Implementation of the Programme of Monetary Reconstruction and Strategy of Economic Recovery of Yugoslavia in the First Six Months of 1994

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Republic Bureau of Development, Belgrade, Republic Bureau of Development, Belgrade, Republic Bureau of Development, Belgrade

1994

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Abstract
The article deals with the implementation of the Program of Monetary Reconstruction and Economic Recovery of Yugoslavia in the first six months of 1994. It were explained the phases of the Program implementation and then the global movements in Yugoslav economy in first half of 1994 (production, transport, commerce etc.). Each of these branches are then separately analyzed, particularly in 1992 and 1993, that were characterized with hyperinflation, one of the greatest in the world economic history. In further, it were analyzed prices and the movements on the market, as the employment, wages and the living standard. In last section the monetary movements and the public spending were explained. In whole, the implementation of the Program in the first six months of 1994 let's be very optimistic for the recovery of Yugoslav economy in the future, despite certain problems in its implementation, which are pointed out in the article.

Keywords: Program of Monetary reconstruction and economic recovery, Yugoslavia, economic movements, first half of 1994, economic optimism

The implementation of the Programme of Monetary Reconstruction and Strategy of Economic Recovery of Yugoslavia has been under way from 24 January 1994. The Programme has two parts: one relating to the reconstruction of the national monetary system, and the other, to the strategy of Yugoslavia's economy recovery. Priority has been given to the monetary system reconstruction, since the strategy of Yugoslavia's economic recovery is to be based on the results achieved in the monetary sphere.

The basic objectives of the first part of the Programme were as follows: achievement of price and dinar exchange rate stability; giving the central role to the National Bank of Yugoslavia and the maintenance of monetary stability; reorganization of public finance by introducing an efficient fiscal system which would not discourage production and at the same time be an abundant source of money for covering public spending; and removal of the existing administrative control over production, capital investment, prices, pays and interest rates. The achievement of these, as well as other aims, should be based in the first place on arrested new money issue, which in the course of 1993, tumed practically into the sole source of financing the budgetary deficit, i.e., public spending, and thereby also into the main inflation generator. The main precondition for the achievement of this objective was the separation of the monetary from fiscal policy, with a view to making them complementary, though conducted fully independently. The fiscal policy was intended to make the taxation system good and thereby, also the financing of public spending, while the monetary policy was to provide for the absolute independence of the central bank, its monopoly in money issuing, a single exchange rate, and to deal with the field of credits and interest rates.

The other part of the Programme relates to the strategy of Yugoslavia's economic recovery, and it sets the fundamentals of economic development and recovery. The starting point is the option for a market economy, based on the principles of competition among and equality of ali ownership forms.

The Programme has been planned to be implemented in phases. The first phase is geared to the achievement of the monetary reconstruction objectives and to the elimination of the real uncovered deficitary financing of public spending. In the second phase, action is to be taken towards reviving production, services and trade. The third phase would involve a new investment cycle and measures applied towards a systemic transformation (restructuring and rehabilitation of industries and banks, ownership transformation, etc.). The main Programme implementation phases are supplementary, so that they should increase the total positive results of its implementation.[1]

The application of economic policy measures (Resolution of Monetary Policy in 1994 based on foreign exchange backing of the issued money at first and also goods one subsequently, introduction of the new dinar as legal tender and keeping the old dinar in circulation, full convertibility of the new dinar) almost concurrently with the launching of the Programme, resulted in the arrest of hyperinflationary tendencies, so that a negative price growth rate was registered already in the second week of Programme implementation. The keeping of the inflation rate around zero in the course of ali six months, though with minor oscillations from one week or month to another, and the dinar exchange rate stable, is the best result achieved in the implementation of the Programmes so far. In line with the option for the revival of production, a large number of regulations has been passed in this area, to regulate the extension of credits by banks. However, the results achieved in this area are not as good as those achieved in the field of prices. The principle of fiill foreign exchange coverage of the bank credits extended was abandoned very quickly, and it was switched over to the obligatory goods coverage of credits. Although this has boosted the banks' lending activities considerably, other problems were created, which tend to become manifest upon the expiration of the credit repayment term The low percentage of repaid credits, and the open demands for their rescheduling, have compromised this aspect of Programme implementation and jeopardized the further crediting of successful

[1] For more about the *Programme of Monetary Reconstruction and Strategy of Economic Recovery of Yugoslavia*, see: *Yugoslav Survey*, 1994, Vol. l, pp. 3-30.

manufacturers, the ones who are able to repay credits and who have been doing it.

Besides the positive results scored, the Programme implementation has also created quite a number of problems, on the resolution of which the fate of the Programme is dependent. The risen output has not caused the tendencies to change. The hitherto experience with bank investments and the associated cases of fuiancial indiscipline discipline, are posing a threat to the other, already achieved objectives of the Programme, with particular reference to the stability of the dinar exchange rate. The reality of such a hazard is also indicated by the data relating to the sale/purchase of foreign exchange, where the businesses are the net buyers of foreign exchange. The problems relating to financial indiscipline štand, therefore, as the main obstruction to the further implementation of the Programme, with the resulting negative impacts on ali areas.

Economic Policy Measures Geared to Programme Implementation

The Programme implementation began with the adoption of quite a number of federal and republic regulations.[2] They can be divided into those which are institutionally setting the Programme as a system of measures geared to the reconstruction of the monetary system and the strategy of national economic recovery (federal regulations), and those that provide for the implementation of the Programme itself (federal and republic regulations). A large number of regulations was passed immediately, including the following as the most important ones:

The ***Resolution on 1994 Monetary Policy***[3] is geared to the achievement of the national currency's stability, which in turn would be conductive also to price stability and real interest rates, and to the provision of support to market-oriented enterprise activity. With a view to achieving such aims, provisions have been made for the National Bank of Yugoslavia (NBY) to issue 200 million new dinars covered by the foreign exchange reserves fully and that this amount may be increased on the basis of buying effective foreign currency and gold bullion. This Resolution also provided that no more old dinars are to be issued after 17 January and that the NBY discount rate is to be 7.25 percent per annum, except in the case of the federal and republic budgets, in the case of which 6 percent interest is to be payable yearly on the sums owed to the NBY.

This Resolution was amended with effect from 11 February, increasing the initial new dinar issue to 480 million, which, too, was covered by foreign exchange reserves. Moreover, banks were released from their obligation to deposit in the NBY the foreign exchange coverage for the credits they are extending, and instead of that, such provisions were made that for the sake of

[2] Since the Assembly of the Republic of Serbia and the Federal Assembly were not in session at the time when the Programme was adopted and launched, the relevant regulations were passed in the form of sub-legislative deeds (resolutions, ordinances, etc.), while in Montenegro, appropriate laws and sub-legislative deeds were passed.

[3] *Službeni list SRJ*, No. 7/94; 16/94; 23/94; 35/94; 39/94; 49/94; 57/94.

real coverage of the credit multipiication, the NBY will prescribe the structure and type of the credit portfolios of banks, depending on the volume of credit multipiication. Lastly, the interest rate payable on the federal and republic budget deposits was changed, so that it was set as a certain percentage of the yearly discount rate (30% of the discount rate - 7.5%).

The ***Ordinance on the New Dinar***[4] instituted the new dinar as legal tender. The new dinar was made exchangeable for foreign currencies without any limitations, at the exchange rate based on one dinar being equal to one Deutschmark. Besides the new dinar, the old dinar remained as legal tender until further notice, though without the possibility of its conversion into the new one at the NBY, while the opposite conversion was possible. The new dinar is exchangeable for foreign currencies without any limitations, as provided in detail by the Resolution on the Replacement, Sale and Purchase of the New Dinar for Foreign Legal tender,[5] which came into force concurrently with the start-up of the Programme itself. Since provisions were made for the NBY to reimburse the authorized banks for monthly costs at the rate of 0.3 percent of the amount of the new dinars exchanged and 0.5 percent of the foreign currency bought by them, it means that no fee is chargeable when new dinars are sold/bought for foreign currencies. The ratio of value between the new and old dinar was set by the NBY. Initially, it was 1:13 000 000, but very soon aftenvards, it was changed to 1:12 000 000, and this rate was applicable in the decision of 21 July abolishing the old dinar and allowing it to be converted into the new one.

The ***Resolution of the National Bank of Yugoslavia Regulating the Dinar Investments of Banks and Other Financial Organizations in New Dinars and Setting the Way of Securing the Foreign Exchange Coverage of Such Investments***[6] provides that banks and other financial organizations may extend dinar credits only up to the amount which has a foreign exchange coverage. Such coverage is to be understood to mean that the claim the bank concemed has from the NBY expressed as the dinar equivalent in new dinars, based on deposited effective foreign currency. However, this Resolution wasn't a longlived one. Namely, it was abolished after only 18 days (11 February), in consequence of a moderation of the conditions for bank credit extension, stemming from the Resolution Amending the Resolution on the 1994 Credit Policy.

Besides the se federal regulations, which meant the institutionalization of the Programme options, also ***other regulations providing for the implementation of the Programme*** were passed at the beginning of its implementation. These regulations were geared to the enforcement of the fiscal policy measures, and they boil down to the provision of public revenues to cover the budgetary and other public spending. This group of regulations included also some federal ones, but in view of the constituent republics' factual sovereignty in the fiscal sphere, the most important regulations were passed on republic level.

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[4] *Službeni list SRJ,* No. 6/94; 12/94.
[5] *Službeni list SRJ,* No. 9/94.
[6] *Službeni list SRJ,* No. 8/94.

Thus, the following regulations were passed in Serbia at the beginning of Programme implementation:

- Ordinance on the Levying and Payment of Sales Tax for the Duration of International Sanctions, [7] which has practically superseded the republic (Serbia) Sales Tax Law and prescribed that produets and services are to be taxed through excise tax as a special tax, general product sales tax and general service sales tax;
- Ordinance on the Amount and Way of Levying Corporation Profit Tax in Tax Declarations and the Time Limits for Paying Monthly Tax Advances for the Duration of the International Sanctions,[8] setting a single Corporation profit tax rate (30%);
- Ordinance on the Introduction of a Special Republic Tax Payable for the Duration of International sanctions,[9] levying a special republic tax payable by legal entities and businesses without legal entity status, at a rate which the general public immediately found to be too high, so that after only eight days, this Ordinance was amended and the tax rate reduced;
- Ordinance on the Financial Transaction Tax Rate,[10] prescribing that the special financial transaction tax introduced under the Law on Special Taxes Payable for the Duration of International Sanctions, is to be paid at the rate of 2 percent instead of 1 percent as provided by the mentioned law. This Ordinance, too, was a shortlived one, since the Ordinance Cancelling the Ordinance on the Financial Transaction Tax Rate[11] was passed already at the beginning of February, thus practically putting back into force the provision of the Law setting the rate of this tax at 1 percent. A little while later, this tax was abolished completely.

Following the constitution of the new National Assembly of the Republic of Serbia, at the session of 24 February, the latter adopted quite a number of laws incorporating the mentioned (and other) ordinances, making them thus invalid. The laws passed were the following ones: The sales Tax Law, The Law Amending the Citizen Income Tax Law, The Law Amending the Law on the Corporation Profit Tax, and The Law Amending the Law on Special Taxes Payable for the Duration of International Sanctions.[12]

Corresponding laws were adopted also in Montenegro at the at the start-up of the Programme. The following were the most important ones:

- ***The Law on Financial Transaction Tax***, [13] introducing financial transaction tax at the rate of 2 percent. Very soon after that, this rate was reduced to 1 percent, and in mid-April, this Law was abolished;[14]
- ***The Law on Republic Tax on Title of Firm***[15] on the basis of which was subsequently adopted the ***Ordinance Setting the Amount of Republic Tax Payable on Title of Firm;***[16]

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[7] *Službeni glasnik RS,* Nos. 8/94, 10/94.
[8] *Službeni glasnik RS,* No. 8/94.
[9] *Službeni glasnik RS,* Nos. 8/94; 12/94.
[10] *Službeni glasnik RS,* No. 8/94.
[11] *Službeni glasnik RS,* No. 12/94.
[12] These laws were published in *Službeni glasnik RS,* No. 19/94.
[13] *Službeni list RCG,* Nos. 3/94; 6/94.
[14] *Službeni list RCG,* No. l3/94.
[15] *Službeni list RCG,* No. 3/94.

- ***The Sales Tax Law;***[17]

- Amendments to existing laws: ***The Citizen Income Tax Law,***[18] ***The Social Security Contributions Law.***[19]

Implementation and Results of the Measures Applied

ECONOMIC ACTIVITY, STOCKS AND PAYS. The economic activity in Yugoslavia is determined by a number of factors which can be conditionally divided into three groups, including: non-economic, developmental/structural (long-term) and short-term ones. This division is an extremely conditional one, because the mentioned groups are highly interdependent mutually.

Among the non-economic factors (with strong economic implications), importance is attached to the impact of the discontinuation of trade between the former Yugoslav republics and of the UN Security Council sanctions. Although it would be very difficult to work out how much this factor has contributed to the diminishment of economic activity in the FR of Yugoslavia, it is obvious that the diminished foreign trade activity resulting from it has multiplied the existing negative tendencies in production and trade. Likewise, it is also clear that in view of the siže of the national market and the reseurces available, it would not be possible to make long-term plans for Yugoslavia's economy under the assumption that this factor will persist.

The developmental/structural factors should be to be understeod to mean the inherited economic structure which is not suited to market economy, and the associated with it, though with the economic system effects, declining tendency of economic activity. The effect of these factors, especially in the circumstances of an artificially "closed" economy, implies a longlived instability of the domestic market, without the possibility of eliminating the imbalance on a lasting basis (on the given level of economic activity).

As for the short-term factors, there is the effect of the current macroeconomic policy on market stability. The process of monetizatien of the fiscal deficit, as the factual basis of the *quasi* economic policies pursued before the implementation of the Programme was launched, contributed to the multiplication of the chronic market instability, which was manifest in high monthly price growth rates. Under such circumstances, the likelihood of the industries being able to renew in production the employed working capital is minimal. The effect of this on the economic activity is particularly strong in the case of businesses having long collection terms. The effect of the enormous price growth rates was reflected also on the structure of demand. The decreased receipts of the population in real terms resulted in a decreased demand in durable consumer goods, and in view of the diminished overall economic activity, the industries showed less interest in investing in production expansion or restructuring.

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[16] *Službeni list RCG,* No. 8/94.
[17] *Službeni list RCG,* Nos. 3/94; 13/94.
[18] *Službeni list RCG,* Nos. 30/93; 3/94; 13/94.
[19] *Službeni list RCG,* Nos. 32/93; 3/94.

PRODUCTION AND STOCKS. At the launching of the Programme, the monthly industrial output was equal to 28.1 percent of the average monthly output in 1989. In the 1990-1993 period, the industrial output decreased at the rate of 2.4 percent monthly on average. This decrease wasn't an even one throughout the mentioned period, and it was highest in 1992. The decrease was slower thereafter, but in view of its comparatively low level previously, it produced much heavier consequences (especially in the public welfare sector). The diminishing industrial output was paralleled also by diminishing stocks of fmal products, though at a considerably slower pace. Namely, at the beginning of the Programme implementation, the stocks were equal to 80.8 percent of the average in 1989.

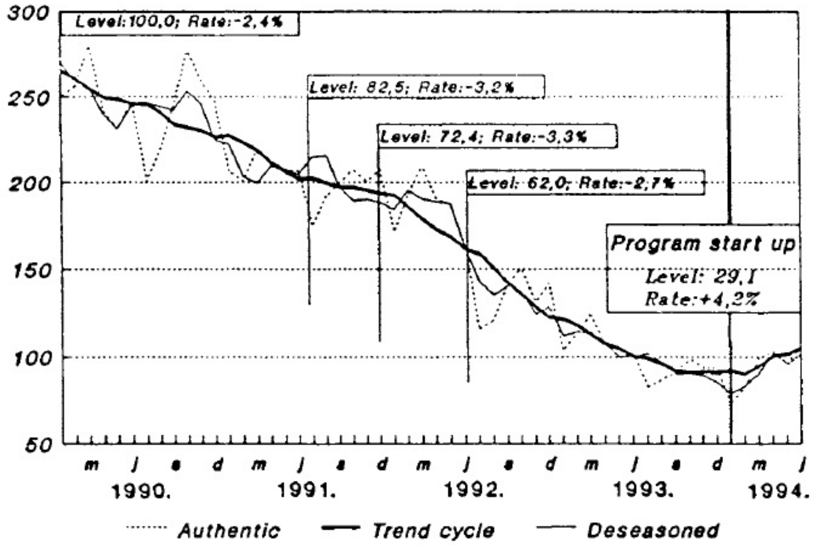
Compared to that at the beginning of implementation of the Programme, the industrial output (Chart I) in June was by 26.8 percent higher, being on the level registered in the middle of the 2nd quarter of 1993 or equal to 35.6 percent of the maximum registered output (January 1989). Although the industrial output growth rate of 1.7 percent was a low one, it is nevertheless a significant one in view of the fact that it was preceded by negative ones over several years. Should the deseasoned June output be maintained also in the second half of this year, the annual industrial output decrease would be 1.9 percent. Compared to the first six months of 1993, the output in the same period this year is by 14.5 percent lower. However, in relation to the July-December 1993 period, the output (deseasoned) has increased by 0.4 percent. Disregarding January, since the Programme was launched towards the end of that month, the output has decreased by 12.5 percent in relation to the first half of 1993, and increased by 2.7 percent in relation to the second half of 1993.

In terms of the intensity of changes for the better, the February-June period can't be compared with any other period of that length in the more recent economic history of Yugoslavia. However, despite the undoubtedly good results scored, the current output movements can't be described as a change of tendency. For the time being, pressure is obviously being applied towards forming a turning point in the output movements. It depends on the factual reach of the Programme-remedied limiting factors whether a tendency turning point will be actually reached.

Since the stocks of final industrial products are stagnating, it can be said that the mentioned output growth has also been absorbed by the market. This is conductive to the conclusion that the output growth in this period resulted primarily from a risen effective demand; hence the growing belief that the attained output level can be maintained without great difficulty in the short run. However, the mentioned occurrence was shortlived and it stemmed from the Programme results directly. When the prices were growing at a high rate, the businesses had the motivation to reduce to minimum the share of liquid assets (especially their own) in the total working assets, or to "defend" the value of working assets by increasing their stocks. The stabilization of the national currency's value and the comparatively high price of liquid assets brought about a change in the working asset structure. Businesses were motivated to increase the share of their own liquid assets in the total working assets, by selling (out) their stocks of final products. The orientation of the formed liquid assets to production will depend on the intensification of market forces under which the businesses are operating. The economic policy could produce an impact on this domain, subject to the creation of preconditions for the strict observance of the principles of "hard" budgetary limitation.

CHART 1 – INDUSTRIAL OUTPUT MOVEMENT

Indices (1993 = 100)



Contrary to the expectations that the implementation of the first phase of the Programme will lead to a rise of the output in consumer goods, the most marked short-term growth was registered in equipment production. However, that can hardly be attributed to the Programme implementation results directly, because the production cycle with these manufacturers is longer than the average production cycle for the total industry (which is three months). However, the inflationary wave lasting several years produced the strongest impact on this production precisely. Consequently, at the beginning of this year, it reached its lowest-ever level. Hence the opinion that the output growth in this area resulted from the speeded-up finishing of the stocked unfinished products.

The industrial output in all components has been growing since the launching of the Programme (Table I).

Table I - INDUSTRIAL OUTPUT MOVEMENT BY PURPOSE

(Indices)

	June '94/ Jan '94 (Deseasoned)	June '94/ June '93	Jan-June 94/ Jan-June '93
Equipment production	159.2	98.7	69.2
Intermediates production	110.3	101.1	88.5
Consumer goods production	141.2	100.9	84.0

The data by industrial branches show that in relation to the first six months last year, six branches (which account for 4.1% of the total industrial output) had higher output in the same period this year. They were the following branches: non-ferrous metal working, production of non-metallic minerals, shipbuilding, production of building materials, rubber processing and production of various products.

Nineteen branches (which account for 51.5% of the total industrial output) registered a higher output in June this year than last June. These are: non-ferrous metal industry (production of non-ferrous metal ores, production of non-ferrous metals), chemical industry (production of basic chemicals, processing of chemicals, paper production and processing), textile industry (production of yams and fabrics, production of final textile products), part of metalworking industry (production of means of transport, ships, electrical machines and appliances), electricity industry, rubber, leather and fur production, beverages and tobacco production, production of non-metallic minerals, and other industries (printing and production of various products).

A closer examination of the scope and structure of the registered output growth from the launching of the Programme to date, would call for making detailed analyses on lower levels of aggregation.

The process of horizontal expansion of the economic recovery in the industrial sector can be examined also on the level of concrete products. The biggest shift in the output movement was registered in March. Thus, the output in 40 percent of products increased in February, while these figures for March and April were 50.9 and 53.5 percent respectively.

As for the usage structure of products from the sample (products selected for analysis), it can be seen that the share of included consumer goods has grown more than average. This group of products accounted for 55.6 percent of the total increment in a sample of 100 for the total increment of the most important products (or 40.4% of the industrial output increment is accounted for by the consumer goods included in the sample). On the other hand, the share of the intermediates and equipment is below average. That, however, casts a shadow of doubt on the opinion that the current industrial output recovery is owed to an increase of the output in equipment. The corner stone of economic recovery is the risen output in consumer goods (particularly the durable ones). The increased output in equipment is important for the given production, but in view of its low level, it has no major effect on global movements.[20] Thus, the risen output in the instruments of work can in no way explain such a high growth of the total industrial output.

[20] The growth of the total industrial output by 1 percent essentially calls for an autonomous increase in the output of instruments of work by almost 30 percent. Therefore, the importance of this

The causes of the growth of the output in durable consumer goods should be sought in risen effective demand. Because of the virtual non-existence of the dinar savings and consumer credits, there were hardly any sales in durable consumer goods in the course of 1993. The currently rising living standards of the population and the price stability have created a climate favouring a risen demand in these products precisely.

The average monthly output in the first six months of this year was 27.8 percent higher than that in January. In relation, the output has increased in 71.5 percent of total production. As much as 19.3 percent of the total six-month production is accounted for by the products (633) whose production was at a stand-still in January. In the same period, the output decreased with 28.5 percent of production (energy sources mostly).

The hitherto impacts of the Programme on the movement of output and stocks can be regarded as positive. The output can be expected to grow further in the short-run, though at a slower pace, and create the conditions for a gradual elimination of the previously mentioned longlived limiting factors.

TRADE AND PAYS. The real turnover in retail trade in January this year was equal to only 8 percent of the average monthly turnover in 1989. In relation to the beginning of 1990, the average monthly decrease of retail trade turnover was 5.6 percent. Evidently, the turnover decreased at a much higher rate than the output. This disproportion grew with the depreciation of the national currency and the resulting expansion of the grey economy. Such tendencies were the cause of an enhanced erosion of the tax revenues, monetization of the growing fiscal deficits and additional depreciation of the national currency.

The stabilization of the domestic currency and market led to the revival of trade channels, so that trade increased by almost five times (385.8%) in the first three months of implementation of the Programme. Even so, the present trade turnover is equal to only 39 percent of the average monthly retail trade turnover in 1989. This means that, conditionally speaking, the effects of the autonomous growth of the retail trade turnover have been exhausted and that further trade movements will depend on effective demand. In view of the retail trade structure, it is clear that pays are the chief limiting factor on the demand side.

The effect of depreciation of the national currency on retail trade was transmitted through pays precisely.

The average monthly pays grew in the January-June 1994 period at a very fast pace, i.e., as follows:

	New dinars
January	26
February	63
March	80
April	114
May	133
June	167

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production for the intensity of the total industrial activity is many times smaller than the individual importance of, for example, electricity industry and production of foodstuffs.

The quick growth of real average pays in the January-June 1994 period has improved the financial position of employees considerably and lessened the social tensions without causing the production costs to rise very much. This was possible because the pays were extremely low at the time the Programme was launched. However, despite the high growth rates of real pays, the pays of many employees are still falling short of the minimum required for survival, because of an uneven pay distribution. The price of the consumer basket is still well above the average net pay.

Looking by branches, a tendency is shown to keep the position of pays at the earlier parities, despite the difference in the rates at which their activities are diminishing. Only the big differences in economic activity, outside the sectors in which the public enterprises prevail, were reflected on the relative level of pays of the employees of such branches.

GENERAL ECONOMIC CONDITIONS are stable in the short-run, which in the present constellation of long-term and short-term growth/development factors provides the necessary preconditions for economic recovery. However, the effect of short-term stability will soon be lost, unless lasting conditions are created for the intensification of economic activity. Therefore, problems will be posed in consequence of the earlier development and action of non-economic external factors (UN Security Council sanctions and severance of relations with the former Yugoslav republics), and because of the delay in adjusting the current economic policy and the economic system to the objectives of the Programme.

PRICES AND MARKET. In the field of prices, the most important objective of the Programme was the elimination of hyperinflation, which would be conductive to the stabilization of the national currency and all necessary operating conditions. However, the curbing of hyperinflation by stopping the money issuing, which was causing and encouraging it directly, was not followed also by the creation of all other conditions for the elimination of the inflation generators which have existed also in the past and which will probably emerge from time to time in the future, too. In the field of prices, one of such generators is the mutual price parity on the domestic market (or markets, to the extent the domestic market is segmented). The disrupted parities have been characterizing the national economy for a long time, and the current state of affairs resulting from a forcible closing of the national economy to the influence of the international market, have only made this situation worse.

PRICE MOVEMENTS. The Programme of Monetary Reconstruction and Strategy of Economic Recovery of Yugoslavia was geared to product and service pricing without any restrictions, though with the exception of the price of the products having the character of natural monopolies and the public Utilities. The product and service pricing system is set by the republic and federal regulations, in line with the mentioned programme options.[21]

[21] For example, the Government of the Republic of Serbia has set the ceiling prices for the following products: electricity, crude oil, oil products (other than mineral lubricants), natural gas, wheat flour and basic types of bread. Criteria have been set for pricing milk and housing/public utility services (which are in the domain of municipal and town authorities). The Federal Government has set

The retail prices were being maintained on more or less the same level, or decreased, until mid-April.[22] From the Programme launching date to the end of the first week of April, the retail prices decreased by 0.7 percent as a whole, in the scope of which the price of goods decreased by 14 percent and the price of services increased by 58.1 percent. The retail price of industrial food-related products decreased by 32.2 percent on average and that of industrial products other than foods by 7.5 percent. The retail price of agricultural products went up by 2.6 percent. As for services, the price of the housing/public utility and transport services decreased by 19.8 percent, and that of the PTT services by 8.8 percent. The price of other services increased from 18.7 percent (education and culture) to 1253 percent (public welfare services).

The retail prices have been growing mildly from the second week of April, so that in Serbia, the April prices were by 1 percent higher than the March ones.[23] The price of goods increased by 3.4 percent - that of industrial food-related products by 3.4 percent and that of industrial products other than foods, by 1.7 percent. The retail price of agricultural products decreased by 0.2 percent and that of services by 6.1 percent.

In May, the retail prices in Serbia were by 0.1 percent lower than in April, which was also the case with the price of goods. The price of industrial food-related products decreased by 0.2 percent and that of industrial products other than foods, by 0.1 percent. The price of agricultural products was by 14.6 percent higher, and that of services by 0.1 percent. According to the Federal Bureau of Statistics, the May retail prices in Yugoslavia were by 0.3 percent lower than the April ones; the price of industrial products decreased by 0.5 percent, while that of agricultural products increased by 20.4 percent; the price of services was by 1.8 percent higher. The June retail prices were by 1 percent higher than the May ones. The price of agricultural products increased again (6.5%), and that of industrial products and services decreased (by 0.5 and 2.3% respectively). Lastly, the July retail prices were by 1.3 percent lower than the May ones; those in Serbia decreased by 1.4 percent and those in Montenegro increased by 13.6 percent.

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the way of pricing the drugs for human use, while in the case of price changes in the field of inland railway transport and PTT services, the relevant ministries have to be notified thereof five days beforehand. In Montenegro, price changes have to be reported to the Ministry of Trade on the effective date of changes, and more prices are subject to reporting there (Ordinance on Obligatory Reporting of Price Changes for Monitoring Purposes, *Službeni list RCG,* No. 15/94). Thus, about 19.94 percent of the industrial output is under price control (republic 17.95% and federal 1.99%). In the case of retail prices, this coverage is somewhat smaller (16.8%, of which 14.7% is under republic control and 2.1% under federal), while 21% of retail prices are under milder control (price monitoring). (Data supplied by the Ministry of Trade and Tourism of the Republic of Serbia).

[22] It is possible to follow the retail price movements from the Programme launching to date, by using, as usual, the monthly and weekly data obtained by conducting surveys in three major cities (Belgrade, Novi Sad and Podgorica). In view of the discrepancies observed between the monthly and weekly data, it is clear that the weekly coverage is inadequate and that the conventional monthly data are more reliable. That is why preference should be given to the latter in monitoring the price movements. Even so, the weekly data can point at some general tendencies.

[23] Data furnished by the Republic Bureau of Statistics. As a matter of interest, the data of the Federal Bureau of Statistics are different, so that according to them, the April retail prices were lower than the March ones, in Yugoslavia by 0.4 percent and in Serbia by 0.5 percent, and in Montenegro, they were higher by 1.5 percent

Based on the hitherto price movements, it can be concluded that following the almost instant elimination of hyperinflation with the launching of the Programme, the general price level has stabilized at about zero growth rate. From 24 January to the end of the first week of July, the retail prices have increased by 0.1 percent. This was brought about mostly by the increase in the price of agricultural products (16.3%), which was responsible for the general price growth in May and June.[24] The price of industrial products decreased (16.3%), though much more in the foods segment (29.9%) than in other segments (10.5%). The price of services increased by 65.4 percent in the same period, mostly thanks to a high increase at the launching of the Programme, which was not compensated even by repeated cutting of the price of some services (PTT services).

The hitherto manifest tendencies in price movements as a whole can be regarded as positive.[25]

The introduction of a new national currency and the elimination of monetization of the fiscal deficits put an end to the practice of incorporating the anticipated inflation in the prices, marking the beginning of a period of cutting the price of many products substantially. The hyperinflationary spiral was cut already in the second week of Programme implementation, when a negative retail price growth rate (-0.5%) was registered. This rate persisted until the second week of April, when the retail prices went up by 1.8 percent. The retail prices continued to grow in the remainder of April and in the first two and the last week of May, though at a slower pace. The biggest price decrease was registered in the course of March, which was indicative of a complete elimination of the psychological factor and stoppage of the practice of incorporating the expected inflation in the prices, proportionately to the growing confidence in the consistence of the anti-inflation policy. This price decrease is partly owed also to the reduction of the commercial rebate. However, the emergence of the so-called agiaged exchange rate (twice), oscillation of the price of energy (electricity, fuels, etc.) and its shortages, shortage of spares and fodder, high public utility rates and various taxes, caused the prices to rise from time to time. As an additional measure towards maintaining the price stability, it has been resorted to the releasing of goods from commodity reserves as of late, and the tax burdens have also been reconsidered.

The prices in the fields of economic infrastructure, power supply and housing/public Utilities have been attracting great attention ever since the launching of the Programme. These prices were kept very much depressed in

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[24] According to the estimates made at the Republic Bureau of Development, of the total agricultural product price growth in May (14.6%), about 40% relates to seasonal effect.

[25] The data on the price growth obtained by the usual statistical methods, are available for the period ending on the last day of June. Methodologically speaking, the usual surveying (between the 20th day of the current month to the 20th day of the following one) has a larger coverage and larger sample than the weekly surveying introduced for the purpose of monitoring the Programme implementation, so that it should be taken as more reliable. Measured like that, the February hyperinflation turned into deflation, since the retail prices decreased by 6.7 percent in March, increased by 1 percent in April, decreased by 0.1 percent in May, decreased by 1 percent in June, and decreased further by 1.4 percent in July. In Serbia in June, only the price of agricultural products was higher than in May (by 6.8%), while the price of industrial products and services showed a decrease (by -0.5 and 2.3% respectively).

1993 for the sake of the living standards of the population.[26] Their enormous increase when the Programme was launched, made it necessary to reconsider them and the way in which they are formed. In their cutting, it was adhered to the principle of "cost plus". These prices have been cut several times in the meanwhile, but even so, they are still higher than what the population can afford and represent a significant cost input for the industries. Of great importance for the future price stability will be a risen output with the achievement of positive foreign trade results under blockade and the establishment of more realistic price parities (in line with world price parity basically). The keeping of prices on a low level forcibly in the circumstances of low output, low foreign trade activity, low pays and low other macro quantities, is creating favourable grounds for the revival of inflation, if it is not conductive to a proportional increase of output (supply).

It would be necessary to formulate in the price sector a policy of pricing the public services by the republic governments, so that in due course it would be possible to attain a price level which would include more than the cost of normal operation, though without endangering the living standards of the population (the programmes of improving the efficiency of public enterprises are under way, so that changes are expected in the price sector, too). In addition to reconsidering the local price levels in the housing/public utility segment, it would also be necessary to formulate common criteria with a view to achieving a greater uniformity of these prices, though bearing in mind the differences by municipalities and towns.

RELATIVE PRICES. Besides the price movement tendencies, the appraisal of the situation in this sector also calls for an analysis of their absolute levels compared to the price levels in one or more preceding years. Of the several possible comparisons, we are comparing here the price of selected products in the current year with that in the same month of 1990, 1989 and 1982.[27] (Current prices were translated beforehand into mutually comparable data and expressed in Deutschmarks calculated at the official exchange rate set by the National Bank of Yugoslavia. The sample included more than 170 products and services.

In 1994, the price of basic agricultural products was in most cases lower than that in 1990 and 1982, and much higher than in 1989.[28] The price of services is also (considerably) higher than in 1989, but in relation to 1982 and

[26] For example, the price of electricity (supplied to households) is now equal to 28 and 40 percent respectively of that in the same period of 1990.

[27] These years were selected for the following reasons. Firstly, the year 1990 is in many respects similar to this one - involving the implementation of a stabilization programme which has some items in common with the present one (pegging the dinar to the Deutschmark in the first place), so that the price levels are comparable with the international ones directly. Secondly, the economy of the former Yugoslavia was experiencing similar (though not as heavy) hyperinflation in 1989, which was preceding the "stable" year 1990. In addition, an anti-inflation programme based on the premises which are much different from those of the present one, was being implemented in that year. Lastly, the year 1982 was selected as the year in which the *Anti-inflation Programme* was adopted and implemented in a (futile) attempt to stop the inflation (about 40% yearly then) from turning into hyperinflation.

[28] An exception is the unusually high price of onions this year, as well as of lemon and oranges and eggs. The prices of these items were higher than in 1990 (except eggs) and approximately on the same level as those in 1982.

1990, the price of some services is even lower. The prices of industrial products (foods and other than foods) are mostly higher by several times than in 1989. An exception is the already high price of electricity. The prices of industrial products are also mostly higher than in 1982. The corresponding data on price parities in relation to selected years indicate, therefore, that despite the leap made in May and June this year (which can be attributed to the seasonal effect only partly), the price of agricultural products is still comparatively lower than the retail price of industrial products practically in relation to ali of the selected years. This means that irrespective of the hitherto price cuts, there is still room for adjusting the price of industrial products downwards.

MONETARY, CREDIT AND INTEREST RATE POLICIES. *Monetary policy* is the key lever of the anti-inflation policy in the Programme. Monetary stability was achieved by stopping the old dinar issuing a week before the Programme was launched and the new dinar introduced, the issue of the latter being backed exclusively by gold and foreign exchange reserves. In that way, the budgetary deficit-money issue-exchange rate-prices spiral was arrested.

The concurrent existence of two national currencies was not a novelty in the implementation of stabilization programmes. Such a model was applied in Russia in the implementation of the New Economic Policy in the twenties, and more recently (1993), in Lithuania. The withdrawal of a certain amount of old dinars from circulation in the first few days following the launching of the Programme resulted in the consolidation of the old dinar and its stabilization at 12 000 000 to 1 new dinar. The fear that old dinars will not be accepted as legal tender was unfounded: because of a shortage of new dinars, the old dinars were accepted by almost ali businesses. With the rapid growth of the real money supply, the relative importance of the old dinar diminished in view of its quantity (the equivalent of about 50 million new dinars as opposed to the money supply which was upwards of one billion at the end of March). However, the low bank liquidity caused the old dinars to return to the transactions in the money market. After several announcements to that effect, the old dinar was abolished as legal tender towards the end of July.[29]

The cessation of the old dinar issuing was followed by the introduction of the new dinar which is convertible into foreign exchange without any major limitations. The exchange rate of the new dinar was pegged to the Deutschmark at the ratio of 1:1, which psychologically, was a good move (after many decades, the basic domestic currency unit had a high value), despite the economically valid remarks about the inadequacy of such a ratio (in the previous anti-inflation package, the rate was 7 dinars to 1 Deutschmark). It was expected that the new dinar would be attractive from the aspect of saving, given the offered interest rate of 6 percent yearly, payable quarterly. However, this was one of the few areas in which the Programme failed to fulfil the expectations. Given the very low pays and other receipts, there are practically no savings. Another reason for this is probably the lack of

[29] The Ordinance Amending the Ordinance on the New Dinar, *Službeni list SRJ*, No. 57/94. Interestingly enough, at the launching of the Programme, the quantity of old dinars was claimed to be the equivalent of 40-60 million new dinars, while at the time of abolishment of the old dinar, reference was being made to about 100 million.

confidence in the financial system, since the question of the so-called old foreign exchange savings has still not been settled, and in view of the full depreciation of all deposits when hyperinflation reigned. In view of this, it is not very likely that the announced increase of the yearly interest rate from the present 9 percent to about 12 percent will encourage saving.

It was assumed that in the issuing of the new dinars according to the "currency board" model, implying full foreign exchange and gold backing, that the dinar exchange rate will be attacked by greater purchasing of foreign exchange. Consequently, besides the foreign exchange reserves kept by the National Bank of Yugoslavia, which were permanent, the so-called Pool II was prepared with a view to boosting the defensive capacity by using the foreign exchange reserves of commercial banks and enterprises. However, it turned out that the fear of a rapid depletion of the foreign exchange reserves was unfounded, since the foreign exchange reserves have been growing ever since the launching of the Programme (Table II). Thus, instead of the expected withdrawal of dinars from circulation on the basis of net sales, there is a greater foreign exchange inflow and a dinar issue on such grounds.

TABLE II - FOREIGN EXCHANGE RESERVES GROWTH AFTER 24 JANUARY

	February	March	April	May	June	20 July
Total net	195	320	312	335	289	280
Total inflow		358	472	580	679	720
Total outflow		39	160	245	389	440
Legal entities net		116	95	60	15	20
Inflow		142	205	231	250	262
Outflow		26	110	171	265	281
Natural persons net		180	183	211	198	196
Inflow		192	212	283	308	317
Outflow		13	29	71	109	121

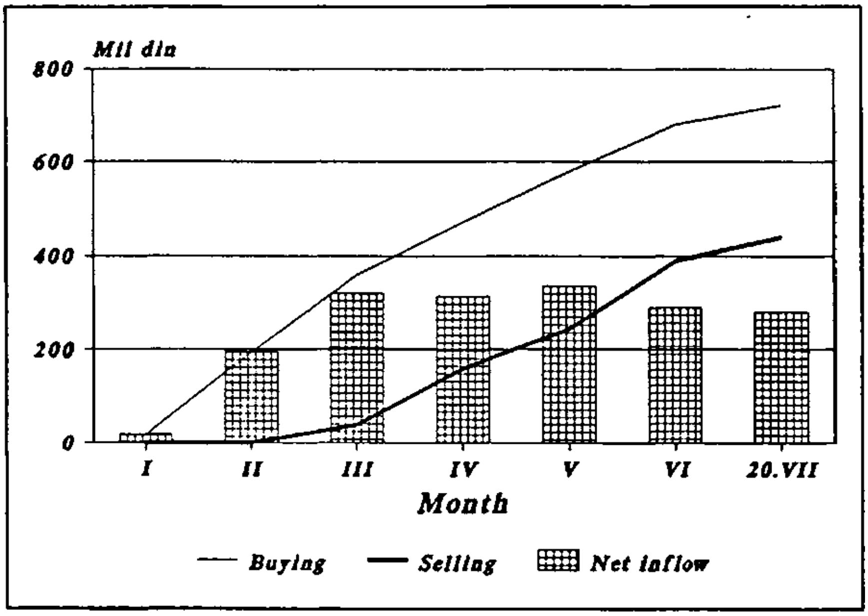
Source: National Bank of Yugoslavia

Despite some weak points and limitations, the convertibility of the dinar has been achieved basically and it is of key importance for the exchange rate stabilization. In addition, the shortage of dinars, because of low pays and other receipts of the population, additionally lessened the pressures on the foreign exchange reserves. For the purpose of building confidence, action was taken in due course towards reducing the limitations by involving the Payments Operations Service in the sale/purchase of foreign exchange, because the banks were not interested in exchange operations (exchanging at mean exchange rate without bank charges). The figures on the foreign exchange outflow and inflow show that citizens have sold more foreign exchange than businesses (317 and 262 million respectively), and bought much less (121 and 281 million respectively). This shows that the main blow on the exchange rate was and can be expected from the businesses. The blows struck at the exchange rate in the early and late March were repelled primarily by limiting the drawing of cash and punishing the agiaging heavily, and less by economic measures - simplified procedure for changing foreign exchange and quicker and easier foreign payment operations. In June, the sale of foreign exchange to citizens was suspended, and in July, the National Bank of

Yugoslavia intervened with the foreign exchange equivalent of 50 million dinars and the latest measure - keeping a record of the persons who are buying foreign exchange.

The foreign exchange reserves kept by the NBY have been almost doubled since the launching of the Programme. The foreign exchange purchases by banks kept growing steadily and it was only two months ago that these purchases began to decrease (Chart II). The sale of foreign exchange by the NBY and other banks, which was very slow initially, was showing a tendency to grow in the March-June period. Consequently, the foreign exchange reserves reached their highest level at the end of March, and remained on that level for the next two months. They decreased in June, and since then, they have been on the level of the foreign exchange equivalent of about 280 million dinars.

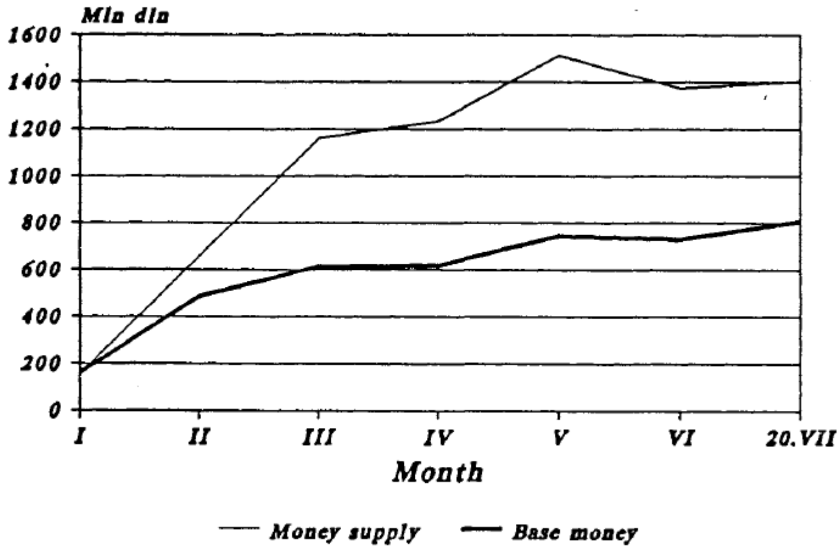
CHART II - MONEY SUPPLV AND NEW MONEY IN 1994



The second autonomous flow of money issuing was the provisional crediting of the republic and federal budgets. Namely, the Programme made provisions for a six-month bridging up of the budgetary deficit, using new money against full foreign exchange coverage. The initial phase of Programme implementation, resulting in deficit cutting, proved that the advocates of this idea were right. However, in May and June, rise was given to an absolute decrease of direct budgetary revenues and funds, and a rising deficit, which once again opened the issue of the justifiability of this approach. The main issue again relates to cutting the public spending.

It is an established fact that on the one ground (net foreign exchange inflow - 279 million) and on the other (budget crediting - 468 million), rise was given to the intensified money issuing,[30] particularly in the first quarter. After the April stagnation, the money supply grew very quickly in May, reaching the record 1 511 million. It decreased in June, and began to grow again in July (Chart III). As of late, new money is being issued towards paying out old foreign exchange savings, securities purchasing by the National Bank of Yugoslavia and credits extended towards maintaining bank liquidity. Consequently, the real money supply has grown very quickly, which was one of the main objectives of the Programme. A large part of the process of remonetization, i.e., bringing the real money supply to a satisfactory level[31], has been carried out so far in the implementation of the Programme so far.

CHART III - FOREIGN EXCHANGE TRANSACTIONS OF THE NATIONAL BANK OF YUGOSLAVIA



Since no more money is expected to be issued towards crediting the budgetary deficits or towards foreign exchange transactions, in the circumstances of money issuing against full gold backing, key importance is attached to the creation of the so-called POOL II amounting to DEM 300 million. It should also be counted on the issuing of gold and silver coins valued at 200 million, as well as with a mechanism for bank liquidity credits, and lombardi and rediscount credits.

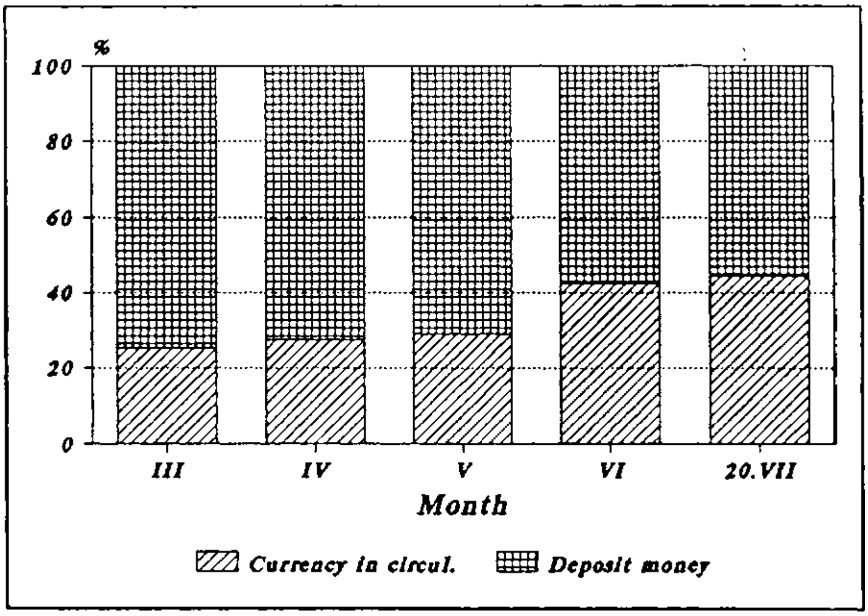
BANK LIQUIDITY. After the initial shortage of dinars, resulting from the usual administrative and organizational problems, the general liquidity was

[30] New money was being issued at a higher rate than planned, since the money supply increased to 1 050 million in the first quarter, in contrast to the planned 950 million new dinars.

[31] The share of the money supply reached almost 18 percent of the estimated social product in the first six months (or 7.9 billion dinars according to the Economics Institute's estimate).

good subsequently, thanks to money issuing on two grounds. The bank liquidity improved quickly, which was conductive to intensified lending activity (after the slackening of the credit approving procedure) on the one hand, and the placement of capital in the grey trends, on the other. Consequently, the NBY securities were offered first, but this was successful only partly. Then the commercial banks' obligatory reserves with the NBY were increased, so that the liquidity of commercial banks was very low throughout April. At the beginning of May, the accounts of many banks showed a negative balance because of increased outgoing payments. Because it was feared that the lending activity of banks might be slowed down, the rate of obligatory reserves was decreased twice (first from 15 to 10, and then to 5% on sight deposits), after which was abolished also the obligation to buy the NBY securities.

CHART IV - MONEY SUPPLY STRUCTURE



After their risen liquidity in May, the banks were on a low liquidity level again in June. There were several reasons for the latter: unavailability of assets when they are needed for investing, slow repayment of credits, reduced deficitary budget financing, cash drain into illegal channels and purchase of foreign exchange. The liquidity of banks resulted in decreased transactions in the money and securities markets and slowed-down lending activity. Following the action taken by the National Bank (extension of credits towards liquidity maintenance and securities purchasing), the liquidity of banks improved in July somewhat.

The issue of low bank liquidity is closely associated also with the issue of the growing and worrisome high share of cash in money supply (Chart IV), which was as follows:

	As %
March	25.4
April	27.7
May	29.2
June	42.4
20 July	44.4

The cash share increased immediately after the application of the measures intended to stamp out agiage. What was involved was a prohibition against transferring funds from giro to current accounts and limitation of cash drawing to 1 000 dinars daily. Hence the still prevailing mistrust towards the financial system and exercise of maximum drawing rights, and the subsequent draining of cash into illegal channels and grey economy.

CREDITING ACTIVITY OF BANKS. At the start-up of the Programme, remonetization was controlled by the foreign exchange coverage of bank investments. Despite their relatively high liquidity, the commercial banks were reluctant to extend credits because of the obligation to deposit foreign exchange, high transaction costs, insecurity of investment under new conditions and uncertainty of repayment. On the other hand, the businesses were not interested in drawing credit lines against foreign exchange coverage, because of high interest rates and, for the first time, fear of also having to repay the credits taken.

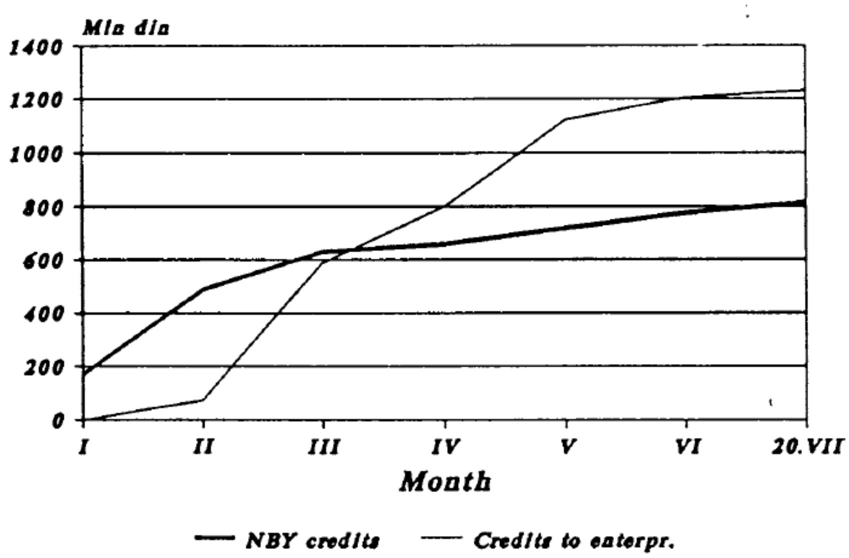
In giving priority to the production revival, the macro-policy makers found that the crediting activity is not being revived quickly enough, so that quite impatiently, they abolished in mid-February the obligation to deposit foreign exchange and replaced it by the obligation to have the credit taken covered by goods. In consequence of this, the crediting activity of banks intensified. It is felt that the obligation to deposit foreign exchange was abolished prematurely, before it was possible for the enterprise foreign reserves to be immobilized and make the extension of credits to buyers more justifiable. Namely, this would be conductive to an indirect selection of production programmes in favour of those in which there is an effective demand. The slackening of control over the crediting activities is thought to have been rash in view of the fact that in the absence of stiffer controls, some credits were extended without a coverage in goods, and that a large portion of the credits taken was reinvested in banks through the obligatory purchase of shares.

With a view to stimulating the agricultural sector when there were no credits available from the new money and the sowing season was about to begin, the banks were allowed to include in their credit potential the unemployed deposits of the government and funds. About a third of the total credits extended were earmarked for agricultural purposes.

April was characterized by a fallen liquidity of banks, resulting in the first place from the purchase of the NBY securities and the risen obligatory reserve rate. In consequence of this, the crediting activity also diminished somewhat. Besides risen bank liquidity, the reduction of the obligatory reserve rate on two occasions resulted in another intensification of bank crediting activities

(Chart V). Following its June diminishment, the crediting activity intensified in July.[32]

CHART V - NEW MONEY AND BANK INVESTMENTS



According to the estimates made by the Banks Association, a half of the credits taken is being serviced, about a third has been rescheduled, and the remainder has not been repaid. What this means is that banks are still not behaving as profit-making enterprises, or they prefer multiple borrowing and greater revenue on such grounds, or they are still doing as they are told by somebody unidentified. Moreover, at a time when there is a shortage of capital, this is limiting very much the possibility of new credits being extended and posing a threat to the current liquidity of banks.

INTEREST RATE POLICY. In the monetary system reconstruction programme, provisions were made for conducting a policy of unrestricted interest rate formation, where the discount rate of the National Bank of Yugoslavia, as the basic one, would be set as a positive one in real terms. As in foreign and earlier domestic experiences in hyperinflation control, it was expected that also after the cutting of the price growth rates, the interest rates would remain highly positive in real terms for a long time.

Despite their dramatic and very quick reduction, from more than a million percent monthly, the interest rates stayed in February on a relatively high level, i.e., 20 - 25 percent yearly. In view of the discount rate (7.25%) and the interest payable rate, as well as the low profitability of domestic enterprises and high production costs, this was found to be unjustifiable, on the one hand,

[32] So far, credits amounting to 1 224 million dinars have been extended, and to this should be added also about 200-million worth of credits extended in old dinars.

and on the other, it was of crucial importance for cutting the demand in credits. Quite unjustifiably, the discount rate applicable to old dinars was kept at 18 percent monthly, even after the launching of the Programme. It was not before 24 February, when the discount rates equalized, that the interest rates were equalized at about 20 percent yearly (until then, the monthly rates on old and new dinars were 18 and 2 percent respectively). The interest rates have been showing a tendency to fall since then. However, at the time of high liquidity (until the end of March), they were still kept on a high level, which is a reflection of high banking costs, on the one hand, and on the other, of high taxes and other charges relating to credits. Paradoxically enough, in April, when capital was in short supply, the interest rates went down to about and under 9 percent[33] (agricultural credits), mostly thanks to the reduction of the financial transaction tax, fees payable to the Payments Operations Service and bank margins.[34] The subsequent abolishment of the financial transaction tax and the reduction of bank charges helped the interest rates to stabilize on the attained level.

There is a danger under present circumstances, when the interest rate is kept at 9 percent yearly and capital is still in short supply, of the available assets being channelled to the grey markets, where interest rates are even upwards of 10 percent monthly. Furthermore, the banks are being pressed into increasing the interest payable and receivable rates and getting them closer to the usual ones in the free capital markets. This is explained by the fact that low interest rates resulted in an imbalance between capital supply and demand, reduced savings, rationed credit extending, non-repayment of credits and low bank liquidity. However, quite convincing are also the arguments against increasing the interest rates. Firstly, the existing interest rates are too high for most domestic businesses. Secondly, the commercial banks want to insure themselves against investment risks through risen interest rates, by shifting the risk on the orderly borrowers. It is felt that there is no need for departing from the principle of unrestricted interest rate formation.

The movements in the field of interest rates are regarded as positive, which also goes for the involvement of the National Bank of Yugoslavia particularly in the cutting of the rate of interest receivable. The remaining major issue is how to get the people to start saving again, in view of the fact that an attractive interest rate is not enough for that.

BUDGETS AND FUNDS. Being almost completely sealed off, the domestic industries were faced with a growing public spending deficit which was acting as the chief generator of hyperinflation. The recession and the subsequent depression have limited the activities of the industries, limiting in tum also the budgetary and fund revenue sources. The secession of four republics and the ongoing civil war have placed an additional burden on the public finance sector. In the absence of complete data relating to Montenegro, we will present hereinafter the main characteristics ef the Federal Budget and the Budget and funds of the Republic of Serbia only.

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[33] With the almost complete disappearance of loans in old dinars, the interest rate on such loans was decreased to 5- 6% yearly.

[34] The interest rate decrease is partly owed also to the increase of other costs associated with borrowing.

FEDERAL BUDGET. The 1994 Federal Budget was planned to amount to 9.9 percent of the social product of the FR of Yugoslavia, with a budgetary deficit of 3 percent of the social product. It was subsequently cut by 8 percent (1641.5 million new dinars). A little more than a half of the deficit was planned for the first half of the year and it was to be financed from provisional loans taken from the National Bank of Yugoslavia, while the remainder would be raised by selling securities on the financial market. The temporary bridging up was intended as a means of facilitating the adjustment of budgetary spending to what the economy can actually afford. On the other hand, the deficit monetization would facilitate the growth of the real amount of money in circulation.

The balancing of the budgetary revenue and spending has been slow in the course of the implementation of the Programme so far. Namely, the monthly borrowings from new money are even and close to planned amounts (30 million new dinars in January, 29 million in February, 20 million in March, 29 million in April, 10 million in May, 21 million in June and 6.7 million in July). What is worrisome is the July loan amounting to 4.7 million dinars.[35] The prevailing opinion is that an appropriate reduction of spending in the Federal Budget domain has not been carried out yet. The coverage of spending by direct revenue has improved in relation to the same period last year. However, from the aspect of the objective - balancing of the Budget by the end of the first half of the year - the balancing rate is thought to be not good enough.

In order te finance the Federal Budget from direct sources, the Federal Government put in the money and securities market an issue of attractive bends amounting to 15 million new dinars, with 30-day repayment term and an interest rate 2 points above the daily rate. Thanks to the favourable interest rate offered and even more to an extremely low supply in securities and money in April, this issue was sold almost completely. However, the National bank of Yugoslavia did not take too kindly to the emergence of these securities, given its endeavours to decrease the interest rate and keep it at 9 percent. The Federal Government was also reproached for securing quality assets in the financial market, while borrowing from the National Bank of Yugoslavia at the same time. Consequently, the issuing of these securities was suspended.

TABLE III - FEDERAL BUDGET REVENUES

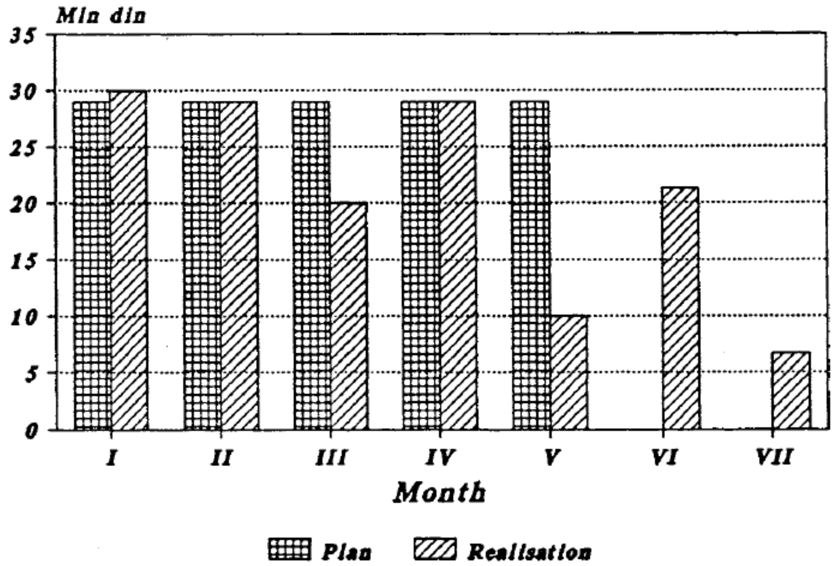
In mlln.din.

	January	Jan-Feb	Jan-March	Jan-Apr	Jan-May	Jan-June
Direct revenues	11	65	160	278	408	
NBY credits	30	59	79	108	118	139

Source: Federal Centre for Development and Economic Policy

[35] The particulars about the distribution of the last credit installment amounting to 54 million dinars are not known (20 July).

CHART VI - NBY CREDITS TOWARDS FEDERAL BUDGET FINANCING



For the purpose of balancing the Federal Budget and keeping it in that state, it was necessary to consider the possibility of a higher participation being made by the republics, redirecting a part of the republic budgetary revenues, parallel to the reduction of the Federal Budget spending. Particular importance was attached on the federal level to the possibility of selling or leasing out a part of the assets, which is surplus to requirements, and also of joining some federal and republic government functions into one.

Budget of the Republic of Serbia. One of the objectives of the Programme was to keep public spending at 52 percent of the social product, and the Budget of the Republic of Serbia, at 39.2 percent of the social product initially. With the adoption of the Serbian Budget, the share of the total public spending in the social product of Yugoslavia decreased to 42 percent, and that of the Serbian Budget to 32 percent (the share of the Budget in Serbia's public spending should be 57.5%). Such an objective called for continued deficit financing in the first six months of Programme implementation (11.6% of the total revenue), while throughout the year, the Budget should cover 78.2 percent of the spending from direct revenues. The loan would be returnable within a year at 6.25 percent interest rate. The deficit would be eliminated in the transitional period.

For the purpose of increasing the direct Budget revenues, the tax rates were cut and unified, the number of tax exemptions was decreased, excise tax was levied on some products, some special taxes were introduced (enterprise tax, etc.) and the rates of some dues, such as financial transaction tax, were adjusted upwards at first, after which they were cut and then abolished.

Thanks to the elimination of hyperinflation and partly to the risen output and trade, as well as the effect of tax changes, the inflow of direct Budget revenue was accelerated in the January-April period. In consequence of this, the budgetary deficit began to decrease gradually, which also goes for borrowing from the National Bank of Yugoslavia (103 million new dinars in January, 107 million in February, 22 million in March, 5 million in April; Table IV and Chart VII). In the observed period, the total funds drawn towards deficit financing of Serbia's public spending were by 41 percent lower than planned initially.

However, the inflow of direct revenues slowed down in May (194.8 million dinars or 20.4% less than in April).[36] Consequently, credits totalling 25 million dinars were taken from the National Bank. In June, the Serbian Budget direct revenues were on the May level (187.8 million dinars), so that 22.8 million new dinars were drawn from the NBY towards provisional deficit financing. The coverage of Budgetary spending by direct revenues was 82 percent in the course of June, and 94 percent throughout the first half of the year.

The decreasing tendency shown by the direct Budget revenue is adverse in view of the fact that revenue and spending have to be balanced by 24 July. This is also reducing the space for maneouvering in the spending management because of the forthcoming big commitments: interventions in the economic sector (in agriculture particularly), public welfare programmes, public enterprise restructuring and bank rehabilitation. With a view to balancing the revenues and spendings, action was taken towards controlling the growth of pays in public services and public enterprises (May - July), as well as towards directing the grey economy flows into legal channels. Also a package of tax regulations was adopted, where everything is geared to the further reduction of tax rates and the increase of the number of taxpayers, as well as to encouraging new investments, acquisitioning of equipment and risen employment rate.

TABLE IV - PUBLIC SPENDING REVENUE IN SERBIA

	January	Jan-Feb	Jan-March	Jan-Apr	Jan-May	Jan-June
Direct revenue	65	359	851	1,469	1,864	2,480
NBY credits	103	210	232	237	262	285

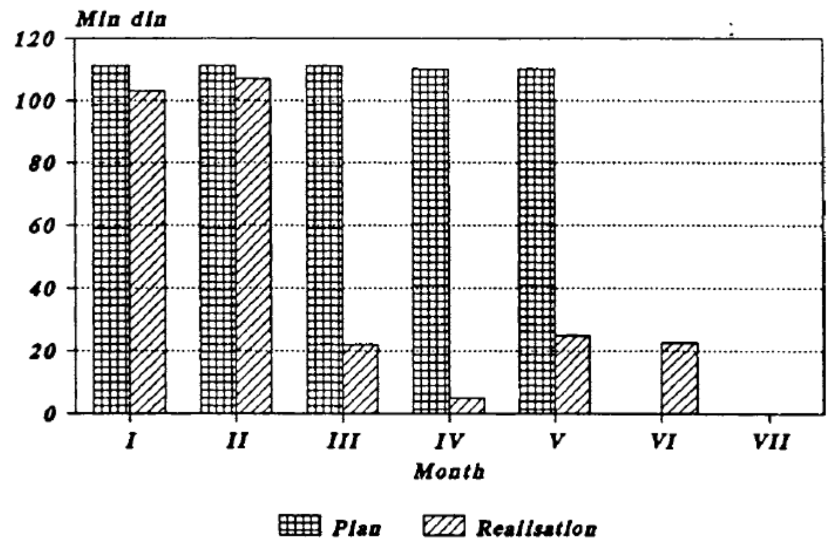
Source: Ministry of Finance of the Republic of Serbia

The action towards cutting the tax rates and abolishing some taxes was not paralleled by action towards cutting the spending side of the budget or towards increasing the direct revenue from other sources. The future economic policy measures should be geared to the quickest possible balancing of public revenue and spending on the lowest level possible.

[36] The causes of the reduction of direct revenues are as follows: reduced revenue from sales tax (decreased sales in May and seasonal reasons), abolishment of financial transaction tax (its share in direct budgetary revenues was 5.6% in January, 4.6% in February, 4.1% in March and 2.6% in April), and reduced income tax rate from 30 to 23% (this tax was the basic source of revenue - 59%). The changes of the consumption structure in favour of the green market have also caused these revenues to decrease.

REPUBLIC OLD-AGE PENSION AND DISABILITY INSURANCE FUNDS. Thanks to the stabilization of general economic conditions, the old-age pension and disability insurance funds started to balance their revenues and spendings following the launching of the Programme. The February revenue increase allowed the pension advances to be paid out first, and the balance subsequently. From the beginning of the year to the end of February, the borrowings from the Budget, which were practically loans from the National Bank of Yugoslavia, reached 12 million new dinars. The March increase of the direct revenues was already on a level which was conductive to having the revenues and spendings balanced, thanks to which it was possible to use the unemployed assets towards extending loans and buying securities.

CHART VII - NBY CREDITS TO THE BUDGET OF SERBIA



At the launching of the Programme, the first payments, based on new money covered by foreign exchange reserves, related to pensions - the receipts which were depreciated the most when hyperinflation reigned. The pensions were reduced to almost zero in January (15 dinars). Thanks to these corrective payments, the average January pension was about 30 dinars. It was found then that the mass of the paid out pensions was perhaps excessive and that from the macroeconomic aspect, it would have been better if the pensions were paid out in kind already then, as was set in the Programme. In February, the pensions went up to 40 dinars, and to 64 dinars in March. For the sake of quicker balancing, the average pension was then set at 75 percent of the average net pay in Serbia. Although this practically meant that the average pension was reduced to 64 dinars in April, the fund revenue and spending sides were balanced (and the pensions went up to 102 and 117 dinars in May and June respectively). Irrespective of the absolutely low average pension and the resulting low effective demand on such grounds, it should be borne in mind that the average pension in the economies undergoing transition - East

Europe an countries - is far lower in relation to the average pays. It is therefore only natural that the pay and pension increases should be paralleled by an adjustment towards increasing the difference between them.

HEALTH INSURANCE FUNDS. The direct revenues of the health insurance funds were growing at a somewhat slower pace than those of the old-age pension and disability insurance funds. As a remedy for this, the rates of contribution and participation were increased, thanks to which the revenues began to grow at a faster pace and the revenues and spendings became more balanced. However, the spendings and revenues are still not balanced. The funds available are not sufficient to cover particularly the cost of drugs and health care of some categories of the population. Besides the shortage of funds for the pays of the public health workers, another problem is posed also by the shortage of funds for the maintenance and purchase of medical equipment, drugs and medical supplies.

Main Problems Encountered in Programme Implementation

The initial results achieved in the implementation of the ***Programme of Monetary Reconstruction and Strategy of Economic Recovery of the FR of Yugoslavia*** relate to the stabilization of national currency and the elimination of inflationary expectations. However, the mentioned initial impetus has a limited range, so that with regard to the main results and accomplishments of the Programme, the following needs to be pointed out:

Firstly, the economic activity is intensifying. From the aspect of intensity of the positive changes, the February-June period can be compared with no other period of the same length in the more recent economic history of Yugoslavia. Despite the undoubtedly good results scored, the current movements in the output cannot be defined as a change of tendency. The actual output and trade growth is owed to short-term factors or factors with strong short-term implications (stabilization of the national currency and market, remonetization and increased share of money in the total working assets of the industries, elimination of the inflationary depreciation of nominal receipts, growth of effective demand, and diminished inflationary expectations and money turnover). The effect of the mentioned short-term factors is weakening in favour of the long-termed ones which, globally speaking, are producing a negative effect. In view of the fact that economic activity can be expected to intensify in the near future, at a lower rate of course, it would be necessary to link the specific economic policy measures more consistently with the proclaimed strategic options. It would be necessary to set time limits for the implementation of key strategic options (the role of the government in the regulation of economic trends, defining ownership rights, transfer of the welfare function from enterprises to the government, rehabilitation and restructuring of enterprises and banks), for the purpose of achieving the maximum possible market stability. A belated performance of these tasks, with the resulting accumulation of problems, could make the programme a failure or increase the cost of its implementation substantially. The current output growth based on the revival of installed facilities is of a limited range, since production potentialities are not up to market potentialities and demand structure (with or without sanctions alike). The growth of domestic savings and an investment activity based on it and the principles of market (re)allocation of resources, are the conditions for the elimination of the structural limitations. The conditions for long-term stability would be created with the provision of economic incentives and elimination of the non-economic limitations to the free inflow of foreign capital.

Secondly, the growth of the real average pays registered in the January-June 1994 period is a reflection of the process of balancing the relationship between the pays and economic activity level. In view of the fact that the significantly increased pays of employed people did not contribute much to the increase of production costs and prices, they have contributed to the intensification of economic activity. That is why national economic recovery should be based on the production of consumer goods (particularly the durable ones). Besides their effect on economic activity, the pays may be considered also in the context of creation of the conditions necessary for the domestic price stability. The financial instability, undefined ownership rights and inconsistency of the economic system solutions constitute a potential basis for the autonomous influence of the pays on the price movements. Unrestricted formation of pays, with due observance of the principle of "hard" budgetary limitations on ali levels, would be sufficient for maintaining the balance.

Thirdly, in the field of monetary policy, the hyperinflation was eliminated quickly and the real amount of money in circulation was increased, the exchange rate being stable. The task of the economic policy now is to set and have a suitable amount of money in circulation, in view of the foreign exchange inflow stabilization and the necessity of reducing the deficit financing to zero. The credit policy was too expansive, especially in view of the diminishing financial discipline. The interest rate movements are regarded as positive, which also goes for the effort put in by the central bank primarily towards cutting the interest receivable rates.

The rehabilitation and restructuring of enterprises and banks is an essential condition for the crediting policies of commercial banks to be geared to the financing of profitable enterprises. In that case, a more balanced supply and demand structure would be secured in the domestic market in the long run.

Fourthly, the problem of fiscal balancing is still open. In the implementation of the fiscal strategy set out in the Programme, some counterproductive moves were made (e.g., introduction of enterprise tax) and there was some wandering about (increasing and then decreasing some rates), which is why it cannot be claimed that everything possible has been done towards having the public revenues and spendings balanced even before the expiry of the set six-month term. Balanced public revenues and spendings are essential for the preservation of the price and exchange rate stability. The basic course of further action should be aimed at a broader coverage (increased number of taxpayers) and lower rates, so that increased activity would result in higher revenues. The drawing of the grey economy into the regular flows, and thereby also into the fiscal system, would be possible by the simultaneous reduction of the tax rates (incentives) and introduction of strict controls. An emphasis must be placed on the rationalization of spending, in view of the fact that the growth of the output and trade will slow down and that the possibility of expanding the scope of taxability further on the basis of diminished grey economy activity, is a limited one. In addition, it would also be necessary to change the structure of public spending in such a way as to increase the allocations towards family social security.

Fifthly, the Programme has scored the most important results in the field of price stabilization. A lasting stabilization of prices and the consolidation of the results already scored, call for the resolution of many of the already mentioned problems. Besides the aggregate dynamics, in appraising the results, it is necessary to bear in mind also the changes in the price parity. The price of agricultural products, even with its marked increase in May, is still comparatively lower than the retail price of industrial products. What this means is that the hitherto industrial product price decreases have still not ruled out the possibility of their further adjustment downwards.

Besides the general level of the prices which are primarily regulated by monetary policy, the pricing in the public sector is particularly important for the economic policy. From the macroeconomic point of view or from the aspect of a successful implementation of the Programme, it is essential that prices in this area are sufficient to cover the spendings towards satisfying the needs of the industries and population.

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The implementation of the Programme is characterized by a certain disregard of the long-term (and fundamental) causes of instability, which is resulting in growing short-term implications. Hence, it would be reasonable to expect another blow in the monetary and crediting field. The gravity of the situation is pointed at by the emergence of financial indiscipline on the level of enterprises and banks, which in the circumstances of a still fragile stability, can acquire large proportions very quickly. The economic policy measures can only be preventive in relation to the mentioned occurrences, which is the reason for the fear that they are already too late. In the first place, no compromises should be made in connection with the repayment of matured credits. All the more so in view of the fact that it would be reasonable to assume that these problems will grow further with the introduction of the measures relating to the buying up of agricultural products.