' association, representing their interests in respect of production, sales, and prices on foreign markets. Producers' associations advocate joint production, processing, and sale of certain products, joint use of equipment, facilities and investments, and joint dealings in foreign trade. They are not allowed to limit production capacity, to eliminate competition, or to make any agreement concerning selling prices on the domestic market. These associations have become important because they exert influence on government policy on imports, prices, protection, subsidies, and retention quotas of foreign exchange. They are expected to become even more important in the future as the adjustment of production to demand becomes increasingly necessary.

Meat is exported mainly to the EEC, and within the EEC mainly to Italy. The Italians have developed a special demand for "baby beef" (9 to 12 months) which is expensive to produce, and suffers from price fluctuations which can lead to losses for producers. A number of export marketing problems have been solved by the March 1970 Yugoslav-EEC agreement.

Annex 8 d

THE INSTITUTE FOR AGRICULTURAL RESEARCH

Dr. Relja Savić, Director.

Dr. Savić is an internationally renowned researcher and the Institute at Novi Sad is known for its corn research.

9

Dvadestprvi Maj Motor Factory (DMB)

Mr. Brkic - General Manager

DMB is Yugoslavia's only producer of passenger car engines. It produces the requirements of Crvena Zastava which manufactures cars under FIAT license.

DMB has balanced up and supplemented its original, now outmoded facilities to progressively increase production to about 42,000 engines last year without any major investment in assets. Now DMB is compelled to build a new shop for the main manufacturing lines and equip it with modern machinery to produce about 100,000 engines - and 200,000 at a later stage - to keep up with Zastava's expansion programs. The project, which is estimated to cost ND 158 million (US $12.6 million) is engineered by DMB's technical staff with assistance from FIAT.

The factory is small by international standards, and DMB is earning a relatively low return on sales and on its own funds. At present the lack of mechanization is not adequately compensated by the relatively low cost of Yugoslav labor. Until DMB increases production runs, it can expect a continuing small margin between costs and competitive selling prices which it must use in light of liberalized imports. Although the project is not meant to bring output, mechanization and automation up to the levels attained by international producers, it is designed to improve efficiency by further mechanization and should contribute to increasing profitability.

Car manufacture in Yugoslavia is in a stage of transition from a small-scale protected industry. As a result of its close relationship with Zastava, DMB is playing an important part in this development. It faces the problems of a plant with basically one customer, has to share margins with him while staying internationally competitive even when scale is smaller than other engine producers supplying the car industry.

Zastava

Mr. Prvoslav Rakovic - General Manager

Mr. Rakovic has been the General Manager of Zastava for sixteen years, and is an engineer with thirty years of experience, mostly in the manufacturing industry. He is a member of the Federal Assembly and has been personally associated with the strong relationship between Zastava, FIAT and the YIB.

Zastava is the only integrated manufacturer of automobiles in Yugoslavia and has completed its first phase of expansion, as scheduled, in January 1970, raising its production capacity to 96,000 vehicles per year. Phase two of the project for which IBRD and IFC financing has been sought will increase its capacity to between 193,000 to 200,000 vehicles per year. This project has secured an IBRD loan of US $10 million, and IFC equity investment of US $8 million, together with quasi-equity of US $20 million from FIAT.

Zastava was founded in 1853 as a foundry for producing guns and cannons for the Serbian army and, having gone through a few changes in its production line, in 1954 decided to undertake automobile manufacturing. Technical collaboration was secured with FIAT and assembly commenced in 1962. Zastava has seven factories in Kragujevac, two of which manufacture automobiles and the rest produce hunting arms, forgings, tools, car parts, and electricity generators. There is one factory in Macedonia for producing small car accessories, and one in Kosovo to produce chassis sets and other parts. There is an extensive network of 65 component suppliers in Yugoslavia; of these suppliers the major ones are : DMB, which supplies engines; Zmaj, which supplies wheels; and Trepca, which supplies energizers.

There is an arrangement with FIAT, whereby Zastava supplies components to FIAT in Italy, Poland and USSR. The value of these exports in 1975 is expected to be around US $300 million.

In 1967 there were seventeen cars per thousand inhabitants in Yugoslavia, while in 1971 it is estimated that the ownership will increase to 31.5 cars per thousand inhabitants, assuming that the relationship between ownership and per capita income continues to follow the trend of the past seven years. The price of the Zastava 750 car (the same as the FIAT 750) is about US $1,000 while the same car made by SEAT in Spain sells for US $1,050, and that made by FIAT in Italy sells for about US $980. Zastava's component suppliers are linked in a federation which negotiates with the government on car prices.

Energo-Invest and The Aluminum Industry in Yugoslavia

Mr. Emeric Blum - General Manager

Mr. Emeric Blum was born in 1912 and studied electrical engineering at Prague. He started the trading firm of Energo-Invest at Sarajevo 18 years ago, as the General Manager, and built it up into one of the leading firms in the country. He is a member of the Federal Assembly. Mr. Blum was persuaded to take over the new aluminum project in Mostar as the General Manager.

Yugoslavia accounts for about 33% of the total bauxite production in Europe. About 2.2 million tons were produced in 1967, of which 1.9 million tons were exported and 300,000 tons processed within the country. It is estimated that bauxite production in 1972 will reach 3 million tons. Despite the large volume of bauxite only 101,500 tons of alumina were produced in 1967. By 1973, however, it is expected that 500,000 tons of alumina would be produced within the country with the installation of the two new plants at Titograd and Mostar.

At present there is only one enterprise producing primary aluminum in Yugoslavia, namely Boris Kidric (Kidricevo and Sibenik), which has an output of about 46,500 tons and which is to expand to 50,000 tons by 1972/73. Current consumption of primary aluminum within Yugoslavia is well in excess of this capacity, and the balance is supplied mostly by imports from Russia. The development plan approved by the National Assembly in June 1967 had provided for the setting up of two aluminum plants, namely at Titograd and Mostar. The Titograd plant is sponsored by Aluminijunski Kombinat in Titograd together with the YIB, while the plant at Mostar is sponsored by Julgo (Association of Electro-Aluminum Industry) together with a consortium of banks at Sarajevo, Zagreb and Split. The Titograd and Mostar plants are securing technical know-how from Pechiney and Kaiser respectively, who are also believed to be considering taking up some equity. Each plant will have the capacity to produce 200,000 tons of alumina and 50,000 tons of aluminum. The new plants are planned to be completed in 1972 so that the total production of primary aluminum should reach 150,000 tons per year by 1973. The completion of construction of the new railway line from Belgrade to Bar should coincide with the installation of the new aluminum plant at Titograd, and conveniently connect it with Sevojno. (See separate Annex 9 - k on Sevojno)

Energo-Invest started to operate in 1951 as a small engineering unit specialized to design thermal and hydropower units as well as the transmission facilities. Over time it grew up into a complex producer of power and other industrial plants including consumer durables. "Energo-Invest" now encompasses 41 producing factories which are located in various parts of Yugoslavia. The production, coordination and programming are provided for by six production sectors, each of them representing complete technological units. Although it has a wide scope of production, starting from metals to complete power and industrial plants, Energo-Invest is a homogenous enterprise.

The wide scope of business activity of the enterprise "Energo-Invest" can be illustrated by the production program for 1970, which consists of:

- zinc concentrate	26,400 tons;
- lead concentrate	13,400 tons;
- engineering	US $3.1 million;
- electric engines for cars	347 tons;
- compressors	1,144 tons;
- metal constructions	10,386 tons;
- iron and steel rolling construction	32,408 tons;
- armatures	4,472 tons;
- electric high and low tension devices	2,716 tons;
- various types of transformers	6,988 tons;
- switching devices	7,745 tons;
- non-ferrous metals rolling materials	4,273 tons;
- electric cookers	4,005 tons;
- washing machines	45,000 pieces;
- refrigerators	240,000 pieces;
- Boxit	772,000 tons.

Total gross income of the enterprise amounted to about $84 million in 1969. In the same year, the exports amounted to about $26 million. The major item of exports was the electric equipment, about $7 million.

Skoplje Steelworks

Mr. Tomic - General Manager

Skoplje Steelworks is an integrated flat products mill with an initial ingot capacity of 600,000 tons per annum. Its main production facilities comprise:

3 prereduction kilns
5 - 1,500 tons per day electric smelting furnaces
desiliconising plant
LDAC shop with two 100-ton converters
ingot stripper and soaking pits
slabbing/plate mill
68 inch wide semi-continuous hot strip mill
68 inch wide cold reduction and temper mill.

Site clearance for the mill started in 1961 and, after suffering a set-back as a result of the earthquake in July 1963, the plant was commissioned in October 1967.

The location of the plant (like that of OHIS) appears to have been determined largely by the need to provide opportunities for employment in Macedonia. Skoplje is landlocked and the plant is therefore dependent on local raw materials, which are essentially low-grade iron ore (about 35% Fe) and lignite. This has resulted in the selection of the iron making facilities, which are believed to represent the first commercial application of the pre-reduction and electric smelting processes. The balance of the equipment has been selected on conventional lines.

The enterprise is known to have encountered considerable difficulties in getting the iron making facilities to operate at their rated capacity. Consequently, in order to utilize the mill, large quantities of slabs have been purchased from Russia for processing into hot and cold rolled strip and plate.

While technical solutions for the iron making problems can and will no doubt be found, it is questionable whether the cost of ingots produced at Skoplje will ever be in line with the cost of ingots produced in modern, coastal blast furnace and converter plants.

Banja Luka Pulp and Viscose

Mr. Maglajlic - General Manager

The earthquake which hit Banja Luka in October 1969 severely damaged the installations of the "Pulp and Viscose Factory, Banja Luka". This enterprise used the occasion to draw up a plan not only for the reconstruction but also for the modernization and expansion of the factory, estimated to require an investment of about $46.5 million (of which $20 million in foreign exchange). In May 1970, the Yugoslav Investment Bank, with the backing of the Government, approached the Bank to request a loan of $20 million. The documentation sent with the request proved to be inconclusive with respect to the financial and technical viability of the project. In particular, the supply of raw material for expanding the original capacity was not adequately proven. At about the same time, the Bank learned that the Banja Luka had signed a contract with the International Investment Corporation for Yugoslavia to search for a potential foreign partner that would bring in equity as well as know-how. The Bank therefore suggested to YIB in July 1970 that this possibility be thoroughly reviewed prior to a decision on possible Bank financing, and also raised a number of basic technical queries.

At the Annual Meeting the overall question of Bank financing of Yugoslav industry was discussed with the Government (cf. paragraph C, 15, of the general brief). It was agreed that, if IICY did not find a foreign partner and finance, the Banja Luka project would be viewed in the overall context of industrial lending, i.e. a decision on Bank participation could only be taken when the subsectors for which Bank assistance would be most useful had been identified and when a review of the potential industrial projects had taken place.

Rade Koncar, Zagreb

Mr. Ante Markovic - General Manager

Rade Koncar was established in 1946. Originally, the production program consisted of electromotors, transformators, telephones, isolators, boilers, etc. Over time, the scope of production widened as well as the size of the enterprise. Thus, in 1946 the enterprise had only 890 workers, but 15 times more (13,049) at the end of 1969. "Rade Koncar" encompasses 14 factories located in various parts of the country, and it handles selling, programming, organization, finances and education programs for all 14 factories.

In 1969, total production of various products amounted to 45,313 tons. The production consisted of electromotors (56 percent of total Yugoslav production), transformators (50 percent of total Yugoslav production), different electric devices (32 percent of total Yugoslav production). Besides that, the enterprise widened the production of elevators, moving staircases, electric locomotives, washing machines, dishwashing machines, refrigerators, cookers, ventilators, etc.

Total gross income of the enterprise amounted to about US $112 million in 1969, and was more than three times higher than in 1965. In the same year, exports amounted to about US $11.2 million. Basic export markets were: Austria, Algeria, Belgium, Ceylon, Ethiopia, France, Greece, Italy, Poland, Norway, Syria, Sweden, USSR, Sudan, Switzerland, Turkey, United Arab Republic.

The General Manager, Mr. Ante Markovic, is also a Deputy to Parliament and the President of the Committee for Industry within the Parliament.

INGRA

Mr. Pavlisko - General Manager

Ingra is an association of 20 enterprises engaged in the design, engineering, construction and sale of power generating and industrial plants and equipment.

No information is currently available on the group's revenues. Apart from substantial operations in Yugoslavia itself, Ingra's member enterprises are active in a large number of mainly underdeveloped countries.

INA

Mr. Andjelko Bubanj - General Manager

INA produces oil (about 2 million tons annually), gas (about 411 million cubic meters), processed oil products (4 refineries located in Rijeka, Sisak, Zagreb and Lendava, together having a capacity of 7.6 million tons annually), distributes oil products on the domestic market (3.4 million tons in 1969), and exports oil products and fertilizers (about $15.3 million in 1969). INA is the biggest Yugoslav petroleum enterprise producing 72% of total production of crude oil, 66% of total production of gas, and about 59% of the total production of oil products. It employs about 15,000 people.

INA was originally established in 1963 by merging a number of smaller enterprises like "Naftaplina-Zagreb", Refinery "Boris Kidric" Rijeka, and "Refinery Sisak". Later other factories joined INA, such as: producers of oil like "Nafta" Lendova, Slovenia; Enolis-Zagreb, and enterprises for the distribution of oil products, "Interpetrol" and "Croatia Petrol" - Zagreb, and "Petronafta" - Solin. In addition, a factory of carbon black and a factory of fertilizers in Kutina, Croatia, joined INA. Throughout its relatively short history, INA steadily widened its scope of activity. It already covers all the phases of primary and secondary oil processing, starting from production, through processing and distribution of oil, gas and oil products. Its ambition is to grow further in order to cover the whole petrochemical field. At this stage it comprises also a fertilizer factory with an annual capacity of 800,000 tons, a formaldehyde factory with a capacity of 30,000 tons, and is about to bring into operation a factory producing aromates. It is in fact a wide association of various enterprises in the western part of the country (Croatia and Slovenia).

In order to strengthen its position against its Yugoslav rivals (in Serbia and Vojvodina), INA has formed local consortia for the development of petrochemical industry. The participants are producers of chemical products "Oki" in Zagreb (Organic Chemical Industry), and "Jugovynil" in Split. The petrochemical program of the consortia envisages the setting up of a factory of ethylene (300,000 tons), polyethylene (150,000 tons), polypropylen (30,000 tons), polyvinyl-chloride (100,000 tons), polystyrene (30,000 tons), and synthetic rubber (50,000 tons).

No information is available on sales, revenues and investments. It appears, however, that the heavy investment expenditures resulted in workers' discontent during 1969, which led to the resignation of top manager of INA and some other key personnel. The new Managing Director of INA is Andjelko Bubanj, who was previously the Director of the Petroleum Institute.

"Jadranbrod" - Zagreb

Mr. Ilija Marjanovic - General Manager

An association of enterprises specializing in shipbuilding, ship repair and production of diesel engines, "Jadranbrod" was established in 1968. There are six participants in this association: "Uljanik", a shipyard and diesel engine factory located in Pula; "Split", a shipyard and diesel engine factory located in Split; "3 Maj", a shipyard and diesel engine factory in Rijeka; "J.L. Mosor", a shipyard located in Trogire; "Victor Lenac", a shipyard located in Rijeka; and "Tito Shipyard" located in Kraljevica. The enterprises have not lost their independence since the establishment of "Jadranbrod"; "Jadranbrod" carried out on behalf of them the functions of administration, programming and information.

The above-mentioned enterprises which formed into "Jadranbrod" represent more than 90% of the total Yugoslav shipbuilding industry, and 100% as far as ships of more than 1,000 BRT are concerned. The enterprises built up over the period 1965-1969 about 350 ships, with a total capacity of 2.5 million BRT and about 85% of the production was exported. They produce cargo ships (79% of their total production), special ships for liquid cargo (10%), ships-cargo liners (7%) and the remainder consists of ships for transportation of containers and cars, and ferry boats. At present, "Jadranbrod" has orders for 85 ships, (capacity of 2 million BRT) and 98% is designated for export to the Federal Republic of Germany, Switzerland, Norway, Sweden, USSR, England, Finland, India, Liberia, Pakistan, Turkey, Sudan, Panama, Mexico and Brazil.

In 1969, sales of the combined enterprises amounted to 2,490.6 million dinars ($199 million). Exports in the same year amounted to 1,967 million dinars or about $157 million.

The General Manager of "Jadranbrod", Mr. Ilija Marjanovic, was formerly assistant of the Federal Secretary of Finance. He speaks English, and while being with the Secretary of Finance spent four months in Washington as a participant at the IMF course.

Elektronska Industrija Nis (EINIS)

Mr. Vladimir Jasic - General Manager

Mr. Jasic is a graduate electrical engineer, who has been with EINIS since 1956. A series of mergers has transformed EINIS into a giant enterprise known as ELEKTRONSKA INDUSTRIJA with six divisions controlling (a) electronic components (b) machine tools (c) TV, radios and electrical apparatus (d) cardiograms, x-ray (e) electrical automobile equipment. The enterprise owns 30 factories and employs 2,400 workers. Finance, planning, marketing, buying and exports are centralized for the whole group.

The group's sales income is expected to be US $200 million in 1970, and is projected at US $500 million in 1975, when 40,000 workers are likely to be employed. The group's production in the first half of 1969 rose by 42% over that in the first half of 1969. The net profit in the next five years is anticipated at 7.5% to 8% of sales income. New investment plans in the next five years will range from US $80 to $100 million, to be obtained as follows:

from Banks	US $ 25 million
" Collaboration/Commercial Credits	US $ 25 million
" Own funds	US $ 50 million
	US $100 million

Basically there are two large groups in Yugoslavia manufacturing and marketing television and radio sets, namely EINIS and ISKRA. Initially, there were several other producers but these have merged in the last few years to form the present two groups. The domestic market for the industry is increasing steadily with the level of personal incomes.

Sevojno

Mr. Vlajko Brkovic - General Manager

Mr. Brkovic, who has been with the copper rolling mills, Sevojno, since its inception, was elected General Manager in 1960 (each term is four years) and is now in his third term, which takes him up to 1972. Mr. Brkovic is a metallurgical engineer and has undertaken specialized training in this field in Czechoslovakia and West Germany. He is Deputy in the Economic Chamber of the Yugoslav Federal Assembly and is currently the President of the Yugoslavian Business Association of Copper Producers and Processors. Mr. Brkovic is very dynamic and is now about forty-five.

Sevojno is the largest Yugoslav processor of copper (and alloy materials, such as zinc and lead) into semi-finished products, mainly sheets, strips, bars and tubes. The plant is located in Serbia at Sevojno and presently produces 60% of the total Yugoslav output of semi-finished copper and brass. It obtains its principal raw material from the copper mines at Bor. Production in 1969 was about 41,000 tons of which 22,000 tons were rolled products and 19,000 tons extruded and drawn. Total sales in 1969 amounted to US $93.76 million of which US $60.08 million, or 64.2%, represented exports, about 72.5% of which went to convertible currency areas.

Sevojno had originally drawn up a project for increasing its capacity by a further 12,000 tons of rolled copper. The IBRD had allocated a loan of US $3.5 million for this project under Loan 554-YU. It has now revised this project so as not only to achieve this additional copper output, but also to roll and process 35,000 tons of aluminum semi-products. (See Annex on Energo-Invest and the Aluminum Industry in Yugoslavia.) It expects to export 15,500 tons of aluminum semi-products per year. The range of aluminum semi-products will include painted and lacquered sheets and strips, intended for building and architectural purposes. The enterprise now employs about 2,700 workers. The original project was estimated to cost ND 77 million against the cost of the present project of ND 492.81 million. The original foreign exchange cost of US $3.5 million now stands at $14.88 million.

In entering the field of aluminum processing, Sevojno will be joining the following three established processors:

	1973 Production Capacities
"Impol" - Slovenia Bistrica	29,400 tons
TLM - Razine	41,000 tons
"Djurno Salaj" - Nis	7,500 tons
	77,900 tons
Sevojno	35,000 tons
	112,900 tons

Other users of aluminum, including the electrical cable industry, will consume about 24,600 tons of primary aluminum giving a total requirement for processing of 137,500 tons per year, which is well covered by the projected total production capacity of 150,000 tons per year.

The total quantity of semi-products will be handled as follows:

Domestic consumption	83,500 tons
Exports	54,000 tons
	137,500 tons

The area in which Sevojno is located is considered as relatively backward in the country, and has a higher than average rate of unemployment. The expanded project is, therefore, considered an important source of additional employment in the area.

Energoprojekt

Mr. Mucalov - General Manager

Energoprojekt is one of Yugoslavia's largest engineering enterprises. Its fields of activity are: hydro, thermo and nuclear power generation; irrigation and land reclamation; industry; architecture and town planning; and tourism.

Energoprojekt has acted as consulting engineers for a few Bank projects (notably in Yugoslavia itself, Ceylon and Zambia) and is currently engaged in the design of the Ibar Multipurpose Water Supply Project, which has been appraised for Bank financing.

The company employs 1,200 professional staff and has at the moment about 8,000 laborers on sites in Yugoslavia and abroad. It has subsidiaries in 20 countries and joint ventures in five.

Generalexport, Beograd

Mr. Vladimir Visnjic - General Manager

Generalexport was established in 1952 as an enterprise for international trade transactions. In 1954, it also started representation of foreign firms on a large scale. The enterprise managed to accumulate substantial capital due to reexport and other trade intermediary transactions. This helped substantially to broaden the scope of activity and the enterprise established a number of trade representations abroad or companies, invested capital into producing enterprises, tourism and as a corollary also established its own air carrier company, "Aviogenex".

The present activity of the enterprise consists of all kinds of international economic operations, starting from representation of foreign firms in Yugoslavia and promotion of their sales, commercial activity on behalf of Yugoslav enterprises abroad through own agencies or mixed companies, financing of production for exports, joint ventures, tourism, switch operations, retail trade, air traffic, etc. It is supposed that the total capital of the enterprise invested both at home and abroad amounted to more than $30 million. The total gross income of the enterprise amounted to about $12 million in 1969. It has recently concluded joint investments in a Coca-Cola plant, in an export refrigeration plant, a supermarket and a motel complex, a packaging material factory, and in several hotel and resort projects. In 1970, Generalexport joined with IFC, FIAT and the Yugoslav Investment Bank in making an equity investment into the Nominal Capital Account of the Zavodi Crvena Zastava/FIAT joint venture. During the expansion period, Generalexport will invest $8.8 million and this investment may grow to $12 million. Generalexport has also been active in financing construction of hotels, and it has discussed hotel projects with IFC and IICY which it would like to promote in cooperation with Western companies. It appears to be well-managed and very aggressive.

According to available information, Generalexport agencies abroad helped to sell Yugoslav products to a value of about $160 million in 1969, and they provided a link on the import side for a value of around $67 million of imports to Yugoslavia.

The General Manager of the enterprise, Mr. Vladimir Visnjic, has occupied his position since the establishment of the enterprise. He is considered to be one of the most skilled managers of international business in Yugoslavia.

10

Skoplje Urban Plan

On July 26, 1963, a severe earthquake struck the city of Skoplje, the capital of the Republic of Macedonia. Within a matter of seconds, damage estimated at $1.3 billion was wrought, over 1,000 people were killed, and some 80 percent of the city's population (200,000) was rendered homeless.

Early in August 1963 a representative of the Secretary General of the UN visited Skoplje to determine the possibilities of assistance from the United Nations and its specialized agencies. Initially the emphasis was to be placed upon emergency measures for rescue and survival, but plans for the long-term reconstruction of the city were also envisaged. As far as the latter is concerned, a UNDP project was rapidly formulated and approved (total cost $4.8 million) and by June 1964 a team was in the field. Its purpose was to prepare a definitive Urban Plan for Skoplje, based on detailed survey of physical, social and economic conditions in the city, and taking into account its future development in relation to development plans for Macedonia and the country as a whole. The UNDP project consisted of the following stages:

(a) a planning survey;

(b) an urban plan;

(c) detailed engineering for city sectors.

In June 1966 the Project was completed and the reconstruction of Skoplje was started soon thereafter.

The South Adriatic Development Plan

In 1966 the Yugoslav Government requested UNDP technical assistance for a regional development plan which would cover the southern Adriatic coast from about 30 km. south-east of Split to the Albanian border. The high potential of the Adriatic coastline for tourism development had never been in doubt. It is endowed with an excellent climate, a beautiful sea-shore and mountainous hinterland and an abundance of historical cities and monuments. However, it was only after the opening of the first convenient access road along the shore (the Adriatic Highway, financed by Loan 344-YU) that the southern part of the Yugoslav Adriatic coast was widely discovered by the international tourist.

To keep the momentum of the spectacular increase in tourism, it was obvious that considerable investments in facilities were needed. And rather than have an uncoordinated haphazard development, the Government decided that an overall framework should be provided to guide all investments in tourism facilities and related infrastructure in such a way that the most efficient allocation of resources could be obtained and nothing of the attractions of the coast would be spoiled.

In 1966 the Government approached UNDP for technical assistance and in January 1967 the Governing Council of UNDP approved the Project. The Plan of Operation was signed in October. UNDP allocated $1.1 million, while the Government's contribution amounted to $1.9 million equivalent. Execution was expected to take about 3½ years.

The purpose of the Project is to provide a physical framework for long-term development. Major emphasis is placed on tourism, but the Project has been defined in a broader sense and covers the overall economic development of the region with the specific target of raising the regional income to the national average by about 1990.

The Project will produce a Regional Plan, four Master Plans for areas of special importance to tourism, and eight Detailed Plans for action areas where major facilities for tourists are proposed in the near future. As usual for UNDP assistance, the Project is basically a pre-investment study. The investments recommended by the Project, the detailed engineering, construction and exploitation of the new facilities will be carried out by the Yugoslavs.

Now that the UNDP exercise has been practically completed, the following main lines have emerged with respect to the development of the region in the next 20-25 years:

- the capacity of tourist accommodations will increase approximately five times to 600,000 places;

- new branches of industry will be developed to provide additional employment (the population will double in this period to about 1 million): petrochemicals, oil refineries, metallurgy, etc. The industrial development will take place in two sub-regions based on the Ploce and Bar harbors and extending along their respective railway lines.

- intensification of agriculture will take place in a number of specific zones;

- the road system will be extended, mainly through a highway to be constructed beyond the coastal mountain range parallel to the existing Adriatic Highway and by branching to the shore and the hinterland;

- water supply systems will be expanded;

- master plans will guide the development of the major urban settlements.

The total cost of the envisaged investments is presently estimated at roughly $6 billion.

Two of the three projects in tourism which the Bank has under consideration are located in the zone covered by the South Adriatic Development Plan: Babin Kuk near Dubrovnik, and Jaz near Budva.

The experience gained with the Development Plan for the southern part of coast has induced the Government to approach UNDP again to carry out a similar project for the remaining part of the Adriatic coast. This project was approved by the Governing Council in June 1970.

NOTE ON YUGOSLAV TOURISM PROJECTS

Babin Kuk - Dubrovnik (Croatia)

Background

The historical old town of Dubrovnik stands today virtually unchanged since its rebuilding in the seventeenth and early eighteenth centuries. It contains examples of Romanesque, Gothic, Renaissance and Baroque monuments and architecture in a setting which is mostly still residential. The shortage of natural beaches has been met by individual hotels constructing plages to provide sea access. To these traditional attractions Dubrovnik has added an extensive cultural summer festival. The result constitutes a formidable tourist package which has led Dubrovnik to become one of the leading Yugoslav tourist destinations for foreign visitors. During 1969, approximately 250,000 people stayed in Dubrovnik, of which 170,000 were from abroad. The foreign visitors stayed approximately 5.3 days and spent approximately $11 per day on average. Dubrovnik attained an hotel bed occupancy level of about 60% for 1969, which is unusually high for the Mediterranean. The large numbers of foreign visitors to the area make a substantial contribution to the Yugoslav balance of payments. Dubrovnik has demonstrated its appeal to foreign visitors and large additions to accommodation capacity will be needed there in the next decade.

To supply the needs of the new mass tourism, new concepts will be required, not only in the transport industry, but also in the provision of accommodation, recreation, etc. Such a concept is envisaged at Dubrovnik where a large integrated tourism resort operating on a scale larger than anything so far developed is proposed. The possibility of helping to develop the tourism concepts of the future, the strong appeal which Dubrovnik has for European and North American tourists, and the opportunity to develop tourism in a part of Yugoslavia which has few other alternatives for economic development, justify the Bank's consideration of this project.

The Project

The project itself, first identified with the joint Yugoslav/UNDP "South Adriatic Project Study", will be built on a site of approximately 114 acres situated on the northern section of Lapad, a small peninsula within the Dubrovnik boundaries, and approximately two miles from the old town. It is planned to be an integrated tourism complex of 5,000 beds comprising luxury (300 beds), class A (1,700) and class B (3,000) categories, with facilities for entertainment, recreation and shopping both for residents of the complex and transient visitors. The complex is estimated to cost about US $42 million. Studies to date indicate that if properly carried out, the project will be financially and economically feasible. There are, however, some problems which are being considered within the Bank to identify the potential solutions.

The proposed operator of the complex is "MINCETA" (General Manager Mr. A. Lujak), a wholesale and retail enterprise operating mainly in the Dubrovnik area. MINCETA's rapid growth since its formation in 1962 is slowing down. It probably sees the provision of tourist facilities not only as the next logical step in its growth plans but also as a method of obtaining substantial foreign exchange which it can use to acquire foreign merchandise for resale in its traditional business. MINCETA is planning other tourism developments in which Bank involvement has not, so far, been suggested.

A tourism complex of the size proposed presents opportunities to benefit from economies of scale. To realize these opportunities, problems and difficulties, some of which have not generally faced the tourism industry before, have to be successfully identified and overcome.

The Problems

1. MINCETA has no actual experience of operating hotels. One possible solution is that MINCETA retains expert hotel and general management consultants. The latter may be necessary because of the unique nature of some of the problems posed by Babin Kuk. Another potential solution that is also being explored is the possible involvement of hotel operating companies.

2. The first designs for the complex, when evaluated, were found to be uneconomically expensive. It is considered essential to employ qualified architects and engineers to revise the designs and supervise construction. This is vital, both to control the construction costs and to ensure that the detailed designs of the complex minimize operational costs after completion.

3. Local infrastructure of airport facilities and road access to the airport from the project site is going to be reviewed by Bank missions to establish the improvements necessary in the light of the complex and to determine whether these should be made loan conditions.

4. Dubrovnik lacks an adequate sewerage system. At present raw sewerage is discharged into the sea in immediate proximity to tourism beaches and facilities. This is not only a major potential danger to all Dubrovnik tourism, but constitutes a special hazard to Babin Kuk as sewerage from town discharge points is carried along the seaward side of the project site. The sewerage problem is going to be reviewed by a Bank mission to consider the plans already made and consider what further steps should be taken. It is felt that, in the absence of Bank involvement, there is little likelihood that the necessary work to correct the sewerage problem will be carried out in the near future.

5. It is proposed by the Yugoslavs that all the finance necessary to construct the complex be raised by MINCETA, borrowing from the Bank and the Privredna Banka Zagreb, and that no equity be introduced either by

MINCETA or from other sources. It is also proposed that the complex be operated as part of the MINCETA enterprise. The full impact of these proposals on financial viability, the legal position of the complex and on possible foreign participation in management and investment is being examined.

6. In common with most other Mediterranean countries, Yugoslavia provides incentives to encourage investment in tourism facilities. These take the form in Yugoslavia of subsidized interest rates in respect of the Bank's loan as well as that from Privredna Banka Zagreb. The Secretary of Finance has undertaken to supply a memorandum on the interest subsidy system, following receipt of which the effect on the financial and economic viability of the project can be assessed.

7. The financial plan of the project is currently under examination and is not, therefore, completely determined. Preliminary estimates of the project's investment cost and net operating profits, however, indicate that the financial return on total invested capital for an average year is between 8% and 9%, depending on the extent to which inflation is taken into account. The economic rate of return, assuming a conservative estimate of the shadow rate of foreign exchange (15:1), is 12% - 13%. Assuming a shadow rate of exchange of 18:1, the economic rate of return would be 15% - 16%.

8. The gross foreign exchange earnings of the project are estimated at US $13.5 million per year over the 20-year operating period. The foreign exchange component of the operating cost is estimated to be US $0.94 million. Assuming a loan of US $16.8 million (40% of the investment cost) over 25 years (including a grace period of 5 years), at 7.25% rate of interest, the average interest payment would be US $0.76 million per operating year. Repayment of principal would average US $0.84 million per year. The initial investment of just over US $40 million is thus expected to yield about US $11 million of net foreign exchange earnings per year over the 20-year operating period of the project.

Personalities

Mr. Antun Roko Lujak (39) has held the position of General Manager since MINCETA's formation in 1962. He is credited with taking the initiative which led several Dubrovnik enterprises (of one of which, "Dubrawa", he was General Manager) to amalgamate to form MINCETA. He has since vigorously sought ways to expand its operations firstly into export/import trade and now into tourism. To our knowledge he does not speak English but may understand a little.

Mr. Ivo Bautovic (37) is Deputy General Manager of MINCETA. After training and working as a teacher, Mr. Bautovic was in charge of various "professional-political functions" of the center and commune of Dubrovnik. He attended Political University Zagreb before taking the position of Manager of the Personnel Department of MINCETA, the post he held prior to his present position. He has recently been elected to the Yugoslav Federal Senate. To our knowledge he does not speak English but may understand a little.

Bernadin - Portoroz (Slovenia)

Portoroz, on the substantially developed North Adriatic Coast of Slovenia, is a project of 2,500 beds costing approximately US $18 million. This project is in the process of being appraised. "EMONA", the proposed operator, produces and processes meat, operates supermarkets, hotels, a travel agency, and is in the import/export trade. While the tourism market is not of the same type as in Dubrovnik, it does have the advantage of proximity to large tourism generating areas of Germany.

Jaz - Budva (Montenegro)

The Jaz project area is situated about 70 miles south of Dubrovnik on the Adriatic Coast. The project area comprises a flat valley with a small river and a good sandy beach over 1,000 yards long. The area is practically uninhabited. The project is estimated to cost about US $18 million. A project preparation mission is scheduled to visit Budva in October 1970.