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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

REPORT AND RECOMMENDATIONS
of the
PRESIDENT
to the
EXECUTIVE DIRECTORS
Concerning a
PROPOSED LOAN TO YUGOSLAVIA
(Key Projects Program)

February 5, 1953

INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT

REPORT AND RECOMMENDATIONS OF THE PRESIDENT TO THE EXECUTIVE DIRECTORS CONCERNING A PROPOSED LOAN TO YUGOSLAVIA

1. I submit the following report and recommendations with regard to an application from the Federal People's Republic of Yugoslavia for a loan in various currencies in an amount equivalent to $30,000,000.

Part I - Historical

2. The Bank has already made two loans to Yugoslavia. The first, a two year loan in the amount of $2,700,000, made on October 17, 1949, to finance imports of timber-working machinery, has been completely repaid. A second loan, a 25 year loan in various currencies in an amount equivalent to $28,000,000 was made on October 11, 1951. Its purpose was to provide part of the foreign exchange needed to finance imports of equipment to be used in seven projects, making up a portion of the Key Projects Program of investment being undertaken by Yugoslavia. The seven projects, each consisting of several sub-projects, were the following: the extension of the electric power system; the modernization of coal mining; the production of non-ferrous metals; the expansion of industrial facilities; the utilization of forest products; the improvement of agriculture and fisheries; and the modernization of transportation.

3. The 1951 loan is closely related to the loan presently under consideration. In the more than two years of detailed discussions that preceded the conclusion of the 1951 loan, the Bank and the Yugoslav Government agreed upon a group of investment projects in the Yugoslav Key Projects Program as suitable for Bank financing. The Yugoslav Government proposed that these projects should be financed through two loans, one of $28,000,000 to be made at once and a second of $30,000,000 to be made at a later date. In my report recommending the loan of the equivalent of $28,000,000 in October 1951, I stated that a second loan proposal might be presented to the Board in the near future, if developments in Yugoslavia proceeded satisfactorily. The present loan proposal thus represents a second tranche of the larger loan program discussed in 1951, and the projects in the proposed loan are closely related to those financed by the 1951 loan.

4. The 1951 loan has operated satisfactorily. Orders have already been placed for most of the equipment being financed under it. By December 31, 1952, the Bank had disbursed or guaranteed letters of credit totaling $25,548,000. The Yugoslav Government has reported on a bi-monthly basis on the progress of the projects and Bank missions which visited Yugoslavia in December 1951, and July - October 1952,

have inspected almost all of the projects and sub-projects. The Bank is satisfied that the Yugoslav Government is executing the projects with due diligence. A Loan Administration Report of the operation and status of the 1951 loan to Yugoslavia, Report EA-4A, dated January 29, 1953, has already been circulated to the Directors (R-665).

5. The Government cooperated fully with the Bank in solving a problem arising from increases in prices of the equipment being financed under the 1951 loan between the time when it was negotiated and its effective date. This problem was solved by eliminating certain portions of the projects and modifying others to reduce total costs and bring foreign exchange requirements into line with availabilities. Full details on these modifications, as well as on the arrangements made to handle disbursements of the seven currencies employed to make purchases in ten countries are given in the Loan Administration Report.

6. When the 1951 loan was signed, the Yugoslav Government sent the Bank a letter, undertaking that it would not contract external indebtedness in an amount which would bring the total Yugoslav foreign debt above the equivalent of $380,000,000. The total foreign debt of Yugoslavia at the end of November 1952 was approximately $300,000,000, or only about $20,000,000 higher than in October 1951, prior to the $28,000,000 loan. Thus, there has been no net increase in the Yugoslav foreign indebtedness, and in fact a slight decrease, since the previous loan by the Bank was made.

7. The 1951 Loan Agreement provided that Yugoslavia would consult with the Bank before assuming any additional foreign obligations. Consultations in accordance with this provision have taken place, from time to time, when credit operations were considered by the Yugoslav Government, This provision has operated satisfactorily with respect to consultation prior to the incurring of long-term debt and Yugoslav representatives have discussed proposals for debt transactions in the very early stages of their consideration so that Bank views could be effectively considered before the proposals had become crystalized.

8. The Draft Loan Agreement (attached as Appendix I) provides in Section 5.02(c) for continuation of these consultation arrangements. This clause is in the same form as the consultation clause in the 1951 agreement. Experience has shown, however, that it is administratively impractical and undesirable to attempt to effect consultation on short-term obligations which are relatively small in amount and which are incurred in the normal course of business. In the case of Yugoslavia in particular, because of state ownership of industry and enterprises engaged in foreign trade, a very large number of normal business credit transactions, which in other countries would be private debt, would be subject to the requirement for consultation as Government or Government Agency debts. It is proposed, therefore, to provide by separate letter (attached as Appendix II), that the Bank would waive its rights for prior consultation on short-term debts, the amount of which in any one transaction does not exceed the equivalent of $1,000,000. Consultation

would be required for any debt with a maturity of more than one year, regardless of amount, and for any transaction of $1,000,000 or more, regardless of its term. The letter also provides that Yugoslavia would report quarterly on its total short-term debt position and the Bank would fully reserve its rights to require consultation on all short-term debts if experience indicates that the volume of short-term indebtedness is rising unduly.

9. In indicating its willingness to give prompt consideration to an additional loan to Yugoslavia, the Bank had made it clear that such action was dependent upon a showing that developments in Yugoslavia were proceeding satisfactorily. In the first half of 1952, reports on economic conditions in Yugoslavia submitted to the Bank by the Yugoslav Government and published material on the economy (which for the first time began to appear in gratifyingly increasing volume) showed that the economic situation of the country was improving.

10. A mission, headed by Mr. Martin M. Rosen, Assistant Director of the Department of Operations, Europe, Africa and Australasia, and consisting of two members of the Department of Technical Operations and consultants on steel and aluminum, went to Belgrade, in July 1952, and carried on intensive discussions with Yugoslav representatives until early October 1952. In the course of their stay, members of the mission examined developments in the Yugoslav economy in great detail, reviewed progress on projects financed under the 1951 Bank Loan and inspected most of the large projects, investigated projects that might be financed under an additional loan if the examination of the economy indicated that such a loan might prudently be made, and discussed future Yugoslav economic policies with ministers and senior officials of the Yugoslav Government.

11. The mission gave particular attention to the problem of investment because Yugoslavia's overambitious investment program has been one of the basic causes of its chronic balance of payments deficit and was one of the major reasons for the protracted negotiations preceding the 1951 loan. I had discussed the problem in September 1950 in Belgrade with Marshal Tito and other high-ranking officials. Shortly afterwards, the Yugoslav Government made public a revised investment program, much smaller in magnitude than the former program and concentrated on projects that were already under construction or that could yield rapid balance of payments benefit. The Government also decided, as already pointed out, that, at least during the next four years, it would not permit its foreign indebtedness to exceed $380,000,000, or $200,000,000 more than the amount outstanding in September 1950 when I had discussed the matter in Belgrade.

12. The mission's intensive studies confirmed the impression of an improvement in economic conditions which the Bank's staff had gained from reports received in Washington before its departure. It was satisfied, too, that the concentration on the completion of a smaller number of projects, rather than continuously undertaking a large number of new projects, meant that Yugoslavia could reap virtually all the benefits in production and in its balance of payments from its current investment program by 1955-56.

13. The mission found some cause for concern, however, in the slow response of the Yugoslav Government to a crisis arising from a severe drought and a crop failure in 1952. It was clear as early as August or September that the harvest would be very poor and that steps would have to be taken to reduce consumption and investment in order to prevent serious balance of payments difficulties. At first, however, the only step taken by the Government to deal with the crisis was the postponement of several investment projects. From conversations with Yugoslav representatives, the mission gained the impression that at least some members of the Government were reluctant to take drastic action, although failure to act would mean both a sharpening of the crisis and an undue increase in Yugoslavia's foreign indebtedness.

14. In subsequent discussions, however, both in Belgrade and Washington, responsible officials of the Yugoslav Government assured the Bank that the Government intends to manage its foreign trade in the light of foreign exchange availabilities. Since October, moreover, the Government has taken more vigorous action to cope with the problem, including domestic price increases to cut individual consumption; budget cuts in general government expenditures, social services and even in military expenditures; increases in exports of items not affected by the drought; and decreases in imports. Its position has been eased by a grant by the United States, announced on January 7, 1953, of an additional $20,000,000 to finance extraordinary imports of foods and feedstuffs. This grant is in addition to an aid program, financed on a tripartite basis by France, the United Kingdom and the United States, amounting to the equivalent of $99,000,000 which had previously been announced.

15. On the mission's return to Washington, it reported orally to the Executive Directors on the results of its intensive study. The Yugoslav Government was then invited to send representatives to Washington to attempt to work out a loan. A delegation, headed by Mr. V. Guzina, Director of the Federal Statistical Office, arrived in Washington for such negotiations in mid-November, 1952.

16. The Bank's 1951 loan to Yugoslavia was made entirely in European currencies because it was recognized that there was a ready market in European countries for Yugoslav expo ts, while its dollar export earning potential was limited. There has been no change in Yugoslavia's prospects in this respect. Before negotiations for the present loan could be successfully concluded therefore, it was necessary for the Bank to obtain sufficient currencies. Austria, Belgium, France, Germany, Italy, the Netherlands, Norway, Sweden, and the United Kingdom have agreed to release a portion of their 18% capital subscription for the proposed loan. In addition, Denmark has indicated that it would authorize release of Danish 18%, if needed, for purchases to be made in Denmark. These releases, together with the utilization of Swiss franc proceeds of sales of bond issues in Switzerland, will make it possible for the loan to be disbursed entirely in currencies other than dollars.

Part II - Description of the Proposed Loan

Borrower

17. The Borrower would be the Federal People's Republic of Yugoslavia, a member of the Bank.

Amount

18. The loan would be in various currencies in an amount equivalent to $30,000,000.

19. According to present estimates, the proceeds of the loan would be disbursed as follows:

For Purchases in:	$ Equivalent
Austria	939,000
Belgium	977,000
France	8,618,000
Germany	5,351,000
Italy	1,695,000
Netherlands	186,000
Norway	332,000
Switzerland	912,000
United Kingdom	4,040,000
United States	3,853,000
Total Allocated	26,903,000
Unallocated Contingency Reserve	3,097,000
Total Loan	30,000,000

Contracts have already been signed for about 70% of the allocated amounts. To the extent to which contracts have not yet been signed, there will undoubtedly be some modifications in the amounts actually disbursed in each country from those shown in the preceding table. The unallocated reserve may be expected to be disbursed in the supplying countries in amounts approximately proportionate to disbursements of the allocated amount of $26,903,000 except that it is likely that a contract will be placed in Sweden for equipment costing the equivalent of about $150,000 and some procurement may be made in Denmark.

Currencies Available for Disbursement

20. Releases of 18% capital subscriptions, to be used in connection with the proposed loan, have been agreed by the following countries in the amounts indicated:

Country	$Equivalent
Austria	250,000
Belgium	1,000,000
France	12,000,000
Germany	3,100,000
Italy	1,750,000
Netherlands	1,000,000
Norway	360,000
Sweden	150,000
United Kingdom	5,768,000
Total	25,378,000

21. The total amounts released by Austria, Belgium, Germany, Italy, Norway and Sweden will probably be used, but the full amount of the releases authorized by France, the Netherlands, and the United Kingdom is not likely to be needed for disbursement in those countries. However, the United Kingdom has authorized the utilization of a portion of its 18% for disbursement in Austria.

22. Disbursements in Switzerland, the United States, and half of the expected disbursements in Germany (the other half being financed by release of Germany 18%) will be financed by disbursement of Swiss francs.

23. The following table summarizes probable disbursement of the proposed loan:

	$ million equivalent
Utilization of 18% releases by Austria, Belgium, Germany, Italy, Norway and Sweden	6.6
Probable disbursements in France, the Netherlands, and the United Kingdom financed by releases of their 18%	14.3
Probable utilization of United Kingdom release for disbursement in Austria	.8
Probable use of Swiss francs for disbursement in the U.S., Switzerland and Germany	8.3
Total	30.0

24. Thus, according to present estimates, there would be no dollar disbursements from the Loan Account and Yugoslavia would not be burdened with any additional dollar debt as a result of this loan.

Purpose

25. The proceeds of the loan would be used to finance the acquisition of imported equipment for seven specific projects making up a part of the Key Projects Program. These projects are electric power production and distribution, modernization and expansion of coal mining, expansion of non-ferrous metallurgy, expansion of iron and steel production, utilization of forest resources, expansion of industry, and modernization of transportation. These seven projects consist of 27 sub-projects.

26. In view of the close connection between the projects financed in the 1951 loan and the projects presently proposed for financing, the draft loan agreement provides in Section 3.01 that the proceeds of the proposed loan may also be utilized, to the extent to which the Bank shall agree, for disbursement on the projects in the 1951 loan. It is for this reason that the unallocated reserve for contingencies has been fixed as high as $3,097,000 so that there will be an ample reserve for contingencies for the projects both in the present loan and for projects in the 1951 loan.

Terms of the Loan

27. The loan would be amortized by semi-annual payments beginning August 15, 1956, in the amounts set out in Schedule I of the draft Loan Agreement. These repayments would retire the entire loan by maturity on February 15, 1978.

28. The loan would bear interest (including 1% commission) at the rate of 4 7/8% per annum. A commitment charge of 3/4% per annum has been provided for. The commitment charge would accrue from April 1, 1953, and would be payable as to 35% in French francs, 35% in Swiss francs and 30% in sterling. These percentages are the same as in the 1951 loan and represent a division of the commitment charge on a basis comparable to the proportionate amounts of the three predominant currencies expected to be disbursed under the loan.

29. I am satisfied that the rate of interest and other charges are reasonable and that such rate, charges, and the schedule for repayment of principal are appropriate to the proposed loan.

Legal Instruments and Authority

30. The draft Loan Agreement (attached as Appendix I), except for special features which have already been mentioned, follows the general pattern of the Bank's loan agreements. The proposed agreement incorporates Loan Regulation No. 3, dated October 15, 1952. In addition to the Loan Agreement, two letters (as set forth in Appendices II and III) are to be exchanged at the time of the signing of the agreement.

31. Appendix IV contains the Report of the Committee provided for in Article III, Section 4(iii) of the Articles of Agreement of the Bank.

Part III - Appraisal of the Proposed Loan

32. A report on Current Economic Developments and Creditworthiness of Yugoslavia, EA-5A, was submitted to the Executive Directors on February 5, 1953 (R-665).

33. The report concludes that the completion of the Key Projects Program of investment in Yugoslavia, as financed by the proposed loan and by the loan extended by the Bank in 1951, will contribute substantially to the achievement of balance of payments equilibrium by Yugoslavia, at a level permitting the servicing of Yugoslavia's external indebtedness, including the loan now under consideration.

Description of the Projects

34. The projects are described in detail in the "Technical Report on the Projects Included in the Second Yugoslav Loan Application" and its Annex, which were distributed to the Executive Directors on February 4, 1953, (R-669). The projects are:

Projects	$ Equivalent
1. Electric Power Production and Distribution	1,531,000
2. Modernization and Expansion of Coal Mining	3,890,000
3. Expansion of Non-Ferrous Metallurgy	3,871,000
4. Expansion of Iron and Steel Production	7,291,000
5. Utilization of Forest Resources	3,975,000
6. Expansion of Industry	4,295,000
7. Modernization of Transportation	2,050,000
Unallocated Contingency Reserve	3,097,000
	$30,000,000

35. The amounts of foreign exchange shown are based largely on orders already placed and include provisions for adequate amounts of spare parts. They also provide for partial reimbursements for payments made by the Borrower since September 1952. According to present plans, 70% of the proceeds of the loan would be disbursed in 1953, about 20% in 1954 and 10% in 1955.

36. The projects are:

I. Electric Power Production and Distribution. The project consists of (i) the expansion of the boiler capacity at the Kostolac thermal power station, near Belgrade; (ii) the installation of the third and final generating unit and accessories in the Vinodol hydroelectric power station, near Rijeka; and (iii) the completion of 129 kilometers of transmission lines, and 27 primary and 58 secondary transformer stations in various sections of the country. This is part of the program to increase the production and distribution of power to meet the needs of expanding industries.

II. Modernization and Expansion of Coal Mining Project. The project is the modernization of eight mines, both underground and open cast,

producing brown coal and lignite, and the installation of a separation and washery plant at the Banovici brown coal mine (the largest coal mine in the country). The objective of this project is to increase the total coal producing capacity to 20.2 million tons yearly by 1955 from the present level of about 14 million tons annually.

III. Expansion of Non-Ferrous Metallurgy. This project consists of (i) the completion of the first phase of the Strnisce Aluminum plant in Slovenia. This will include an alumina plant equipped to produce 60,000 tons of alumina, a smelting plant equippped to produce initially 15,000 tons of aluminum annually and with capacity for later expansion. At first, about 30,000 tons of alumina and about 12,000 tons of aluminum are to be exported; and (ii) the completion of the rehabilitation and expansion program at the Lead-Zinc-Gold Mine and Mill at Lece in Serbia (part of which has been financed by the Export-Import Bank). The plant is designed to produce annually 2400 tons of lead concentrates, 5400 tons of zinc concentrates and 324 kilograms of gold. Total annual gold production from Lece, including gold contained in the lead concentrates, is estimated at 540 kilograms.

IV. Expansion of Iron and Steel Production. This project consists of: (i) the expansion of production at the Zenica Iron and Steel Works in Bosnia - Herzegovina. The facilities to be installed will enable the plant to add 200,000 tons of coke, 200,000 tons of pig iron, and 12,000 tons of forgings to its production and to increase its production of steel ingots by 185,000 tons and its output of rolled products by 122,000 tons. The additional production should enable Yugoslavia to reduce its annual imports by 28,000 tons of pig iron and 75,000 tons of steel products and supply additional steel for Yugoslavia's growing industry; (ii) the expansion of production at the Vares Iron Ore Mine in Bosnia-Herzegovina to supply the new pig iron furnaces at Zenica and the existing pig iron furnaces at Vares. It is planned to increase production from 200,000 to 1,100,000 tons of ore annually by 1955; (iii) the expansion of the Sisak Seamless Tube Plant in Croatia to increase its pig iron capacity by 30,000 tons, to add open hearth steel furnaces with a total annual capacity of 90,000 tons and a casting plant with a capacity of 5,000 tons annually, and to install equipment for the manufacture of 60,000 tons seamless steel pipe. It is estimated that the plant will provide annually 30,000 tons of pipe for export and will enable Yugoslavia to reduce annual imports by about 7,000 tons of pipe; (iv) the construction of the first phase of the Ilijas Cast Iron Pipe Plant in Bosnia. This involves the installation of furnaces and accessories for melting pig iron and scrap and pipe casting equipment for the production of 15,000 tons of cast iron pipe annually.

V. Utilization of Forest Resources. The project will consist of: (i) the construction of new roads, railroads and cableways for the exploitation of new forest areas in Bosnia-Herzegovina, Croatia and Montenegro with a production potential of 2,200,000 cubic meters of hardwood and 1,100,000 cubic meters of softwood annually. Some of the loan would be used for construction equipment needed to build access roads, but most of

it would be used to finance the importation of transportation equipment, such as locomotives, trucks, tractors, cableways and skidders, to recover the timber from the forests and haul it to market; (ii) the erection of a newsprint plant near an existing pulp mill at Videm Krsko in Slovenia. The new plant, which will be the only producer of newsprint in Yugoslavia, will have a capacity to produce 20,000 tons of newsprint annually. The capacity of the existing market pulp mill will be expanded from 9,000 to 14,250 tons annually and its power plant capacity will be increased from 1,000 kw to 6,400 kw. The newsprint plant will enable Yugoslavia to eliminate imports of newsprint and will supply a small surplus for export.

VI. Expansion of Industry. This project consists of: (i) the completion of the Svetozarevo Cable and Wire Plant in Serbia. This plant will produce about 34,000 tons of lead-covered and rubber-covered copper cables, transmission cables, enameled copper wire and steel wire rope. It is expected that about 17,000 tons of the products of the plant will be available for export and the savings in imports of copper wire and cable will amount to about $2.5 million annually; (ii) the addition of equipment in the chemical plant at Sabac in Serbia to provide more sulphuric acid capacity and to bring the superphosphate production capacity up to 120,000 tons annually in line with the existing grinding, bagging and storage capacity now lying idle for lack of sulphuric acid and relatively small amounts of equipment. The demand for fertilizers in Yugoslavia will absorb all of the production; (iii) the expansion of production at the Pancevo Glass Factory in Serbia. This involves a new department for the production of 40 to 45,000 m^2 of safety glass annually, the expansion of facilities for the manufacture of medical glass and the installation of a small Diesel generating unit. The plant will supply much needed safety glass for plants manufacturing transportation equipment, and thus make imports unnecessary. The medical glass is also urgently needed; (iv) the construction of a starch plant at Zrenjanin in Serbia to produce annually 30,000 tons of corn starch and, as by-products, 14,600 tons of corn waste suitable for cattle feed, and 1,600 tons of corn oil. The plant would supply starch, oil and animal feed for domestic consumption, in addition to exports of 10,000 tons of starch. The thermal power station, being constructed to provide power and process steam to the starch plant, will also supply an adjacent sugar-factory, making new boiler installations at the sugar factory unnecessary. This power plant will produce 44 million kwh of electricity annually, above the needs of the two factories which can be used for general consumption; the electric power will be produced from steam which would otherwise be wasted.

VII. Modernization of Transportation. This project consists of the modernization of transportation by the importation of equipment for the railroads, harbors and airports. The goods to be imported and financed with the proposed loan are: for the Railways, electric locomotives, sub-station equipment, signalling equipment and wheel tires and springs, required for the rehabilitation and modernization of the railways; for the Harbors, tractors and trailers, which will make it possible to load and unload vessels speedily and to reduce cargo handling crews; and

for the Airports, very high frequency radio equipment for both airports and airplanes, flight control tables and medium wave transmitting and receiving equipment in order that the two international airports in Yugoslavia may meet minimum international standards.

Justification of the Projects

37. The projects described above, like the projects financed under the Bank's 1951 loan, are, with one exception, included in the Yugoslav Government's Key Projects Program which is aimed at securing rapid improvements in the Yugoslav balance of payments. The exception, a coal washery, was selected for Bank financing even though it was not included in the Key Projects Program, because it merits higher priority than other uncompleted projects. All the projects have been carefully reviewed both from an economic and technical point of view; the examination of their technical soundness was facilitated by the fact that virtually all the projects are in a fairly advanced stage of construction.

38. The loan is intended to finance the completion of projects in which a very considerable investment has already been made. The $30 million to be made available will make possible the completion of projects with a total foreign exchange cost of $119 million, of which $92 million had been financed by the third quarter of 1952. Domestic expenditures on these projects are even larger, totaling the equivalent of $343 million, of which $208 million had already been made by the third quarter of 1952.

39. Because so large an investment has already been made in these projects, the loan may be expected to have an unusually large and rapid impact on the Yugoslav balance of payments. Yugoslav estimates, confirmed by the Bank staff, indicate that the projects to be partly financed by this loan of $30 million equivalent will yield foreign exchange benefits of about $49 million a year to Yugoslavia, of which $26 million represents expected increases in exports and $23 million anticipated reductions in imports. These benefits may, moreover, be expected to accrue to Yugoslavia within a very few years, for virtually all the projects should be in full operation by 1955. The figures of foreign exchange benefits to be anticipated and the estimates of completion dates may be somewhat optimistic, but I have every reason to believe that the projects will make an important contribution to the improvement of Yugoslavia's balance of payments position within a very few years.

40. The facilities whose completion is being financed are well distributed throughout the country and cover a wide range of economic activities. They may be expected to yield large internal benefits as well, therefore, even though it is not possible to measure the size of such benefits.

41. The fuel and energy supply would be increased by 244 million kwh of electric power and 3,600,000 tons of coal, about 9% and 28% of the respective national totals in 1952. The increases in aluminum (15,000 tons) and iron and steel (275,000 tons of steel ingots) will augment current production even more substantially. Other commodities to be produced in larger quantities include lead-sheathed cables, safety glass, newsprint,

starch, phosphatic fertilizers, etc. A detailed listing of the direct production benefits of the projects to be financed is given in the Technical Report (R-669). Among the indirect benefits of the projects are probable reductions in fuel costs (including transport savings) and a more ample supply of metal products which should facilitate fuller utilization of available capacity in existing metal working plants.

Part IV - Prospects for the Fulfillment of Obligations

42. Yugoslavia has had a balance of payments deficit since the close of the war. To meet this deficit, it has virtually exhausted its monetary reserves, incurred large debts under bilateral clearing agreements, and borrowed heavily abroad. Since the fall of 1950, it has received substantial grant economic assistance to finance essential imports, provided on a tri-partite basis by the governments of France, the United Kingdom and the United States.

43. Nevertheless, I am even more convinced now than I was in October 1951, when I recommended that the Bank make Yugoslavia a loan equivalent to $28,000,000, that the country's economic prospects are relatively favorable. Apart from temporary factors which have caused difficulties -- the need to make up for wartime destruction, to reorient its trade from an initial dependence upon the USSR and Soviet satellites to other areas, and the severe droughts in 1950 and 1952 -- and special factors such as the need to make very heavy expenditures for military purposes, its problems were due mainly to unwise policies with respect to investment and a failure to recognize the importance of incentives to production, especially in agriculture.

44. An overambitious investment program placed a heavy burden on Yugoslavia's balance of payments not only directly, but indirectly by reducing the supplies of consumers' goods and thus impairing incentives to production, especially of farmers. The investment program was, however, scaled down in the fall of 1950. The new Key Projects Program developed at that time, was smaller in magnitude than the former program and concentrated on projects that were already under way or that might be expected to yield rapid benefits for the balance of payments. The future investment plans of Yugoslavia, after completion of the Key Projects Program, seem soundly conceived since they place greater emphasis on agriculture, transport and housing and less emphasis on industry, and involve reduced expenditures in foreign exchange.

45. The Government's policy of centralized and detailed direct control over the economy impaired incentives to production, especially in agriculture. Since late 1950, however, the Government has been gradually substituting indirect for direct controls and attempting to provide greater incentives to production. It is, moreover, recognizing increasingly, both in its current and future plans, the importance of agriculture which employs almost three-quarters of the population and is a very important source of exports.

46. As a result of its concentration on a smaller number of projects, the Key Projects Program of investment has been brought fairly close to

completion. If the present loan proposal is accepted, financing will be assured for all but about $20 million of the total of $272 million required for equipment imports in the Program. The uncovered balance involves a few projects which have been deferred because they are considered of lower priority or consist of miscellaneous small amounts which can be expected to be covered out of Yugoslavia's own exchange earnings. The Bank staff has concluded on the basis of detailed study that the great bulk of the projects included in the program can be completed and in operation by the mid-1950's.

47. The Bank staff has also made a careful assessment of Yugoslavia's balance of payments prospects for the period after these projects are in operation. Their estimate, which I believe to be rather conservative, is that the increase in exports made possible by the investment program will enable Yugoslavia to earn a trade surplus of $35 million, at first half 1952 prices. This estimate is based upon crop production and exports which would result from average weather conditions. In addition, on the basis of results in recent years, earnings from invisibles may be expected to amount to $10-$15 million. The Bank staff have regarded it as prudent to make some allowance for the possibility of a deterioration in Yugoslavia's terms of trade, which have improved considerably since the first half of 1950 (pre-Korea). Even with such an allowance, however, they believe that Yugoslavia can have a balance of payments surplus of $30-$35 million in the mid-1950's. Such a surplus would be sufficient to cover Yugoslavia's post-war foreign indebtedness, which amounted to about $300 million on November 30, 1952, and the proposed loan of $30 million, together with some service on its pre-war debt.

48. The present schedule of debt service, however, requires very heavy payments during the next three years in amounts which are clearly beyond Yugoslavia's servicing capacity during this period. I called attention to this problem in my report recommending the loan in 1951. Since that time, Yugoslavia's indebtedness to the Export Import Bank, amounting to $55 million, has been refinanced on a long-term basis, and standstill arrangements made with some other creditors to defer a part of the repayment obligations due in 1952 and 1953.

49. Debt repayments scheduled for the next three years total the equivalent of almost $140 million. Part of this is in the form of short-term revolving credits (partially secured by gold or foreign exchange) which will probably be renewed in the normal course of business, and part consists of amortization payments on credits which are already funded on a long-term basis. The bulk of the repayments, however, is due on maturing medium-term loans. The total repayments to Austria, Belgium, Germany, France and the United Kingdom on medium-term credits coming due in the 1953 to 1955 period are the equivalent of $102 million, of which the equivalent of $41 million is owed to Germany and the equivalent of $27 million to the United Kingdom.

50. The effective solution to this problem would be to refinance, on a long-term basis, the medium-term credits now coming due, and Yugoslavia has been negotiating with its creditors for such refinancing. The urgency of the problem is recognized by the governments of France and the

United Kingdom, which, together with the United States, are engaged in a tri-partite program of assistance to Yugoslavia. This problem was referred to in the notes which were exchanged on October 11, 1952, between Yugoslavia and these three governments. These notes include the following provision:

> "The four Governments are agreed that amelioration of Yugoslavia's present schedule of debt payments is essential. They further agree that an effective method of obtaining such amelioration must be sought. One possibility which has been suggested is a conference of creditors. Other methods may emerge from joint consideration of the problem. The four Governments will therefore undertake prompt consultation with a view to arriving at an effective means of achieving amelioration of Yugoslavia's debt position."

51. I feel confident, therefore, that, to the extent to which they have not already done so, the governments of France, the United Kingdom and the United States will refinance debts owed to them on a long-term basis and, in addition, will use their good offices to assist Yugoslavia in negotiating similar arrangements with other countries, or will otherwise take some appropriate action to bring Yugoslavia's debt service obligations due in any one year within the limits of Yugoslavia's debt servicing capacity. The successful solution to the problem, however, will necessitate action by other creditors as well. Since a reasonable solution to this problem is clearly in the interests of all of Yugoslavia's creditors, I believe that it is likely that necessary action will be taken.

52. As mentioned in paragraph 6, at the time the 1951 loan was signed, Yugoslavia sent the Bank a letter in which it assured the Bank that it would not, prior to December 31, 1954, undertake external indebtedness in amounts which would increase total external indebtedness to more than the equivalent of $380,000,000. The December 31, 1954 date for termination of this assurance had been selected because it was expected that the Key Projects Program would be completed by that time and that Yugoslavia would have reached balance of payments equilibrium by then. As a result of the effects of the 1952 drought on the economy, completion of the Key Projects Program and balance of payments equilibrium may not be achieved until 1955. For this reason, Yugoslavia agrees that its undertaking not to increase its external indebtedness to an amount greater than $380,000,000 should be continued in effect until December 31, 1955. A letter providing this assurance will be given the Bank in the form attached as Appendix III.

53. The status of the pre-World War II debt of Yugoslavia has not changed from the position when the 1951 loan was signed. At that time the Yugoslav Government sent the Bank a letter stating that it would make every reasonable effort to effect a mutually satisfactory settlement of the pre-World War II debt by April 15, 1954 and that, if a settlement were not reached, the government would set aside from its foreign exchange resources an amount which was communicated to me in confidence. The Yugoslav representatives have reassured the Bank that this position, contained in a letter sent to the Bank in October 1951, remains the firm policy of the Yugoslav Government.

54. I recognize that there are risks in the loan proposal I am now presenting. In my opinion the most important economic issue is whether the government will adopt and maintain appropriate economic policies or not. Unsound economic policies in the past were among the most important reasons for Yugoslavia's economic difficulties.

55. The substantial modifications in economic policy which have been adopted in the past two years are, however, encouraging signs for the future. In addition, relations between the Yugoslav Government and the Bank have been very good, a factor which I believe may be of considerable importance in the future economic policies of the country. Representatives of the Yugoslav Government have discussed fully and frankly with me and with members of the staff the whole range of problems and policies. The Yugoslav Government has provided the Bank with the extensive data and information we have requested on progress under the 1951 loan, on the progress of the economy, and on future plans. Members of the Bank's missions have traveled extensively through the country, and inspected projects financed under the earlier loan and the sites of projects proposed for financing under this loan. I am confident that there will continue to be close, frequent and useful consultation between the Bank and the Yugoslav Government on its economic problems and prospects.

56. The projects included in the proposed loan appear to be sound technically and economically and are of high priority in meeting Yugoslavia's needs. The foreign exchange earnings and savings directly resulting from the projects will make an important contribution to the solution of Yugoslavia's balance of payments problems.

57. Taking all these matters into account, I am satisfied that the risks involved in the proposed loan are reasonable ones for the Bank to undertake and that in making this loan, the Bank will be acting prudently in the interests both of Yugoslavia and of the members of the Bank as a whole.

Part V - Compliance with Articles of Agreement

58. I am satisfied that the proposed loan complies with the requirements of the Articles of Agreement of the Bank.

Part VI - Recommendations

59. I recommend that the Bank at this time extend a loan to the Federal People's Republic of Yugoslavia in various currencies equivalent to $30,000,000 for a total term of 25 years with interest (including commission) and commitment charges, at such rates and on such other terms as are specified in the form of Loan Agreement attached.

Eugene R. Black
President

February 5, 1953