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Former Yugoslav Republic of Macedonia: Recent Economic Developments

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INTERNATIONAL MONETARY FUND

FORMER YUGOSLAV REPUBLIC OF MACEDONIA

Recent Economic Developments

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Approved by the European I Department

June 4, 1998

		Contents	Page
I.	Introdu	action	6
II.	Recen	t Real Sector and Price Developments	7
	A.	Overview	7
	B.	Developments in Output and Expenditure	
		Income and expenditure	
	C.	Labor Market, Wages and Employment	11
		Employment and productivity	
		Unemployment	
		Labor markets statistical issues	
	D.	Enterprise Sector	
	E.	Prices	
Ш	. Corp	orate Governance	21
	A.	Overview	21
	В.	Insider Privatization	21
	C.	Bankruptcy and Creditor Markets	
	D.	Behavior of Banks	
	E.	Stock Exchange	
	F.	Information	28
IV.	. Rece	nt Monetary Developments	30
	Δ	Overview	20

	В.	Recent Developments	
		Overall monetary developments and targets	
		Developments in bank portfolios and lending	. 34
		Bank supervision	. 37
V.	The F	inancial Sector	
	Α.	Institutional Structure	
		Banking system	
		Deposit Insurance Fund	39
	В.	Instruments of Monetary Policy	
		Credit ceilings	
		Reserve requirements	40
		NBM credit auctions	40
		National bank bills	41
		Lombard credit facility	41
		NBM interest rate policy	41
		Inter-bank money market	
	C.	The Payments System	42
		The system	
		Weaknesses of the current system	43
		Plans for reform	44
VI.	Fiscal	Policy and Developments	45
	A.	Overview	45
	В.	Recent Fiscal Developments	
		Revenue	45
		Expenditure	47
		The fiscal stance	
	C.	The 1998 Budget	48
	D.	Longer-Term Fiscal Issues	49
		Tax reform	49
		Expenditure reform	50
	E.	Public Debt	50
VII.	The (General Government Sector	51
	A.	Overview	
	В.	Structure of the General Government	51
		The central government	
		The Pension Fund	
		The Health Fund	52
		The Employment Fund	
		The Road Fund and local governments	
	C.	General Government Revenues	

	D.	The Structure of Public Expenditure Pensions	54 50
		Health	39
	E.	Public Expenditure Management	21
		Unemployment Benefits	53
			33
VIII.	Rece	ent Balance of Payments Developments	
	A.	Overview)O
	В.	Competitiveness	00
	C.	The Balance of Payments	00
		Current account developments)8 :0
		Exports)8 71
		Imports	1
		Capital account and reserves	3
		Medium- and long-term flows	4
		Errors and omissions and short-term capital	4
		External debt) 15
			3
IX. I	rade	and Exchange System	· =
	A .	Trade System) 5
		The old trade regime	5
		The new trade regime	7
		Free trade agreements	Ω
	B.]	roreign Exchange System	Q
		Foreign exchange market	g S
Refere	nces .		3
			J
Text B			
	Class	sification Scheme for Overall Trade Restrictiveness	7
			,
Appen		Statistical Issues and Measurement of GDP	9
Appen		The Social Safety Net	
Appen	dix III	Balance of Payments Statistical Issues	
Figures			
1.	Com	ponents of Expenditure).
2.	Indus	strial Sector Wages and Productivity	2
3.	Illiqu	Id Enterprises	7
4.	Enter	prises Submitted to Bankruptcy	5
5.	Mone	32)
5.	Comi	mercial Bank Liquidity and Private Credit	t
7.	Real	Interest Rates	;
3.	Gene	ral Government Operations, 1995-9755	;

9.	Central Government tax Revenue, 1995-97	56
10.	General Government Expenditures, 1995-97	58
11.	Nominal and Real Effective Exchange Rates, 1993-97	67
12.	Average Net Dollar Wages in Selected Transition Economies 1993-97	60
13 .	Developments in the Balance of Payments, 1993-97	70
14.	Destination of Exports and Origin of Imports, 1993-97	72
	•	. 1 22
Table		
1.	Composition of Unemployment by Duration	15
3.	Method Privatization	22
4.	Summary of Transactions Executed on the Macedonian Stock	
_	Exchange in 1997	29
5.	Special Revenue Accounts, 1997	57
6.	Government Expenditures for Selected Countries, 1995	60
7.	Classification Scheme for Overall Trade Restrictiveness	77
8.	Gross Domestic Product by Economic Activities, 1992-97	QΛ
9.	Industrial Output, 1992-97	25
10.	Output of Specific Industrial Products	86
11.	Agricultural Output, 1992-97	Q7
12.	Gross Domestic Product and Aggregate Demand, 1992-97	ያያ
13.	Investment in Fixed Assets, 1994-96	90
14.	Average Nominal and Real Net Wage 1992-98	٥Λ
15.	Average Net Wage, By Sector, 1993-97	01
16.	Labor Force, Employment, and Unemployment, 1992-97	92
17.	Enterprises Experiencing Liquidity Problems, 1992-97	03
18.	Profit Performance of the Enterprise Sector, 1996-97	04
19.	Price Indices, 1992-98	05
20.	Monetary Survey, 1994-97	20
21.	National Bank Accounts, 1994-97	97
22.	Deposit Money Bank Accounts, 1994-97	20
23.	Interest Rates, 1992-97	oc
24.	Non-Government Sector Monetary Aggregates, 1992-97	ገብ
25.	General Government Operations, 1996-98	٦1
26.	Central Government Operations, 1996-98	12
27.	Dollar Wages in Selected Transition Economies, 1993-97	13
28.	Foreign Direct Investment in Selected Transition Economies 1993-97	14
29.	Balance of Payments, 1993-97	15
30.	Commodity Composition Exports, 1992-97)6
31.	Destination of Exports, 1992-97	17
32.	Commodity Composition of Imports, 1992-97	18
33.	Origin of Imports, 1992-97	n
34.	Exports and Imports by Final Use, 1992-1997	n
35.	Services Account, 1992-97	1
36.	External Debt Stock, 1992-97	2
37.	Official Gold and Convertible Foreign Exchange	3
38.	Exchange Rate Developments	4

39.	Tax Summary as of April 1, 1998	115
Appen	ndix Table	
2.	GDP Estimates, 1993-97	. 20

I. INTRODUCTION

- 1. A combination of wars, embargoes, trade sanctions, and economic instability in the Balkans have provided an especially difficult environment for the former Yugoslav Republic of Macedonia (FYRM)'s transition to a market economy following independence in 1991. A lack of foreign direct investment and the postponement of key reforms to the enterprise and banking sectors has further prolonged the adjustment process. The economy is only just beginning to reap the rewards of a successful stabilization effort and the implementation of structural reforms that began in 1994-95. Macroeconomic policy options remain constrained by a weak balance of payments. Much is still to be done to complete the reform agenda.
- 2. Following independence in 1991, FYRM experienced substantial economic dislocation as a result of the loss of sizable transfers from the former Socialist Federal Republic of Yugoslavia (SFRY) and the disruption to key trade links associated with UN sanctions against the Federal Republic of Yugoslavia (FRY) to the north and the imposition of a blockade by Greece to the south. Output contracted sharply and by 1993 was some 33 percent below pre-independence levels. With mounting enterprise losses being effectively refinanced by the National Bank (NBM) and severe fiscal imbalance arising from large subsidies and social transfer payments, near hyper-inflationary conditions arose. Unemployment, always a problem before independence, rose to very high levels.
- 3. In 1994-95, the authorities reasserted control over monetary policy, stabilized the exchange rate, and undertook a substantial fiscal adjustment. As a result, price stability was restored by 1996 and the decline in output was arrested. Programs for recapitalizing banks and accelerating the process of enterprise adjustment and privatization began in 1995.
- 4. The loss of exceptional rents following the end of sanctions against the FRY in December 1995 placed increasing strains on the external accounts, which were by then bearing the cost of servicing inherited debt from the former SFRY. Access to foreign direct investment and private market financing was extremely limited. Monetary policy remained tight to support the exchange rate and growth failed to materialize. By mid-1997, it was clear that improvements in competitiveness stemming from structural reforms had been too late and insufficient to keep the balance of payments viable. The exchange rate was devalued by 14 percent against the deutsche mark in July.
- 5. The devaluation did not spark a revival of inflation, in part because a wage freeze and measures to bolster government revenue and reduce discretionary expenditure helped to dampen inflationary expectations. By early 1998, liquidity in the economy had recovered and there were signs of a growth revival. Improved prospects for external financing, including from the sale of shares in Macedonia Telecom, has provided some scope for a loosening of credit and budget policies in 1998. However, the authorities have moved cautiously in this direction and the general government deficit is projected to rise only modestly from 0.4 percent of GDP in 1997 to 0.7 percent of GDP in 1998.

6. The following chapters discuss in more detail recent developments in the real, monetary, fiscal and external sectors. FYRM faces many challenges in the field of structural reforms, which must be overcome if the economy is to reach a sustainable growth path and unemployment is to be brought down. Two chapters focus on the particular problems of enterprise governance and the structure of public sector.

II. RECENT REAL SECTOR AND PRICE DEVELOPMENTS

A. Overview

7. FYRM experienced a sharp fall in output following independence. While inflation was brought under control by 1996, recovery in the real economy has been hesitant, reflecting the poor regional situation, very limited foreign investment and FYRM's status as a late reformer. There are now signs that growth is accelerating following the devaluation in 1997 and progress on structural reform. Unemployment, however, remains very high.

B. Developments in Output and Expenditure¹

- 8. Near hyper-inflation, the loss of subsidies from the former SFRY and the Greek blockade between February 1994 and September 1995 contributed to a decline in output of 36 percent between 1991 and 1995. With stabilization, investment started to recover in 1995 and positive growth returned in 1996. The recovery remained hesitant for a number of reasons. While the end of the war in Bosnia, the lifting of sanctions on FRY and the removal of the Greek blockade in 1995 improved the prospects for exports and foreign investment, this was offset by the collapse of neighboring economies Bulgaria and Albania. In addition, with the end of sanctions on FRY, foreign exchange inflows fell sharply and monetary policy was tightened to support the exchange rate. Finally, the first round effect of restructuring depressed output while the positive impact of improved productivity on output took some time to be felt.
- 9. In 1996, the economy started to pick up, but a surge in industrial output in late 1996, partly reflecting the restarting of the oil refinery, could not be maintained. Early 1997 saw a fall back in industrial output and the prices of some goods fell, although this largely reflected a cut in tariffs. The collapse of a savings house (TAT), in March 1997, undermined confidence and the exchange rate came under strong pressure. The authorities devalued against the DM by 14 percent in July. Subdued demand pressure, a wage freeze, and tight fiscal policy, meant that inflation remained muted and the devaluation translated fully into improved competitiveness and higher profits. Since July, output has begun to recover and growth in 1997 as a whole was (according to official estimates) 1.5 percent—with most of this coming in the second half of the year. There is reason to believe, however, that growth in the period

¹This section is based on official statistics which may underestimate informal activity. This issue is discussed in more detail in Appendix 1.

1993 to 1997 has been underestimated by official statistics. This issue is discussed in Appendix I to this Chapter.

Sectoral developments

- 10. Heavy manufacturing suffered the sharpest drop in output while trade is the only sector of the economy to have grown throughout transition (Table 8). The former SFRY pursued a growth strategy that emphasized heavy industry at the expense of consumer goods and services—although prices and output were much less distorted than, for example, in the U.S.S.R. In an attempt to bind the various regions of the country together, elements of vertically integrated production processes were distributed across different Republics.
- 11. FYRM, which was one of the least developed republics in the federation and reliant on transfers from the center equal to 6 percent of GDP, was left at independence with a core of inefficient large scale manufacturing plants designed to provide inputs to factories in other parts of the former SFRY. Manufacturing exports were therefore badly affected by the collapse of output in the rest of the former SFRY.
- 12. Since independence and a move towards a more market economy, there has therefore been a shift in the composition of output from manufacturing and mining and towards trade and financial services. Other services have not experienced the growth seen in some transition countries, partly because initial distortions were more limited than elsewhere and partly because, as a low income country, FYRM could be expected to have a lower level of services in equilibrium.

Manufacturing and mining

- 13. Industrial production fell more rapidly than GDP, reaching its trough in 1995. Recovery started in mid-1997 following the devaluation and in the first quarter of 1998 was 8 percent higher than during the same period last year. Heavy industry, such as the machine industry, which was an intensive user of previously subsidized energy, was the hardest hit in the initial years of transformation (see Tables 9 and 10). Output in some sectors of heavy industry, for example the production of chemicals and steel, is now beginning to recover.
- 14. It is likely that industrial production figures underestimate the recovery in production as surveys used to collect the data tend to cover the older enterprises and do not cover the new formal sector or the informal sector. The high variability of production of the state-owned oil refinery makes it difficult to detect the underlying trend in the industrial production figures.

Agriculture

- 15. Agricultural production has suffered less from the transition process than other sectors of the economy, however, production has not risen as sharply as in some other Eastern European economies partly due to the mixed pace of reform. Even prior to independence agriculture was predominantly a private sector activity with social enterprises, including a few large agro-kombinats, representing only about 24 percent of production. Thus it was never likely that FYRM would experience the type of dramatic increase in agricultural production seen in countries like Romania or China with decollectivization. Nevertheless, there was significant room for efficiency improvements as agricultural prices had been distorted by a system of tariffs, quotas, subsidies and price supports. The budgetary cost of these interventions was estimated at denar 2.7 billion (2 percent of GDP) in 1994. Most of this support went to agro-kombinats. The producer subsidy equivalent (PSE), which reflects the support given to producers through budgetary means and through trade protection, was denar 4.3 billion (3 percent of GDP) in 1994.
- 16. By 1996, direct budgetary support to the agricultural sector had been cut to denar 0.2 billion through the elimination of directed credits and interest subsidies for agro-kombinats, the elimination of guaranteed prices for sugarbeet and sunflower and the reduction of guaranteed prices for tobacco and wheat to 70 percent of the world price. Indirect support was still provided through the purchases of agricultural goods by the strategic reserve (see Chapter VI). In 1996, the government also undertook a substantial reform of the trade system, eliminating import quotas and reducing tariffs on many items. These reforms are reflected in the changing composition of agricultural output (see Table 11) although the recent rise in tobacco output also reflects good weather conditions and the entry of foreign buyers to local markets, bypassing the previous monopoly purchaser of tobacco and bidding up the local price of tobacco. In addition, a ban imposed by the EU on the import of Macedonian lamb, as a result of foot and mouth disease, depressed production and exports in 1996 and 1997.
- 17. Reform of the agro-kombinats has been slow. The percentage of production accounted for by the private sector has risen only marginally and agricultural output has remained at around 10 percent of GDP throughout transition. Only 5 of the large agro-kombinats were sold prior to 1998 (3 were part of the special restructuring program). A further two are due to be restructured and sold in 1998. In total 38 percent of agricultural enterprises have been privatized by April 1998 (weighted by the number of employees), compared to 80 percent of enterprises as a whole. However, the remaining 62 percent are in the process of being privatized. Restructuring the agro-kombinats and introducing competition will be as important as transferring ownership as agro-kombinats have benefited from considerable monopoly power in the provision of inputs, such as fertilizer, and monopsony power in the purchase of agricultural goods for processing, distorting the prices paid to small farmers.

Trade and services

18. Reflecting the move to a more open and market-oriented economy, the share of the trade sector in GDP has risen throughout the transition period. The share of services has stayed relatively constant. Within the total, financial services saw an initial rise as a large number of new banks and savings houses were set up. In 1996 and 1997, however, there was a consolidation in this sector. The share of services in GDP is probably underestimated as informal activity is likely to be disproportionally high in the service sector.

Informal sector

Informal sector activity can be of two types. First, some enterprises never register with the authorities and so avoid paying taxes completely. Unless explicitly covered by surveys, these enterprises and their output is never recorded in official statistics. However, to operate as unregistered entities in the FYRM, enterprises would have to operate entirely in cash as all bank accounts have to be registered with the Bureau of Payments Operations (BPO). The efficiency of the BPO means that this form of informal activity is likely to be less common than in some other transition economies. Most informal activity in FYRM is likely to be of the second type in which officially registered enterprises under report the number of workers they employ and the level of production in order to reduce their tax liabilities. On some estimates, informal activity represents 20-30 percent of GDP. While this activity is unlikely to be recorded in, for example, industrial production figures, some of it may be included in official GDP figures as these are based on surveys which are designed to capture some informal activity. One method of estimating the size of the informal sector not captured in GDP is to look at the consumption of electricity (which has a demand elasticity roughly equal to 1).2 In FYRM, electricity consumption rose by 8.6 percent between 1992 and 1997, compared to a fall of official GDP of 10 percent over the same period. On this basis, GDP could be as much as 20 percent higher than currently estimated.³

Income and expenditure4

20. The increase in output in 1996 was preceded by a modest recovery in investment (see Table 12). Investment weakened in the first half of 1997 in response to the loss of confidence from the collapse of TAT and the uncertainty about the exchange rate and hence macro

²Kaufmann and Kaliberda (1996).

³This method will underestimate activity if producers have become more efficient uses of electricity. However, this is less of a problem than in other transition economies because the price of energy has not changed as much during transition. This method overestimates value added to the extent that large, energy intensive loss makers continue to operate.

⁴Official statistics showing GDP on an expenditure basis only exist up to 1994. Figures since then are based on staff estimates and are subject to wide margins of error.

stability.⁵ It picked up in the second half of the year following the devaluation, fall in real wages and improved profitability of enterprises. Investment since 1994 has been highest in transport and communication, trade and construction (see Table 13).

21. Public consumption has fallen over the transition period while estimated private consumption has grown rapidly (see Figure 1). Private consumption estimates from 1995 on are calculated as a residual and should be treated with considerable caution. However, some growth in private consumption is consistent with data on retail sales, sales tax revenue and import growth. The increase in private consumption since 1994 more than accounts for the deterioration in the external balance. While some of the increase in consumption was probably financed by an increase in officially measured transfers from abroad, financing for the rest cannot be identified. Given the collapse in employment and low real wage growth, it cannot have been financed by formal sector wage income, except in the second half of 1997 when a higher proportion of wages were paid on time, increasing the cash available to households.

C. Labor Market, Wages and Employment

22. Rigidities in the labor market have delayed restructuring of enterprises while limiting the growth of new employment. Real wages, which fell sharply in the first years of transition have remained flat while productivity is now recovering.

Wages

23. The loss of subsidies from the former SFRY meant that either real wages had to fall or productivity improve after independence. A sharp fall in real wages was achieved during the years of high inflation (see Figure 2 and Tables 11, 14 and 15). Since stabilization, real wages have continued to fall although more gradually. This continued fall reflected the effects of a Wage Control Law, introduced in December 1993 under which enterprises were only permitted to increase monthly wages below targeted inflation with an additional increase of 50 percent of any unanticipated inflation. Wage restrictions were allowed to lapse at the end of 1996 and real wages recovered somewhat. Following the devaluation, a new Wage Control Law was introduced and wages in all enterprises not 100 percent privately owned were frozen. Between July 1997 and the end of the year, real wages fell by 4 percent. The law was

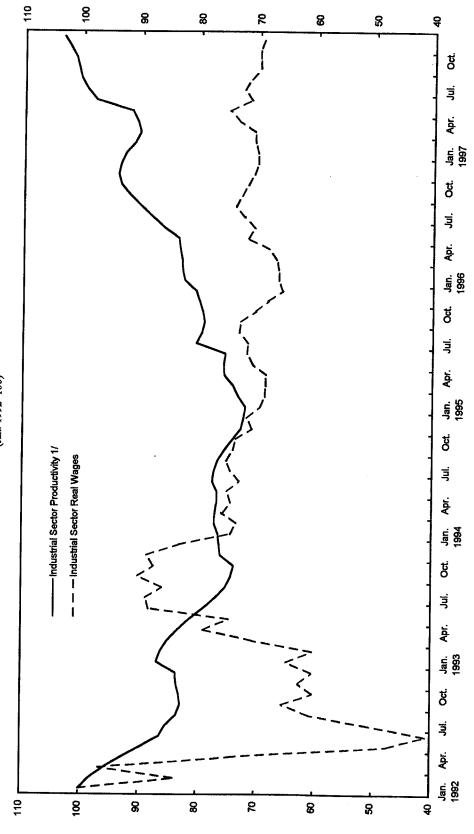
⁵Within-year data on fixed capital formation is inconsistent with data collected on an annual basis. The coverage of enterprises is much narrower and the series is highly volatile. However, broad trends can be distinguished and suggest that investment was weak in the first half of 1997 but bounced back in the second half.

⁶The law covered about 80 percent of employees including those in companies which had not fully paid off privatization installments.



Sources: Statistical Office, and IMF staff estimates.





Sources: The authorities, and IMF staff estimates.

1/ Measured as output per worker in industry.

allowed to lapse at the end of the year as the risk of a devaluation inspired wage price spiral had receded.

24. In response to a sharp fall in profitability following independence, enterprises resorted to delaying the payment of wages. From 1994 to June 1997, workers receiving late wages rose from 23 percent of employees to 41 percent. While data is no longer collected in this form, the indications from other sources are that, since the devaluation and the recovery of profits, a higher proportion of wages are being paid on time. For example, the number of workers receiving no wages fell from 29 percent of the workforce in June 1997 to 19 percent in January 1998. An alternative interpretation of these figures, however, is that an increasing proportion of wages are now being paid through the payments system as a result of penalties introduced in the Financial Working Law (see Chapter VI).

Employment and productivity

- Under the system of social and state ownership of enterprises which operated in the 25. former SFRY, employment conditions were highly regulated and there was widespread overemployment and low labor productivity. Labor laws made restructuring difficult and expensive after independence. For example, the law required that workers be given 6 months notice and up to 24 months severance pay and firms were required to draw up costly plans before making any redundancies to ensure the well being of those being made redundant. In addition, enterprises were required to pay off any wage arrears to workers who were dismissed, making it cheaper, in some cases to maintain excess labor. Privatization, in some ways, actually added to the restrictions as privatization contracts were based, to some extent, on promises from new owners to limit redundances. These restrictions on firing workers as well as very high social security contributions and generous mandatory sick leave, maternity leave, and vacation, have discouraged new job growth. As a result, although formal sector employment fell, the fall was much less than the reduction in industrial output. Since 1995, industrial production has picked up slowly while employment has continued to fall. As a result, industrial productivity improved over this period and is now just above its 1992 level (see Figure 2).
- 26. Nevertheless, progress has been made in reducing labor market restrictions. In 1995, the government amended the Labor Relations Law to reduce severance pay to 1 month wages for every two years of employment up to a maximum of 12 months. Termination notice was reduced from 6 months to 1 month when less than 150 workers were being terminated and 3 months for more than 150 workers. In addition, regulations on the hiring of workers were reduced and severance pay was linked only to the length of service in the current job rather than the employees entire work history.
- 27. The government has attempted to encourage new jobs by exempting enterprises from paying social taxes on new hires under the Law to Increase Employment which came into effect on January 1, 1998. The exemption is limited to two years from the introduction of the

law and applies only when there is a net increase in employment in an enterprise. Data collected under the law shows that there were 30,000 new hires in the first four months of 1998. Many of these probably represent workers previously employed but who were not registered in order to avoid tax. However, 13,000 of the hew hires did not qualify under the law and represent genuine new jobs. Thus, within a general environment of declining employment, there are signs of a surprisingly high level of job turnover.

Unemployment

Unemployment has risen sharply, with the largest rise taking place in 1995 with the imposition of hard budget constraints on enterprises and the implementation of the special restructuring program for enterprises (see Table 16). Since then, unemployment has continued to rise steadily. New entrants to the labor force have been unable to find jobs, at least in the formal sector, and enterprises have not replaced workers who change jobs or retire. The vast majority of the unemployed have been unemployed for more than 18 months and so are not eligible for unemployment benefit, although they do have their health insurance contribution paid by the government (see Table 1 below). The suspicion is that many of these have jobs in the informal economy.

Table 1: Composition of Unemployment by Duration (percent)

Market 1997	1996	1997
Less than 1 month	3.2	2.4
1-5 months	5.2	5.4
6-18 months	18.8	16.3
18 months - 3 years	28.3	32.2
4 years and longer	44.5	43.6
Total	100.0	100.0

Source: Labor Force Survey, Statistical Office

Labor markets statistical issues

29. Labor market restrictions and high labor taxes have led to an increase in informal sector employment. Partly as a result of these problems, statistics on employment in FYRM

⁷For more details on the law, see Chapter VI.

are highly unreliable. The only regularly reported data comes from a survey of large enterprises which has a low response rate is likely to be unrepresentative. These figures show a drop in employment in 1997 of 6 percent. However, this is likely to overstate the fall if the number of small firms is growing. The annual labor force survey is considered a more reliable source of data, as it seeks to cover informal sector employment and shows a fall in employment between April 1996 and April 1997 of 5 percent. However, the survey is conducted annually in April and there are considerable lags between the collection and publication of data. Information on employment following the pick up in activity in late 1997 will not be available for some time. It is also likely that the labor force survey underestimates employment in small scale agriculture. Uncertainty about the true level of unemployment, and the size of the active labor force make estimates of unemployment rates particularly unreliable. Estimates for 1997 vary from 26 percent to 36 percent.

D. Enterprise Sector

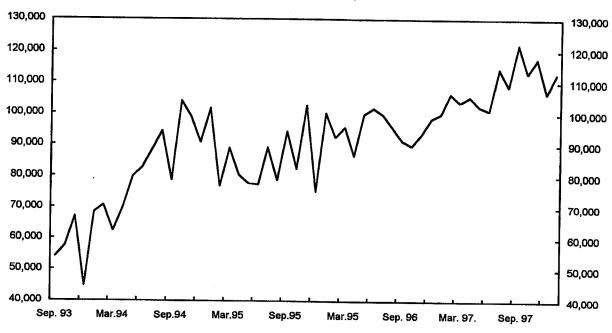
- 30. A small private sector had always operated in the former SFRY and in 1990 a privatization law (the "Marković Law") was introduced under which some enterprises were sold to their employees. A new privatization law was introduced in 1993 and the privatization program took off in 1995. Since then, 1,212 enterprises have been privatized (80 percent of the total identified for privatization). The majority were sold to managers, workers, or a combination of the two.
- 31. With the loss of subsidies and export markets, the number of firms unable to meet their payment obligations rose sharply in 1992 (Figure 3, Table 17). As the process of transformation progressed, however, this number could have been expected to fall as unprofitable enterprises either closed down or restructured to a point where they became profitable and liquid. Instead, the number of illiquid enterprises has continued to rise at a steady rate, with 20 percent of the workforce working in illiquid enterprises, despite the fact that 1997 saw an increase in profitability of enterprises equal to 2 percent of GDP (Table 18). This suggests that the restructuring process has not been fully effective due to an inefficient bankruptcy process, inappropriate lending by banks and ownership of shares by insiders (see Chapter III).

E. Prices

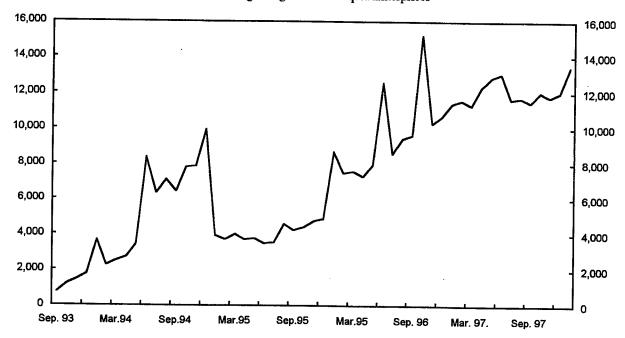
32. FYR Macedonia introduced its own currency in April 1992 at a time when the former SFRY was heading towards hyperinflation. After failed stabilization attempts in 1992 and 1993, the authorities decided to fix the denar to the deutsche mark in early 1994. Monthly inflation fell rapidly and by December 1995, 12 month CPI inflation was below 10 percent (Table 19). With a tight monetary policy required to support the fixed exchange rate

Figure 3. FYRM: Illiquid Enterprises

Workers in Illiquid Enterprises



Oustanding Obligations of Illiquid Enterprices



Sources: Ministry of Development.

(following a drop off in earnings from abroad), CPI inflation continued to fall throughout 1996 and by early 1997 prices were slightly below their level of a year earlier, despite a substantial increase in government regulated prices for oil and telecom. Much of the fall in prices reflected lower prices of food, beverages and tobacco following a sizable reduction in taxes on tobacco and tariffs. Underlying inflation during this period was effectively zero.

- 33. The July 1997 devaluation led to a modest pick up in the CPI and a slightly stronger pick up in industrial prices (which include a higher share of tradable goods). 12 month CPI inflation rates were kept down by the falls in prices experienced in early 1997. While monthly inflation has remained very low in 1998, 12 month CPI inflation picked up to 3.9 percent in April reflecting the exceptionally low level in April 1997.
- 34. The limited impact of the devaluation on inflation can be explained by a number of factors. First, production could increase without triggering inflation as there was significant excess capacity. Second, the government took a number of measures to increase revenue and reduce expenditures. Third, the reintroduction of the Wage Control Law prevented wage inflation. This ensured that the devaluation fed through into a cut in deutsche mark wages. Finally, the government cut excise taxes on oil to ensure prices paid by consumers were unaffected by the devaluation.
- 35. Government control of prices in FYRM is limited to the regulation of state monopolies, some agricultural support and setting a cap for the price of a standard loaf of bread. Prices for oil and petroleum products, energy, railways and post and telecom prices are regulated on a cost plus basis. The government is in the process of establishing independent agencies to carry out the regulation of these monopolies. A guaranteed minimum price is set for wheat and tobacco but this is tied to 70 percent of the world price. The government intends to remove the only other remaining administered price—a cap on the price of a standard loaf of bread. This will have no immediate impact as the current market price is below the government determined cap.

- 19 - APPENDIX I

STATISTICAL ISSUES AND MEASUREMENT OF GDP

- 36. Official statistics have only recently attempted to include estimates of activity in the informal sector. Even in the formal sector, there is a bias towards the coverage of older enterprises and traditional sectors (such a heavy industry), which have seen some of the sharpest declines in output. Partial attempts to improve the coverage of statistics have, however, led the authorities to underestimate real growth and overestimate the GDP deflator.
- 37. Under the former Yugoslav system, with the vast majority of production taking place in socially owned enterprises, it was easy to keep track of aggregate production. With the shift to a more decentralized market economy it became necessary to overhaul statistical collection methods to capture the activity of new private enterprises and the growing informal sector. In addition, concepts such as Gross Social Product (which excluded output of the services sector and government) were replaced by market concepts such as GDP.
- 38. Initial estimates of GDP were derived from rather narrowly based volume indices (in particular the industrial production series discussed in section B above) and estimates of sectoral deflators. However, the Statistical Office (SO) is in the process of upgrading its surveys and techniques to generate consistent figures for GDP on a value added and expenditure basis in line with international standards.
- 39. In 1997 new estimates were introduced, based on surveys of value added at current prices which, for the first time, covered the informal sector as well as improving coverage of new enterprises in the formal sector. Nominal GDP for 1993 was revised upwards by 3.3 percent, while nominal GDP for 1996 was revised up by 8.1 percent. Current estimates for GDP growth in 1997 are based on the old methodology and growth in 1997 is likely to be revised upwards when estimates based on the new surveys are published.
- 40. Despite substantial changes in nominal GDP growth, there have been only minor changes to estimates of real growth. This is because volume indices have not yet been revised to capture new enterprises or activity in the informal sector. Deflators for each sector are calculated by dividing value indices by volume indices. As estimates of the informal and new formal sector are included in the numerator but not the denominator, a bias is introduced into the calculated deflators. In fact, the calculated deflators capture the entire growth of the informal and new formal sectors as measured by the new nominal surveys. This bias is a temporary phenomenon and will be corrected once the volume surveys have been updated. There are two ways to estimate the size of the bias. First, by assuming that the initial estimates of the GDP deflator were accurate and the higher nominal output captured by the survey reflected higher real output, real growth between 1994 and 1996 is estimated to have averaged 0.4 percent per year compared to the official -0.7 percent. An alternative approach is to construct a GDP deflator from a weighted average of CPI, producer prices and import and export prices. This implies an average real growth rate over this period of 0.9 percent (see Table 2).

Table 2. FYRM: GDP Estimates, 1993-97

	1993	1994	1995	1996	1997
Original					**** ·
Nominal GDP	57,294	132,734	141,641	145,559	151,288
Nominal GDP Growth	399.9	131.7	6.7	2.8	3.9
Real GDP Growth	- 9.4	-2.7	-1.6	0.9	1.5
GDP Deflator	452.0	138.0	8.4	1.8	2.4
Revised					
Nominal GDP	59,164	136,034	153,132	157,302	165,989
Nominal GDP Growth	401.7	129.9	12.6	2.7	5.5
Real GDP Growth	-9.1	-1.8	-1.2	0.8	1.5
GDP Deflator	451.9	134.1	13.9	1.9	4.0
Estimate 1					
Nominal GDP	59,164	136,034	153,132	157,302	165,989
Nominal GDP Growth	401.7	129.9	12.6	2.7	5.5
Real GDP Growth	-9.1	-3.4	3.8	0.9	1.5
GDP Deflator	452.0	138.0	8.4	1.8	4.0
Estimate 2					
Nominal GDP	59,164	136,034	153,132	157,302	165,989
Nominal GDP Growth	401.7	129.9	12.6	2.7	5.5
Real GDP Growth 1/	***	3.0	-2.3	1.9	2.8
GDP Deflator 1/	•••	123.2	15.2	0.8	2.6
Memorandum					
Average inflation					
CPI	338.7	126.5	16.4	2.5	1.3
RPI	333.3	120.5	16.4	3.1	3.7
Producer price	258.3	88.9	4.7	-0.3	3.7 4.2
Export prices	346.5	102.4	-3.5	-0.3 2.6	18.8
Import prices	320.9	90.8	-3. <i>3</i> -1.7	5.2	13.0

Sources: The authorities, and IMF staff estimates.

^{1/} This method becomes inaccurate at high levels of inflation.

III. CORPORATE GOVERNANCE

A. Overview

41. Despite a large scale privatization program, the persistence of payment and wage arrears and poor profitability in the enterprise sector suggest weak corporate governance. This reflects a privatization process dominated by insider buyouts, weak legal protection for creditors, an inefficient banking system, limited interest from foreign investors and the lack of publicly available data on the financial health of companies. These problems are being addressed by a redirection of privatization towards outsiders, new bankruptcy and collateral laws, tougher supervision of banks, stock market reforms and new accountancy regulations.

B. Insider Privatization

- 42. Workers and managers hold a controlling stake in 87 percent of privatized companies. While inside owners have an incentive to maximize profit, they also have other objectives including the maintenance of employment, which often conflict with profit maximization.
- 43. In the former SFRY, enterprises operated under a system of social ownership and worker self management in which property rights were not clearly defined and the state had substantial influence. In 1990, the Marković law was introduced under which enterprises could be corporatized and employees could purchase shares—usually at a substantial discount to their market value. By mid 1991, roughly 67 large- and medium-sized enterprises in FYRM had been fully privatized under the law and hundreds more partially privatized. In August 1991, the Marković law was suspended in FYRM. Not until June 1993 was it replaced by the Law on the Transformation of Social Capital and only in late 1994 did the privatization process get under way again. Under the new law, privatization could take a number of different forms (Table 3).
- 44. Enterprises, i.e. the existing management, were permitted to choose the method of privatization although their plan had to be approved by the Privatization Agency. Most enterprises were privatized using the employee and management buyout model, under which shares could be purchased in installments and employees were allowed to purchase shares at a discount of up to 30 percent. Even when shares were made available to both insiders and outsiders (the buyout model), insiders tended to purchase the majority of stake as they had more information on the company and could benefit from discounts and the chance to purchase shares in instalments. In many cases insiders had acquired substantial shares under the Marković law and only a residual share was available to be sold in the second phase of privatization. Again, only insiders tended to be interested in purchasing these residual shares.

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⁸See Sukley (1996).

Table 3. FYRM: Method of Privatization 1/

	No. of Enterprises	No. of Employees	Value of Equity (DM millions)	Average No. of Employees per Enterprise	Value per Employee DM '000
Markaria I are					
MAINOVIC LAW	/9	11,548	114	172	66
1993 Privatization Law	1,212	182,808	3,567	151	19.5
Employee Buy-out	340	16,969	151	50	0 %
Management Buy-out	196	999'19	1.333	345	19.7
Outsider Buy-out	167	56,460	1,106	338	19.6
Foreign Equity	155	1,924	52	12	27.0
Private Equity	66	3,835	45	39	11.7
Capital Increase	16	4,993	87	312	12.4
Debt for Equity Swap	43	14,092	486	328	34.5
Sale of Residual	28	15,538	304	555	19.6
Leasing	4	217	7	54	×
Liquidation	164	1,114	:	7	e :
Total	1,279	194,356	3,681	152	18.9

Source: Privatization Agency.

1/ Based on transactions completed by end March 1998.

- 45. By March 31, 1998, 1,279 enterprises have been privatized, or roughly 80% of those identified for privatization. The most important state enterprises remaining are the oil refinery and the public utilities. Roughly 87 percent (weighted by the number of employees) of privatized companies were purchased by insiders including management buyouts, employee buyouts and sale of residual shares (see Table 3). The very small number of companies sold to foreign investors partly reflected the fact that managers were in a position to choose the method of privatization, but also the general lack of interest by foreign investors due to the uncertain regional situation. At 0.9 percent of GDP in 1997 FYRM has the lowest level of foreign direct investment per head of any transition economy. The low level of outsider, and particularly foreign, involvement in privatizations meant that privatized companies did not benefit from the injection of capital or know-how seen in other transition economies such as Hungary and Poland.
- 46. In addition, insider privatizations create specific governance problems. These are particularly acute in the case of employee buyouts because share ownership is diffuse and employees have a strong incentive to maintain employment. A pure management buyout would have the advantage that ownership is more concentrated while managers have the information and power to restructure the company and are less concerned about maintaining employment. However, in FYRM, the majority of management buyouts in fact involved a consortium of managers and workers. In other cases, a substantial proportion of shares had already been sold to workers under the Marković law requiring managers to take the interests of workers into account. In addition, managers may find that generating profits is not the best way of increasing their income—as profits have to be shared with the tax authorities and other investors. Managers may do better by, for example, selling assets or products at below market rates to related persons.
- 47. Recognizing the limitations of insider privatizations, the government has taken a number of steps to reorient the privatization process towards outsiders. It has amended the law on the transformation of social capital to allow outsiders to purchase shares in installments, thus reducing the bias towards insider privatizations. In addition, a number of existing privatization contracts with insiders have been canceled because of the failure of the purchasers to stay current on their installments. The Privatization Agency is seeking to sell the resulting packages of shares to outside strategic investors.

C. Bankruptcy and Creditor Markets

48. Inefficiencies in the bankruptcy process and weak creditor rights have also undermined the imposition of hard budget constraints and slowed the process of restructuring. Under the former bankruptcy law inherited from the former SFRY, the BPO was responsible for initiating bankruptcy against all legal entities whose accounts had been blocked for 60

⁹In theory, management buyouts were not necessarily to existing management but to those who would take on the task of management. In practice, this was nearly always existing management.

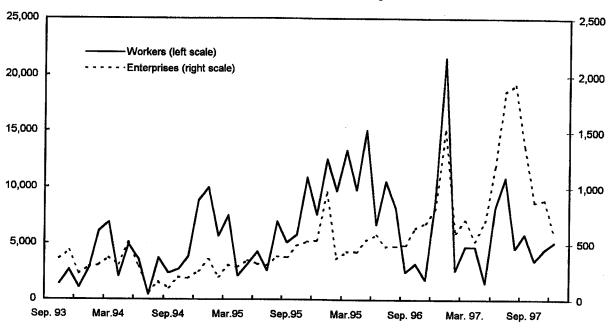
consecutive days or 75 non-consecutive days. Judges, who had little training in financial issues, were required to take into account the interests of workers and wider society as well as those of creditors and had considerable discretion about the timing and outcome of the proceedings. The value of outstanding claims against the enterprise could be written down during the process. Workers dismissed during the bankruptcy process did not have the same rights to severance pay or notice of dismissal as other workers, which gave enterprises an incentive to enter bankruptcy as a way of restructuring.

- 49. While a large number of enterprises have been submitted to bankruptcy courts, few have undergone radical restructuring and even fewer have been liquidated. The process of automatically initiating bankruptcy against illiquid enterprises meant that a very large number of small enterprises—often one person outfits with very few assets—were sent to the courts, causing serious backlogs in the system. This is reflected in the fall in the average size of enterprises submitted to bankruptcy and the fact that processing of cases was often delayed for as much as a year (see Figure 4).¹⁰
- 50. The Ministry of Justice does not collect data on the number of enterprises which are liquidated as a result of bankruptcy proceedings. The perception is, however, that the vast majority of enterprises were restructured, emerging from the bankruptcy process with their debts and labor force reduced. The difficulty faced by creditors attempting to seize assets was heightened by restrictions on their rights when the asset they wished to attach was regarded as necessary to the operations of the enterprise.
- 51. New bankruptcy and movable collateral laws seek to address these problems by giving greater control to creditors. The new movable collateral law gives creditors greater rights to seize the assets of delinquent creditors. Under the new bankruptcy law, which came into effect on May 6th, 1998, any creditor with an overdue obligation can initiate bankruptcy proceedings. The court appoints a trustee who is responsible for assessing the claims of creditors and assets of the company. If there are insufficient assets to cover the costs of the process, the case is dismissed. A committee of creditors is established to whom the trustee reports. The committee, or any individual creditor, has 90 days from the initiation of proceedings to propose a restructuring plan which may include the writing down of debts. The plan must be approved by at least 50 percent, by value, of the creditors otherwise the enterprise is liquidated. At the end of 90 days, the trustee is responsible for either implementing the bankruptcy plan or selling the company's assets and distributing the revenue to creditors.

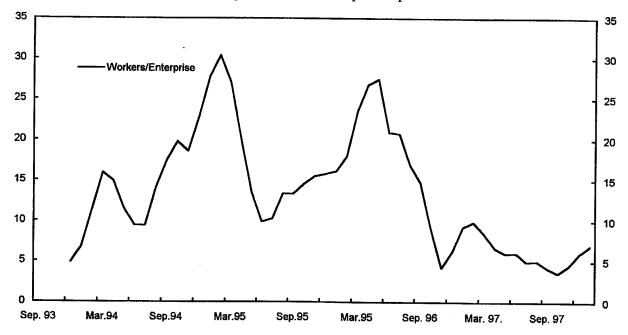
¹⁰The BPO, which was required to resubmit enterprises after accounts were blocked for an additional 60 days, found they were sometimes submitting the same enterprise many times.

Figure 4. FYRM: Enterprises Submitted to Bankruptcy

Number of Workers and Enterprises



Average Number of Workers per Enterprise



Source: Ministry of Development.

- 52. The new law may, in some respects, make restructuring harder. Under the law, workers dismissed as part of a restructuring during a bankruptcy process, have the same rights as other workers. These rights include statutory severance pay and a notice period. While this eliminates the incentive for enterprises to go into bankruptcy, it increases the cost of restructuring during bankruptcy and may make it harder to get approval from creditors to a bankruptcy plan. It therefore increases the likelihood that enterprises will be liquidated.
- 53. Although the new law represents a significant improvement, concerns remain about the efficiency with which it will be implemented. Much will depend on there being a sufficient number of well qualified trustees to undertake the work. Currently there is no adequate system of training, licensing or monitoring of trustees. These tasks are usually undertaken by a professional body but no such body is to be established in FYRM. Instead local chambers of commerce will issue lists of people "qualified" to be trustees. Anyone who has run their own business, has a degree and five years work experience will be considered qualified. In addition, trustees have been restricted to dealing with only one case at a time. Given the large number of cases which are pending, there are concerns that this limit is too low.
- 54. While the new bankruptcy law and law on movable collateral are likely to lead to an increase in the number of enterprises being liquidated, they should also encourage the prompt payment of debts which will help improve the profitability of other enterprises.

D. Behavior of Banks

- 55. Banks in FYRM have continued to lend to older loss-making enterprises thereby contributing to the slow pace of restructuring in the economy (see Chapter IV). One possible reason for this behavior, on the part of banks, is that bank portfolios are highly concentrated and there is a large quantity of connected lending. If a bank has a high exposure to a single loss maker, it may continue to lend because it fears that if it were to stop lending, the enterprise would close and the bank would have to write off all its loans to that enterprise. In the short run, therefore, lending to a loss maker can provide temporary support to the bank's balance sheet.
- 56. Connected lending can be of two types: banks may lend to companies or individuals who own an equity stake in the bank or they can own equity in companies to which they also provide loans. In the first case, the owner of the bank can simply direct the bank to lend on non-commercial terms. In the second case, holding an equity stake in a loss maker leaves the bank open to pressure to maintain output and employment. During the privatization process banks acquired equity in companies which had been unable to stay current on their interest payments as part of a system of debt-equity swaps. Banks, therefore, found themselves with substantial holdings of equity in, usually loss-making, enterprises. The objective was to give banks the ability to turn round or liquidate loss making enterprises. However, banks proved to be ineffective at this task, partly because this had never been their role in the past. Instead, banks found themselves pressurized to extend more credit and to finance the companies' losses of out of bank profits.

57. New supervisory rules are in the process of being implemented by the National Bank which should improve lending practices. In particular, they will require banks to reduce their exposure to single debtors to below 30 percent, force banks to sell equity stakes in companies and restrict lending to entities which hold shares in the bank.

E. Stock Exchange

- 58. The stock exchange has not provided an effective corporate governance mechanism as turnover is very low and companies have effectively restricted workers from trading shares. Measures are being taken to increase liquidity and remove restrictions on the trading of shares.
- 59. Under the Company Law, all trading of shares has to take place on the exchange until 1999 when this provision will be reviewed. Trading is carried out by open outcry, for one hour twice a week, following a preliminary stage of price discovery where bids and offers are sorted by computer. There are three market tiers. Level one is for companies with market capitalization of DM 15 million or more, at least 200 shareholders, 25 percent of shares held by outsiders and 3 years of audited accounts. One company met this standard but was delisted following a scandal. The second tier requires a capitalization of at least DM 5 million, 100 shareholders, at least 15 percent of shares held by outsiders and two years of audited accounts. Two banks are listed on this market and turnover is low. The third market consists of unlisted companies and accounts for the vast majority of trading on the Exchange.
- 60. About 30-35 companies would meet the size requirements for listing but choose not to. 11 Clearing for trades on all three tiers is undertaken by the Stock Exchange. Settlement of transactions in listed companies are carried out by the BPO. The BPO also holds the share registries of the 4 listed companies and can act as a central depository. Settlement for third market transactions is delivery versus payment, organized bilaterally between brokers. There are plans to bring the central share registry and settlement system under the governance of the brokers of the Stock Exchange, although the work will still be carried out by the BPO on a contract basis. From 1999 all share registries will have to be held by the central share registry.

¹¹Listed companies are required to publish their accounts, hold their share registries at the central share registry and are not permitted to restrict trading of their shares. To avoid these regulations, many enterprises choose not to list. During 1997, all companies are required to move their share registries to the central share registry, remove restrictions on share trading and the larger companies are required to provide accounts to shareholders. This will eliminate the most important barriers to listing.

- 61. Total turnover of shares in 1997 was a mere denar 168 million or roughly US\$3 million (see Table 4). 93 percent of this turnover was accounted for by just three companies: Alkaloid (Skopje), Kreditna Banka (Skopje) and City Shopping Mall (Skopje). The shares of only 15 companies were traded during the year while the vast majority of companies saw no trading in their shares on the exchange in 1997.
- 62. The low level of activity on the exchange reflects a number of factors. The majority of workers and managers purchased shares in installments over 5 years and find it hard to sell their shares until all the installments have been paid. The value of shares has in many cases fallen below the purchase price and employees may be reluctant to sell shares at a loss. Managers also discourage workers from selling their shares on the exchange. There are persistent rumors that managers have threatened to dismiss workers who sell their shares to outsiders. Managers have been able to enforce this because the share registry is held by the company. In addition, under rule 290 of the Company Law, companies that have been fully privatized (and all share installments paid for) are allowed to include in their statues a restriction on transactions in their shares. In 1998, however, the law was amended to eliminate this provision and required that all share registries be held by the central share registry. These changes should help improve liquidity on the stock exchange.

F. Information

- deterred outsider ownership and foreign investors. As in other centrally planned economies, enterprises in the former SFRY did not produce accounts in line with Western standards. Definitions of profit and loss, depreciation, etc. were different from those used in market economies, or did not exist at all. Former SFRY accounting practices, however, were much closer to International Accounting Standards (IAS) than those in any other former centrally planned economy. For example, concepts like depreciation were in use. Despite this, FYRM has moved relatively slowly to improve its accountancy standards. 32 of the 34 IAS standards have now been adopted and all companies will be required to comply with them from January 1, 1999. Enterprises with 150 or more employees or DM 6 million in annual revenue or assets valued at more than DM 1.5 million are required to be audited annually by a licensed auditor. The Ministry of Finance is in the process of licensing auditing companies and individual auditors. The Ministry has the right to take away a licence from auditors found to have acted improperly.
- 64. Audited accounts, for the companies described above, will be made available to shareholders but there is no legal requirement for accounts to be made more widely available. Currently, enterprises listed on the stock exchange are required to publish audited accounts but very few companies are listed. Indeed, one of the reasons more companies are not listed is that current insider owners are not enthusiastic about encouraging outsider purchasers of shares and want to avoid the requirement to publish their accounts.

Table 4. FYRM: Summary of Transactions Executed on the Macedonian Stock Exchange in 1997

	Traded securities	No. of transactions	Volume	Turnover in denars	Percent of total turnover	No. of trading days
Second Market Shares						
Balkanska banka - Skopie						
Balkanska banka - Skopje	: 	: -	40			: -
Investbanka - Skopje	-	· m	156	357,300	0.00	- 6
Investbanka - Skopje	÷	:	:	3 :	1 :	, :
Subtotal	2	4	196	437,300	0.26	4
Third Market Shares						
Alkaloid - Skopje	П	5.368	29 788	29.050.110	17.30	. 6
Oteks - Ohrid	-	10	655	102 920	07:71	ye.
Makedonija Tabak - Skopje		5	69	35.880	3.5	ν -
Cementarnica Usje - Skopje		44	2 319	7 357 267	20.0	- [
Cementarnica Usje - Skopje	_	13	464	72,155,201	0.40	7
Cementarnica Usje - Skopje	:	}	2	100617	7.7	0
Cementarnica Usje - Skopje	·	42	3 354	5 135 369	3.05	: 5
Komercijalna banka - Skopje		7	10	50.850	0.00	17
Komercijalna banka - Skopje	1	9	262	131,700	0.00	- 4
Adıng - Skopje	Π	15	297	569,500	0.34	· ·
Kreditna banka - Skopje		ec .	152	81,205,150	48.30	, ~
Geras Cunev - Strumica		1	5	3,865	0.002	۰-
Gradinar Loza - Skopje			43	133,300	0.08	-
ALOUK Makedonija - Skopje	 -	П	270	2,700,000	1.61	· -
City Shopping Mall - Skopje	1	74	15,612	45,497,233	27.06	14
Subtotal	13	5,582	53,300	167,694,713	99.74	115.00
Total	15	5,586	53,496	53,496 168,132,013	100.00	119
) () ()	100,104,010	707	3

Source: Stock Exchange (as of 13.11.1997).

IV. RECENT MONETARY DEVELOPMENTS

A. Overview

- 65. The FYRM achieved monetary independence in April 1992, with the introduction of its own currency. It inherited a relatively decentralized economic system from the former SFRY, including prices that were largely market determined, and a banking system similar in structure to those in market economies. However, the widespread control of banks by poorly performing worker-managed enterprises compromised the soundness of bank lending practices and the health of the banking system. Following the multiple shocks associated with the breakup of the former SFRY, enterprise losses mounted substantially and were financed by banks, such that 80 percent of bank assets were estimated to be non-performing in 1993. The NBM's policy of passively rediscounting these commercial bank loans coupled with additional directed credits, contributed to near hyper-inflationary conditions in 1992-93.
- 66. Stabilization commenced in 1994 in the context of a Stand-by arrangement with the Fund, when base money emission was brought under control and the policy of selected credits abolished, supported by a substantial fiscal adjustment. Monetary policy was focussed on a deutsche mark anchor, and proved successful in reducing inflation to industrial country levels by 1996. Increasing strains manifested themselves on the external accounts during 1996-97. The gradual loss of reserves in spite of a tight monetary policy, combined with stagnant output growth and falling prices prompted a 14.1 percent devaluation of the exchange rate vis-a-vis the deutsche mark in July, 1997. Since then money and credit growth have recovered and NBM reserves have increased.

B. Recent Developments

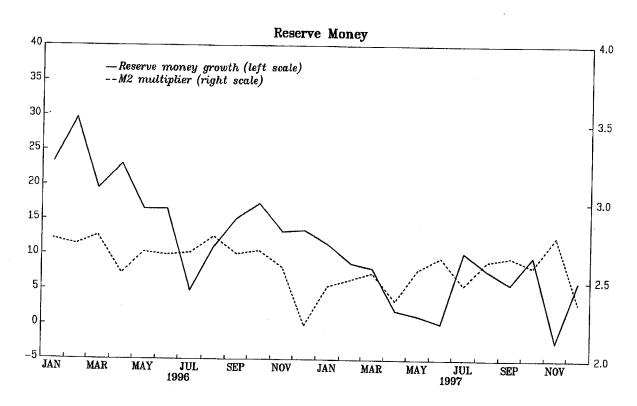
Overall monetary developments and targets

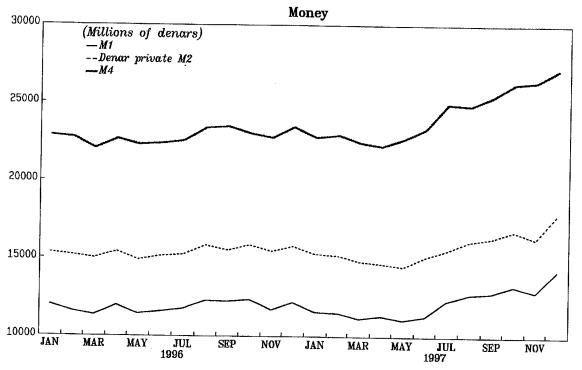
- 67. Adjustment in 1995 had been supported by a strong balance of payments, resulting from exceptional trade and capital flows under sanctions that allowed the NBM to purchase over US\$50 million of foreign exchange reserves in the market while avoiding pressure on the exchange rate. The monetary effects of these purchases were sterilized by negative domestic bank financing of the budget resulting from an almost 2 percent reduction in the general government deficit between 1994 and 1995. Control over reserve money growth was further enhanced by reforms of the largest bank which substantially reduced its need for special liquidity credits from the NBM.
- 68. With the lifting of UN sanctions against the FRY at the end of 1995, the balance of payments surplus dried up. In conjunction with a modest amount of foreign exchange intervention, monetary policy was tightened in the first quarter of 1996 to head off pressures on the denar. Subsequently, the foreign exchange market quietened and monetary conditions eased somewhat before being tightened again towards the end of the year. Supporting the exchange rate was, however, requiring an increasingly restrictive credit policy, such that money growth was on a downward trend throughout the second half of 1996. By December

12-month growth of denar M2 had dropped to only 0.4 percent, with denar private credit growth of 7.4 percent. Although the official discount rate was cut from 15 to 9 percent, market interest rates declined only modestly and lending rates were still around 20 percent in real terms by the end of the year.

- 69. In this context, the 1997 program called for the central government to accumulate deposits of denar 2,400 million at the NBM to support the unchanged exchange rate anchor, and facilitate the programs foreign reserve target of 2.3 months of imports by the end of 1997. However, the underlying pressures in the balance of payments were compounded by the failure of the largest savings house, TAT in March 1997. The ensuing loss of confidence resulted in net foreign exchange sales of US\$13 million in the first quarter and no increase in official reserves during April and May. From the beginning of the year to end-May, cumulative net market sales were US\$20 million compared with targeted purchases of US\$9 million. To preserve the exchange rate, the NBM did not compensate the effect on reserve money such that 12-month reserve money growth by June dropped to 0.2 percent and denar M2 declined by -0.3 percent (see Figure 5 and Tables 20-22). Prices were beginning to fall and real lending rates remained in the 20 percent range. In these circumstances, the denar was devalued by 14.1 percent on July 9, 1997.
- Following the devaluation, the NBM made significant purchases from the foreign 70. exchange market such that reserves increased by US\$20 million in the third quarter of 1997. Most of the purchases were from foreign exchange bureaus indicative of some degree of portfolio re-composition by Macedonian residents selling hard currency savings to finance consumption. The unwinding of previously auctioned NBM credits along with increased issue of NBM bills, was used to withdraw liquidity and sterilize the monetary effects of these large foreign exchange purchases. Slight speculative pressures that arose in the foreign exchange market in November, were headed off by unsterilized NBM intervention such that reserve money contracted by -2.4 percent. Money and credit growth, meanwhile, picked up through the last half of the year, with a spike in December reflecting a rapid extension of credit as banks rushed to meet their allowed credit ceilings, accommodated in part through a reversal of the previous months liquidity withdrawal by the NBM. While the M2 multiplier remained broadly stable through 1996-97 (see Figure 5), commercial bank liquidity trended downwards in the last half of 1997 reflecting increased lending activity (see Figure 6). At December, 12month denar M2 growth reached 13.1 percent—albeit over a low base in the previous year—from an average of 5.5 percent in the preceding three months, while credit and reserve money grew by 14.4 and 6.2 percent respectively in December (see Figure 6).
- 71. While currency in circulation increased by 6 percent in the year to December, 1997, non-government demand deposits increased by 27.8 percent from denar 4,912 million to denar 6,280 million (see Table 24), reflecting an increase in enterprise deposits. This mirrored

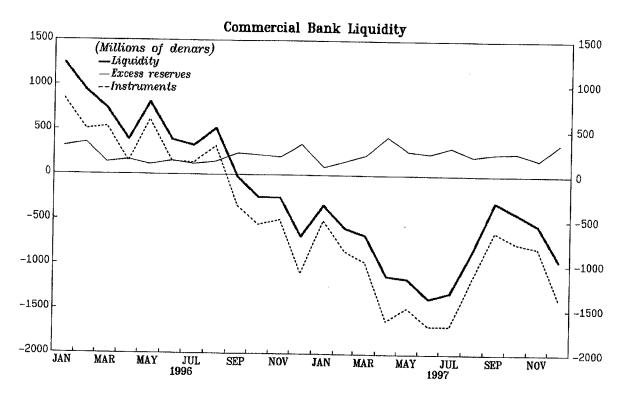
Figure 5. FYRM: Money

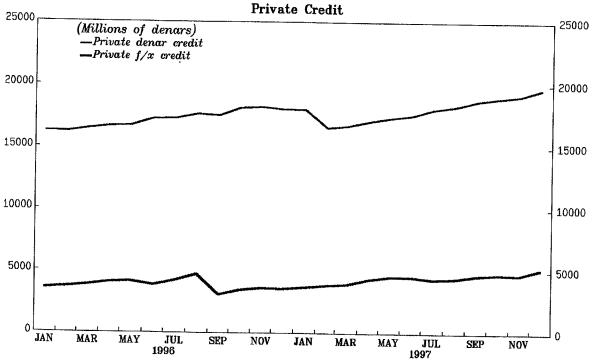




Sources: Data provided by the FYRM authorities and IMF staff estimates.

Figure 6. FYRM: Commercial Bank Liquidity and Private Credit





Sources: Data provided by the FYRM authorities and IMF staff estimates.

improved enterprise profitability but was also a counterpart of the higher credit growth to the enterprise sector. Household demand deposits in the meantime declined, suggesting that higher cash wages received by households were held in other forms. This is consistent with the nearly 54 percent increase in private quasi-money foreign currency deposits from denar 2,684 to denar 4,138 million (nearly US\$30 million), that is indicative of flows into the banking system of residents' cash foreign currency holdings. Reflecting the improved fiscal position, government deposits increased by 46 percent from denar 940 million to denar 1,374 million. Driven in part by the rapid growth in foreign currency deposits, the broadest monetary aggregate including foreign currency deposits, increased by some 16 percent (14.9 percent of GDP in 1996 compared to 16.2 percent of GDP in 1997).

72. Reported nominal lending and deposit interest rates have not varied much in 1997 (see Figure 7, Table 23). However reflecting the looser monetary conditions, implied real interest rates dropped in the second half of the year given the slight pick-up in inflation following the devaluation. Interbank interest rates also fell slightly during the year from 20.8 percent in January to 19.7 percent in December. The structure of NBM intervention rates remained unchanged in 1997, though the interest rate on deposit auction was bid up towards the end of the year rising from 12.4 percent in June to 14.2 percent by December, as the credit activity of the larger banks—which dominate the auction—picked up.

Developments in bank portfolios and lending

- 73. Following one of the largest recapitalization operations of all the transition economies—which involved government action in 1995 to transfer the operations of the 25 most indebted enterprises from the balance sheets of banks to the Bank Rehabilitation Agency—loan collection rates for the large established banks have improved, though a large share of total lending continues to not be serviced on time. This in part reflects the incidence of connected lending as well as excessive exposure to single borrowers. The improvement has been most marked since the devaluation which is a reflection in part of the improved profitability of the enterprise sector.
- 74. On the basis of loan classifications required by the NBM, non-performing loans as a percentage of total exposure dropped from 44.2 percent in December 1995, to only 41.7 percent in June 1997, but then fell to 35.6 percent by December, 1997. These aggregate figures mask significant variation, with certain banks' portfolios deteriorating markedly, and requiring enhanced attention from the Supervision Department. At the same time, newer banks are reported to have preferred to focus on fee-earning business as their main activity, without putting their capital at risk to support balance sheet activity.
- 75. Private sector credit grew by 19 percent in the year to December, of which denar credit grew by 14.4 percent. Foreign currency credit increased from a low base by 45 percent,

¹²Non-performing loans defined as loans classified into risk category 'C' or worse.

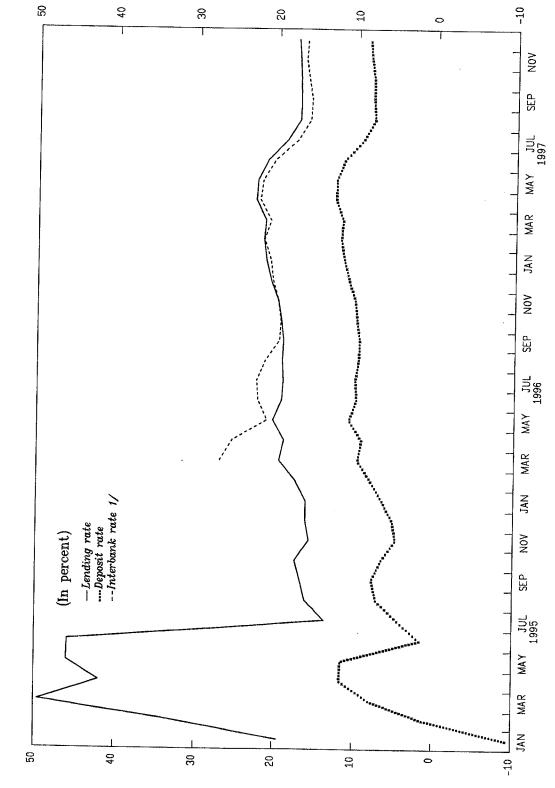


Figure 7. FRYM: Real Interest Rates

Sources: Data provided by the FYRM authorities and IMF staff estimates. 1/ The interbank market was established in 1996.

or by about US\$33 million, as commercial banks on-lent lines of credit from abroad (including US\$10 million in disbursements from multilateral institutions). This on-lending was paralleled by higher commercial bank foreign liabilities. However, commercial bank foreign assets also increased in this period, largely reflecting the strong growth in resident foreign currency deposits, ¹³ such that commercial bank NFA grew by US\$17 million during the year. Net banking system credit to the general government declined by denar 800 million during the year. The public sector ran down deposits in the first half of the year in response to the revenue shortfall, but re-built them towards the end of the year as the effects of the package of measures associated with the devaluation came into play.

- Reflecting traditional bank-client relationships, as much as one half of new lending in 1997 was to enterprises with a poor track record of loan servicing. In particular, between March and December, exposure to the 20 largest delinquent debtors increased by 21 percent from denar 10,206 million to denar 12,296 million. He by end-December, these enterprises alone accounted for almost a third of outstanding private credit. Closer analysis of the quality of the exposure to these enterprises indicates that the exposure classified on average as 'C' or worse, as of December 1997, was denar 5,707 million or about 45 percent of total exposure. There is no obvious pattern to the types of enterprises that are not servicing their bank debt on time—they include amongst others, a large metal producer, a large leather goods producer, the oil refinery as well as a large tobacco distributor.
- 77. The poor quality of portfolios has contributed to perpetuating high interest rates. While the share of non-performing loans is quite high, the level of provisioning is also very high—gross provisions consumed some 80 percent of gross interest income in 1996. As banks do have some incentive to over-provision to avoid taxes, the National Bank is responding with enhanced on- and off-site supervision to ensure appropriate provisioning. Analysis of bank balance sheet data by the NBM suggests that banks effectively collected an average net interest rate of only 11.6 percent in 1997—compared with the reported nominal average lending rate of 21.4 percent—indicative of the cost to income of the poor loan collection rate and concomitant provisioning.¹⁵

¹³Commercial banks must hold 100 percent reserves against resident foreign currency deposits in the form of liquid foreign currency assets with overseas banks.

¹⁴Defined as the 20 largest enterprises that had any loans from banks classified as 'B' or worse. Exposure includes new credits, accrued interest, as well as off balance sheet items (guarantees and letters of credit). The figure does not adjust for exchange rate valuation effects. Given estimates of the share of foreign currency exposure to these 20 enterprises as of September 1997, the inferred growth of total exposure between March and December, adjusting for exchange rate effects, is about 14 percent.

¹⁵This calculation compares interest income reported as collected by banks—adjusted for provisioning— in their profit and loss accounts, with their annual average loans outstanding.

Bank supervision

- 78. Reforms in 1995 provided budgetary resources to clean up bank balance sheets and write-off non-performing loans. Recent increases in non-performing exposure have yet to significantly affect banks' capital given the high level of provisioning, which contributes to high real lending interest rates as banks try to protect their capital. As a result, banks in FYRM are currently well capitalized, with the capital adequacy ratio for the banking system as a whole of 28.3 percent at the end of 1997, compared with the Basle minimum prescribed level of 8 percent. Largely due to foreign exchange gains following the July devaluation, bank profitability increased substantially in 1997, with banking system net profits reported at denar 1.1 billion (0.7 percent of GDP), compared with denar 450 million (0.3 percent of GDP) in 1996.
- 79. The new Bank and Savings House Act was passed in April 1996, with the various prudential norms coming into force as of April 1998. This allowed banks a period of two years to comply with the new regulations concerning connected lending, exposure to single debtors, holding of non-bank equity as well as the size of fixed assets. Bank's have been slow to move in the direction of compliance with the law, reflecting the prevalence of connected lending as well as the widespread concentration of exposure to single enterprises, even in the case of the larger banks. Following the enterprise and bank restructuring programs in 1995, several banks were required to convert their debt claims on enterprises into equity, which under the new law they are required sell. Banks have been slow to comply with this proviso given hopes that equity values will rebound as the economy recovers and foreign direct investment picks up. The large fixed assets of many banks reflect ownership of real estate, mainly bank office space as well as properties acquired as collateral for failed loans. The thin real estate market has hampered banks' efforts to sell these assets.
- 80. The Supervision Department of the NBM received additional resources in 1996-97, and is monitoring closely banks' progress in complying with the law. Eight savings houses were closed during 1997. While most were relatively small in size, the failure in March 1997 of the largest savings house, TAT has since occupied a large portion of the Supervision Department's resources and prevented implementation of the full program of on-site inspections in 1997. When the scandal was uncovered, TAT was found to have about DM 100 million in unreported deposits, equivalent to 12 percent of total deposits in the banking system. Roughly half reflected accumulated interest at high monthly rates. Realizable

¹⁶Comparing guaranty capital with risk weighted assets as per the Basle norms.

¹⁷ While there is some variation across banks, all banks met the Basle minimum standards. One savings house did not fulfill the minimum capital adequacy standards and is under close surveillance by the Supervision Department.

¹⁸Banking system return on assets increased from 1.2 percent in 1996 to 2.2 percent in 1997, and return on equity from 4.3 percent to 9.3 percent.

assets were only a fraction of recorded deposits. While the failure of TAT did not precipitate runs on banks or other savings houses, the added uncertainty fanned speculation in the foreign exchange market by exporters, contributing to the large outflows in March and subsequent sluggishness in the market. The criminal investigation into TAT's operations is ongoing. Thus far the government has announced partial compensation—financed out of the budget and NBM profits—for only small depositors, up to DM 5,000 per household for loss of original principal. Other depositors will have to await further reimbursement pending the sale of TAT's assets under bankruptcy procedures. The Supervision Department also completed in October 1997, the full on-site inspection of the largest bank, Stopanska Banka, a bank that has been under enhanced supervision for several years now in addition to facing limits on its access to NBM liquidity and general credit activity. A course of corrective actions that will be implemented by the bank has been agreed upon. Moreover, the sale of Stopanska to outside investors should lead to better management. The Supervision Department has also initiated full on-site inspections of the second and third largest banks, following a rapid expansion of lending in 1997.

V. THE FINANCIAL SECTOR

A. Institutional Structure

Banking system

- 81. The financial system comprises the central bank, 21 local banks, one foreign branch (from Russia), 20 local savings houses, and a national insurance company. The Post Office also acts as a savings institution. An independent central bank was established with the passage of the National Bank law in April, 1992. The law defines the main goals of the NBM to include safeguarding the value of the currency and supervising the banking system. The NBM prepares an annual program incorporating inflation and monetary targets, which is submitted for approval by parliament. Given the continuing reliance on direct credit controls, the NBM simultaneously releases a quarterly credit program, on the basis of which bank-by-bank credit ceilings are set and announced to banks.
- 82. The banking system continues to be relatively concentrated with the top three banks accounting for 60 percent of total assets. Further, the system remains dominated by Stopanska Banka which accounted for 36 percent of total assets in 1997. The share of the top three banks in total banking system assets has however declined from 68 percent in 1995, and the relative size of Stopanska Banka, has also diminished with its share in total banking system assets declining from 44 percent in 1995. Several savings houses were closed in 1997—most notably, the savings house TAT—and the remaining savings houses account for only a small share of total banking system assets (1.3 percent at end-1997). Minimum capital requirements have been established in terms of deutsche marks. Currently, DM 12.5 million are required for full licenses which permit overseas payments and foreign currency transactions, and DM 4 million for domestic licenses—savings houses are permitted only domestic licenses.

These requirements are due to be increased to DM 21 million and DM 7 million respectively by April 2001.

Deposit Insurance Fund

83. The provisions of the National Bank Law established the NBM as the guarantor of the security of household deposits in FYRM. This issue had a special resonance in FYRM following the experience of the freezing of household foreign currency deposits—amounting to more than 20 percent of GDP—when the counterpart assets were lost following the breakup of the SFRY. Recognizing the open-ended nature of this commitment, the authorities established a Deposit Insurance Fund (DIF)—as required by the new Banks and Savings House Act passed in April 1996—owned and financed by the commercial banks. The DIF was set up as a limited company with a board of directors comprising representatives from commercial banks, but subordinated to the NBM. Its activities are financed by a premium of $2\frac{1}{2}$ -5 percent levied on banks' deposit holdings. The goal is for the volume of the DIF's assets to ultimately reach 15 percent of total banking system liabilities. The authorities are in the process of modifying the DIF's by-laws to cap coverage at DM 10,000, and clarify that coverage will apply only in the case of insolvent—as opposed to illiquid—banks.

B. Instruments of Monetary Policy

While the fixed exchange rate against the deutsche mark provides the nominal anchor for monetary policy, reserve money is the main intermediate target for the NBM. In this context an assessment of the stance of monetary policy is made based on the NBM's ability to purchase foreign exchange on the open market, in conjunction with developments in credit to banks. In the event that a persistent shortfall occurs in the foreign exchange market, the NBM withdraws liquidity from the banking system, allowing reserve money to fall below the programmed targets. In the event of inflows of foreign exchange, the NBM smooths the impact on reserve money by tightening banks' access to NBM liquidity.

Credit ceilings

Bank-by-bank credit ceilings were introduced in January 1994, to control the expansion of domestic credit and for prudential reasons. The factors motivating the imposition of credit ceilings were, (i) the difficulty of predicting money demand in a small open economy, (ii) the uncertainty over the exact nature of the monetary transmission mechanism, and (iii) the prevalence of poor lending practices reflecting the close ownership links between banks and specific enterprises. Aggregate monthly credit ceilings are derived from the quarterly monetary program, and are allocated to banks and savings houses in proportion to their level of capital less foreign exchange position. As a result, market shares tend to be perpetuated without regard for the ability of individual banks to mobilize additional deposit resources. Credit ceilings apply to all forms of denar credit to the private sector with the exception of interbank loans. Banks are penalized for exceeding their credit ceilings by being disallowed from granting any new credits for 15 days following the violation. In 1996-97, developments

in the foreign exchange market required a sufficiently tight monetary policy such that credit ceilings were by and large, not been binding.

Reserve requirements

Reserve requirements for commercial banks' have remained unchanged since 1993 at 86. 8 percent for sight deposits (for savings houses the equivalent rate is 4 percent) and 4 percent for longer-term deposits (for savings houses the equivalent rate is 1.5 percent). The maintenance period runs from the eleventh day of a given month to the tenth day of the next month. Compliance with reserve requirements is determined on the basis of the average daily deposit balances in the banks' reserve account at the NBM during the maintenance period. Compulsory reserves earn an interest rate of 3.4 percent while excess reserves are not remunerated. On any given day, banks may draw down that account up to a remaining balance of no less than 60 percent of the previous month's reserve requirement. If a bank's required reserve funds fall below this limit, it has to pay a penalty rate of interest equivalent to 3 times the discount rate—currently 26.7 percent. In the event that compulsory reserves are exhausted, banks may as a last resort overdraw their giro account balance. In the past this was subject to an additional penalty rate of charge, though since January 1997, the rate of charge on a negative giro account balance has been the same as the rate of charge for use of compulsory reserves. Average reserve requirements have not been used as an active monetary policy instrument, though in the past, marginal reserve requirements have been implemented to limit the liquidity of specific banks.

NBM credit auctions

- 87. NBM credit auctions are the main short-term intervention instrument. Credits are uncollateralized and auctions take place on a daily basis. The Banking Operations Department determines the amount of credit to be auctioned in consultation with the Research Department on the basis of daily liquidity forecasts which take into account the overall monetary program targets as well as the projected liquidity changes arising from budget operations, foreign exchange transactions, and the seasonal movements in the demand for cash. The auctions have generally been used to inject liquidity into the financial system, barring a period after the devaluation when they were used to sterilize the monetary effect of the NBM's large foreign exchange purchases.
- 88. The NBM circulates a daily prospectus to banks, informing them of the total volume of credit to be auctioned on the next day as well as the minimum interest rate. Banks enter confidential bids—with multiple bids allowed—and the NBM allocates the credit, in order, to the highest bids until the total available is exhausted. Each bank pays its bid interest rate. The minimum interest rate is a policy decision of the NBM and currently stands at 11 percent, while the actual interest rate is determined in the auction and is currently on average about 14 percent. During 1997, most activity was concentrated in the auction of credits with a maturity of 7 days. All banks may participate in the auction, subject to a prudential access

ceiling which was previously 50 percent of a banks' total capital. ¹⁹ Given this limit and the current capitalization of the banking system, the NBM could in theory extend credit of about denar 5,000 million using this facility, though the current outstanding is only about denar 1,500 million. The NBM may not deny a bank access to this facility in the event of any unusually high bid that might suggest underlying problems. Instead, it would be up to the supervision department to take appropriate steps.

National bank bills

National bank bills are auctioned by the NBM at irregular intervals. The average level of bills outstanding in 1997 was denar 300 million or some 5 percent of the average level of reserve money. The low interest rate offered by the NBM—currently 8.2 percent—combined with the long maturities—mostly 30 and 60 day bills—have inhibited the deepening of this market. As part of an initiative to move towards more indirect instruments of monetary control, plans are under consideration for improving the yield and liquidity characteristics of these instruments as well as holding regular auctions on a fixed schedule. Bills bought in the primary market can be rediscounted at the NBM or used as collateral for Lombard credits. The NBM can also repurchase these bills as a means of injecting liquidity, though this has yet to occur in practice.

Lombard credit facility

90. The NBM operates a Lombard credit facility to provide lender-of-last-resort funds to banks. Banks must provide collateral equivalent to twice the amount of credit desired, in the form of only NBM bills or government bonds. In practice, this means that only seven banks are currently able to obtain access to these credits. The interest rate charged on this facility is currently 14.4 percent with a maturity of seven days. While this rate has generally exceeded that on the NBM's regular credit auctions, it is substantially lower than rates prevailing on the interbank market. It is however difficult to compare these rates as interbank loans are not collateralized.

NBM interest rate policy

91. NBM interest rate policy is constrained by the low level of financial market development and the lack of a fully articulated set of indirect instruments. The NBM sets a discount rate which forms the basis for much of the structure of other NBM interest rates. Most other rates are determined as some fraction of the discount rate. Given the wide spread quantity rationing of credit, the discount rate is more indicative of the NBM's monetary policy stance than a market clearing interest rate.

¹⁹The NBM has announced its intentions to vary this prudential ceiling as a means of signaling its credit stance to banks in advance.

Inter-bank money market

92. An inter-bank money market was established in 1996. At first the market was segmented with the more active part having deals brokered by the NBM, with the other comprising direct bank-to-bank transactions. Market liquidity was initially quite low during the first year of activity. At the same time interest rates in the inter-bank market—while lower for National Bank brokered placements—remained significantly above interest rates on the NBM regular credit facilities. Towards the end of 1997, the NBM stopped acting as a market maker in the inter-bank market. This function was instead taken up by an independent self-financed agency, set up as a corporation under the Company Law. It is too early to discern a systematic shift in the volume of placements since the founding of this interbank money market agency. By all accounts, one of the main factors retarding the development of this market is the lack of adequate collateral—most transactions are uncollateralized—which in part explains the perpetuation of the high cost of funds.

C. The Payments System

The system

- 93. The Macedonian BPO²⁰ is the successor to the former SFRY Social Accounting Service (SOK), and came into existence in its present form at the end of 1993. In part reflecting the legacy of hyperinflation, the SOK operated with modern computerized systems and facilitated rapid clearance of payment orders throughout the economy, frequently within one day. FYRM has inherited this relatively effective payments system, giving it in this regard a distinct advantage over many other transition economies.
- 94. In addition to operating the payments system, the BPO is responsible for (i) distributing banknotes and coins, (ii) auditing the financial operations of enterprises, (iii) monitoring enterprise liquidity, (iv) implementing and monitoring the wage control law, and (iv) administering the collection of several types of government revenue including the various taxes on labor income, profit tax, sales tax and excise taxes.
- 95. The BPO's operation of the payments system centers around its management of payment flows through the so-called *giro accounts* (currently numbering around 85,000). These are the mirror images of the participants' accounts with commercial banks and the NBM. All legal entities and public agencies must maintain a BPO giro account for the settlement of payments, as do most self-employed persons and private individuals. Typically entities participating in the BPO system must maintain demand deposits with a commercial bank of their choice. Banks on the other hand have separate giro accounts that are the mirror images of their current accounts and required reserves at the NBM. Importantly, the giro accounts do not represent a liability of the BPO which merely processes flows between the economy-wide giro accounts. The NBM has been given nominal oversight over the BPO,

²⁰In Macedonian, Zavod za Planten Promet (ZPP)—the Institute for Domestic Payments.

which in practice remains fairly autonomous. To facilitate its own operations, the NBM maintains three accounts with the BPO—one for transacting with banks, the second for interest payments and other normal operations, and the third for the distribution of banknotes by the BPO.

96. Payment orders submitted to the BPO are typically executed within the same day by settlement time at 8 p.m. However the information regarding the corresponding movement in their deposits is not provided to banks until the next morning. The NBM had in the past been forced to provide an overdraft to banks for any shortfall in meeting required reserves. The concomitant risk to the NBM has been mitigated by pushing the settlement time for the reserve account to the following morning. The costs of the BPO's operations are covered by revenues from ad valorem fees on transactions through giro accounts and no differentiation is made by type of entity, value or timing of the transaction. Until recently, banks were also charged for interbank transactions.

Weaknesses of the current system

- 97. The BPO provides FYRM with a quick and secure payments infrastructure. A testament to the speed and efficiency of the BPO is the fact that there has never been any significant net float in the banking system, which is in marked contrast to the past experience of other transition economies. Further, FYRM has been insulated from the kind of revenue collapses experienced in several BRO countries, in part due to the effectiveness of the BPO in collecting its portion of tax revenue. However, there remain several weaknesses with the way in which the system is designed and operated.
- 98. The BPO is a highly centralized monopoly, that has not evolved in response to the demands of the market. a more decentralized payments system would provide a boost to the inter-bank market, allowing for the further development of indirect instruments of monetary control. This would relieve the NBM of the intra-day credit risk that it is currently exposed to in its role of implicit guarantor of the centralized payments system.
- 99. Currently, the NBM guarantees settlement of the payments obligations incurred by a failing bank, shifting the intra-day credit exposure from other banks to the NBM. If a bank fails in the course of a day, other banks have a claim on the NBM equal to the negative position in the giro account of the failing bank at the time of its closure. While such events

²¹Large net float positions impede the ability of a central bank to effectively implement monetary policy. This has been a major focus of the inter-action between payments system reform and the conduct of monetary policy in other transition economies where large floats impeded early attempts at establishing monetary control. For example net float as a share of reserve money in the first half of 1992 averaged some 5 percent in Poland and 16 percent in Bulgaria, compared with 0.09-0.027 percent in the United States (Baliño, Dhawan, and Sundararajan (1994)) and virtually zero in FYRM.

may be rare, the resulting involuntary accommodation of settlement needs exposes the NBM to considerable credit risk in a time of crisis.

In the past, commercial banks did not know the positions on their giro accounts until 100. late in the evening by which time it was too late to cover any shortfalls in the money market. This resulted in banks' holding large—inherently costly—excess reserves. The inability of commercial banks to monitor their intra-day liquidity had in part hindered the formation of an active inter-bank market. In early 1996 this problem was addressed by allowing banks to cover the shortfall in their reserve accounts through the NBM brokered inter-bank market, the next morning prior to the start of the day's business. This is, however, not quite the same as an inter-bank market that allows banks to manage intra-day large value liquidity needs on a real time basis. Another problem facing banks under the current system is their inability to control payments for other purposes by clients who are delinquent, as their clients submit orders directly to the BPO which has no role in enforcing commercial obligations. Further, users of financial services frequently deal directly with the BPO bypassing their banks, which greatly reduces the incentives for banks to compete with each other in the provision of payments services. Finally, payments systems in other countries are often owned by those who use the system. This creates incentives to develop appropriate computer and communications networks as well establish efficient fee schedules. The fact that the present system processes payments quickly reflects a large investment in technology which, however, may not reflect a cost minimizing—and therefore efficient—allocation of resources.

Plans for reform

- 101. Further reform of the payments system is an important objective under the ESAF supported program. The long term strategy envisions movement to a real time gross settlement system operated by the NBM, for large value transactions. More numerous retail payments (currently over 90 percent of the total volume of transactions) would be processed on a net basis through a separate clearing house with final settlement on the books of the NBM. The result would be a redistribution of the BPO's existing functions and competencies among other entities. Interim measures would maintain the central role of the BPO, but be aimed at improving the efficiency of its functioning through better information flow, greater competition and a rationalization of its pricing scheme.
- 102. The timing of these measures is being considered in the context of ongoing technical assistance from the Monetary and Exchange Affairs Department of the IMF, and taking into account the important role of the BPO in the collection of public revenues. As an initial step in the transformation of the BPO, the NBM has already been made responsible for supervising the clearing functions of the BPO. Transactions volume on the interbank market remains relatively low, partly because liquid banks have perceived such lending as too risky. Further, corporate entities, previously allowed to submit payment orders only to the BPO, have been offered the option of initiating payments through commercial banks. In tandem with this, the NBM has set up a scheme for commercial banks to themselves process the clearing of large value payment orders (above 5 million denars), arriving at figures for final net settlement by the BPO. It is expected in the future that the BPO will cease to accept and process payment

orders of nonbank entities, in effect leaving banks as the only entities with active giro accounts.

103. Currently, the BPO in effect withholds personal income and social security taxes on wages. The BPO enforces this by not processing payment orders for wages unless the corresponding taxes had been paid. In order to address tax compliance problems, the BPO was further empowered under a July 1997 amendment of the Financial Working Law, to withhold these taxes even if wages have not been paid. As the tax administration department continues to strengthen its audit and collection functions, the BPO will ultimately be relieved of controlling the withholding and administration of these taxes. Under the new Bankruptcy Law, the BPO has been relieved of the responsibility to seize the assets of debtors in the course of enforcing commercial contracts.

VI. FISCAL POLICY AND DEVELOPMENTS

A. Overview

- 104. A tight fiscal stance has provided strong support to the FYRM's adjustment strategy since 1994. The general government deficit in that year fell sharply to less than 3 percent of GDP and was reduced progressively in 1995 and 1996 to only 0.5 percent of GDP (Tables 25 and 26). In order to support a reduction in the external current account deficit, it was planned that the general government would run a surplus in 1997. However, a weakening of the economy and a deterioration in tax compliance caused an unexpected decline in revenue in the first half of the year, which undermined the plan. The policy strategy was adjusted at mid-year to allow the exchange rate and incomes policy to provide more support for external adjustment. The revised strategy was supported by measures to bolster government revenue and reduce discretionary expenditure. Even so, the original fiscal target was missed with the deficit 0.4 percent of GDP in 1997.
- 105. An improved outlook for external financing, notably expected receipts from the privatization of Macedonia Telecom, and a strong structural reform program, permitted some mild relaxation of the fiscal stance in 1998. The general government deficit is projected to rise to 0.7 percent of GDP. With economic recovery providing for some strengthening of revenues, there is scope to increase public investment from its very low level.

B. Recent Fiscal Developments

Revenue

106. General government revenue, which had declined from 42 percent of GDP in 1995 to 41 percent of GDP in 1996, fell sharply during the first half of 1997 in the context of a stagnating economy and a related deterioration in tax compliance. Weakness was spread over most tax categories and social security contributions. At the central government level, a decline in revenue was accentuated by the effects of trade liberalization, which pushed revenue

from import duties down by 24 percent in the first half of 1997 compared to the same period of 1996. A halving of the profit tax rate to 15 percent also contributed to the weakness in tax revenue. However, a 50 percent cut in excise duties on tobacco products did not lead to revenue losses (excise collection actually increased by 6 percent in the first half of 1997) as the introduction of excise stamps and efforts to restrict illegal sales helped to considerably reduce tax evasion. A unification of sales tax rates on services was broadly revenue neutral.

- 107. Social security contributions declined by 7 percent in the first half of 1997 compared with a year earlier. The decline can be traced to severe cash-flow problems encountered by enterprises as monetary policy was tightened to support the exchange rate. The cash flow squeeze led to a vicious circle for revenues as inter-enterprise arrears escalated and lower revenue collection undermined the government's cash flow and led to rising government payment arrears. The circle was reinforced by the perception that penalties for non-compliance were weak.
- 108. The economic recovery and improvement in liquidity that took place in the wake of the July 1997 devaluation alleviated some of the downward pressure on revenues. Revenue collection also received a considerable boost in the second half of 1997 from one-time incentives to clear unpaid personal income tax and social security contributions, and from measures to strengthen tax compliance. At the same time, the government coordinated an attempt to net out inter-enterprise arrears, and, through a tight Supplementary Budget (see below), to help reduce government payment arrears.
- 109. The incentives to pay back taxes took the form of either a 70 percent discount for settlement of arrears within 90 days or payment in installments over a specified time period. Most enterprises took advantage of the discount, while the majority of the installments were paid in 1997. To strengthen compliance, the Financial Working Law (FWL) was amended in June 1997 to empower the BPO to deduct every month from each enterprise's giro account, the minimum presumed social security contributions calculated on the assumption that each reported worker earns at least the minimum wage. If sufficient funds are unavailable, the giro account with the BPO is blocked until the shortfall is remedied.
- 110. These various measures succeeded in increasing social security contributions dramatically, with payments under the discount and installment provisions alone yielding the equivalent of 1.8 percent of GDP in the second half of 1997. Overall, social security contributions were 25 percent higher in the second half of 1997 compared to the corresponding period of 1996. The recovery in taxes was less dramatic, in part because the

²²In addition to a cut in the average effective tariff rate, preferential trade agreements were signed with Slovenia (February 1996), Yugoslavia (October 1996), Bosnia (January 1997), and Croatia (March 1997). Such liberalization more than offset the positive revenue impact of the tariffication of quotas.

²³However, some repayment schedules stretch out until the year 2000.

FWL did not authorize the BPO to deduct personal income taxes from bank accounts directly.²⁴ In addition, oil excises were reduced in August to mitigate the impact of the devaluation on oil prices and to lower inflationary expectations. There was, however, a significant recovery in import duties as the devaluation raised import prices.

111. As a result of the second-half recovery in revenues, general government revenue in 1997 was slightly higher than the 1996 level, although about 1 percentage point of GDP less than the amount forecast at the time of the 1997 budget.²⁵ As a percent of GDP, revenue fell from 41 percent in 1996 to 39 percent in 1997.

Expenditure

- 112. With rising numbers of unemployed and retirees putting upward pressure on expenditure on social benefits and pensions, the burden of expenditure adjustment has fallen primarily on discretionary items in the last few years. Public investment has been particularly hard hit and by 1996 had already declined to 2.8 percent of GDP. A wage freeze for budget sector employees has also been in effect since 1995, and this has facilitated a decline in spending on wages and salaries as a share of GDP. The continued stagnation of the economy in the first half of 1997 and a further shakeout of labor kept the pressure on social expenditures in 1997. These pressures, in tandem with the weakness in revenues, led the government to incur sizable arrears to bond holders, suppliers, and benefit recipients.
- 113. In response to the strains on the budget and in the context of the mid-year macroeconomic strategy change, the authorities introduced a tough supplementary budget. ²⁶ Although some loosening of the fiscal stance was tolerated, the supplementary budget scaled back expenditure appropriations by denar 2.7 billion (1.6 percent of GDP) relative to original budget plans. The axe fell hardest on investment plans, which were scaled back by denar 1,600 million (1 percent of GDP), although cuts in procurement were also sizable. In the event, the response of revenue to the changes in the FWL greatly exceeded expectations. As a consequence, the full supplementary budget cuts were not implemented. In particular, some denar 600 million was restored to the investment budget. Even so, investment amounted to only 1.5 percent of GDP in 1997.
- 114. In the end, general government expenditure on an accruals basis in 1997 was held to a level close to the 1996 level, although it declined as a share of GDP to 39.4 percent from

²⁴ However, the presumptive nature of the FWL as regards social security contributions is reducing the incentive for enterprises to under-report their total wage-bill, which should have a positive impact on income tax collection.

²⁵After adjusting for changes in the accounting treatment of local taxes.

²⁶Although the supplementary budget was not approved by parliament until September 1997, lower spending targets were enforced from July.

41.5 percent in 1996. Expenditure was about 1.3 percentage points of GDP higher than projected at the time of the budget. The main overrun was in health spending, where a planned reduction in arrears to suppliers was not made. However, pension expenditure was also higher by 0.2 percentage points of GDP, owing to 2 percent more retirees than projected, and interest payments were 0.3 percentage points of GDP higher than budgeted.

The fiscal stance

- 115. The general government deficit on an accruals basis was 0.4 percent of GDP in 1997 compared with a planned surplus of 1.5 percent. However, of the 1.9 percent of GDP difference, some 0.8 percentage points of GDP reflected the non-repayment of Health Fund arrears implying a difference on a cash basis of 1.1 percent of GDP. Taking into account the unexpectedly higher interest expenditures, the current account surplus on a cash basis was only 0.8 percent of GDP lower than planned.
- 116. In 1997, the central government ran an accrued deficit of 1.4 percent of GDP while the social funds were in surplus. The Pension Fund, after receiving budgetary transfers equal to 2.4 percent of GDP, ran a surplus of 0.7 percent of GDP, which was used to repay pension arrears and a bank overdraft. The Road Fund ran a surplus of 0.2 percent of GDP. The Employment Fund's budget was roughly balanced; its stock of arrears (mainly overdue unemployment benefits) stood at 0.2 percent of GDP at the end of 1997.

C. The 1998 Budget

- 117. The availability of foreign financing and a strong structural reform program justified a moderate loosening of the *projected deficit* at the general government level to 0.7 percent of GDP in 1998. The deficit will be financed entirely by borrowing abroad, mostly from official multilateral sources.²⁷ The projection assumes an increase in nominal GDP of 8 percent in 1998.
- Reflecting the impact of the devaluation on import prices, import duties are projected to increase by 16.3 percent, while profit taxes increase, admittedly from a very low base, by 26 percent owing to an expected recovery in enterprise profitability and administrative changes that will force firms to make larger payments towards estimated taxes. In contrast, personal income taxes and social security contributions are projected to fall sharply, as payments under the discount provisions of the FWL cease. Revenue in the first four months of 1998 was running at a pace consistent with the annual target.
- 119. General government expenditure is projected to rise by 3.6 percent. Total expenditure on goods and services will rise by 4.2 percent, partly reflecting a 3 percent increase in central government employment to staff the newly established Intelligence Service, Public

²⁷Including assumed pre-privatization from the IFC for Macedonia Telecom.

Prosecutor's Office, and Forestry Service, as well as to hire more teachers. Expenditure on social programs will decline by 3.2 percent in part because of a reduction in eligible unemployment benefit claimants. Capital expenditure will grow by 40 percent, albeit from its severely compressed base.

The projections are subject to considerable uncertainty as the main innovation in the 120. 1998 budget, a tax scheme to tackle the very high unemployment rate, is difficult to cost. Under this Program for Employment (PfE), personal income tax and social security contributions are waived until January 2000 for new hires who were long-term unemployed, whose firms went bankrupt, or who were laid off.28 To claim the exemption, firms must increase their total workforce above their December 1, 1997 level. The Program supplements the wage subsidies already paid to employers of unemployed persons. The budget assumes that the dead-weight cost of the PfE (i.e., the taxes lost from those enterprises that would have increased their employment regardless of the tax incentive) will be largely offset by savings in social security benefit and unemployment benefit payments. In this regard, the authorities assume that the generosity of the tax incentive (social security contributions and personal income taxes add about 80 percent to net wages) will encourage registration of unregistered workers, who may be claiming benefits. The budget makes a net provision of denar 200 million for the cost of the PfE, however it is unclear whether agents will be able to find and exploit loopholes in the Program. As of early May, take up of the tax exemption was broadly in line with expectations (the exemption was claimed on behalf of 17,000 workers) and the cost was not running ahead of the annual budget provision.

D. Longer-Term Fiscal Issues

Tax reform

- 121. A VAT is scheduled for implementation in January 1999. The enabling legislation, which has been drafted with the help of IMF technical assistance, is scheduled for approval in June 1998. The draft law recommends a general VAT rate of 24 percent and a reduced rate of 5 percent; it is unclear what goods will fall into the latter category. There are statutory exemptions for exports, health-care, financial and insurance services, and education. After the VAT law is passed, a pilot project will assess the level of preparation among tax-payers and administrators. The Law on Excises and the Law on Property Taxation will be modified to ensure consistency with the VAT Law.
- 122. There are also plans in 1999 to reform the personal income tax, in line with World Bank technical assistance, so as to eliminate disparities in the treatment of different types of

²⁸More precisely, the exemption applies to new employees who: (i) were registered with the Employment Fund as being unemployed on December 1, 1997; or (ii) have either been unemployed for over 1 year, or fall into one of two categories: workers whose firm went bankrupt or workers who were made 'technologically redundant'.

income. The profit tax is to be amended to reduce the scope for firms to delay their tax liability.

Expenditure reform

123. The authorities are preparing a plan to restructure public expenditure. The plan will address the structure of spending ministries as well as the level of budget sector employment. A World Bank public expenditure and management review in 1999 will help the authorities refine and implement their plan. During 1998, complementary legislation to define the roles and responsibilities of the public administration will be introduced.

E. Public Debt

- 124. Public sector debt amounts to about 60 percent of GDP. Most of this debt is denominated in foreign currency, with some 34 percent of GDP being owed to foreign official and commercial creditors. The main domestic liabilities are household foreign currency deposits, which the government assumed from the commercial banks around the time of independence when the banks lost access to their foreign currency assets held by the Central Bank of the former SFRY. The deposits are denominated mainly in deutsche marks, accrue interest at the rate of 5 percent per annum, and were valued at about DM 1,150 million (21.4 percent of GDP) at end-1997. Other domestic debt includes a limited amount of bank recapitalization bonds.
- 125. Hitherto, the foreign currency deposits have been "frozen", with cash withdrawals so far having only been allowed on the grounds of social need. However, the deposits can also be used to purchase government property, including socially-owned enterprises (in the context of the privatization program), government flats and business offices, and to pay customs duties when importing for private consumption. The servicing of the deposits would impose a sizable new burden on the budget, although the burden could be reduced by spreading repayment over a long period, canceling withdrawals for social need, reducing the interest rate cost significantly, and retaining options to use the deposits to purchase government assets.

VII. THE GENERAL GOVERNMENT SECTOR

A. Overview

126. Since independence, *revenue* collection has been relatively buoyant, in marked contrast to the widespread deterioration experienced by other transition economies. Current revenue to GDP ratios are very high for a country with FYRM's GDP per capita, and far exceed the levels in comparable transition economies. The relatively high revenue ratio partly stems from the high rates of mandatory withholding on labor income. Government *expenditure* in FYRM, as in other transition economies, represents a very high proportion of GDP. Further, the structure of expenditure raises concerns. Specifically, public investment is low while expenditure on wages and transfers—particularly for social benefit programs—is high. The low level of discretionary expenditure implies that, if revenues are lower than expected, the government has limited flexibility to adjust, and is forced to run up arrears. This problem is exacerbated by poor cash management. In addition, the low level of spending on investment, maintenance and equipment is in itself undesirable.

B. Structure of the General Government

- 127. The general government in FYRM comprises the central government, the local governments, and several funds which operate outside the central government budget. The major extra-budgetary funds are: the *Pension and Disability Fund* ('Pension Fund'); the *Employment Fund*; the *Health Care Fund* ('Health Fund'); and the *Road Fund*. Of these four, the first three are by far the most significant. The operations of local government are quantitatively negligible. Total public employment in 1997 was estimated at 93,397. Of these, about 68,000 were employed by the central government, while 23,800 workers were employed in the health care sector, receiving their wages and salaries from allocations provided by the Health Fund.
- 128. The central government and the extra-budgetary funds are linked by a complex system of transfers. The central government contributes to the financing needs of all the major funds;²⁹ total central government transfers to the funds stood at 4.2 percent of GDP in 1997. Some of the funds rely on budgetary transfers to a significant extent, although the central government does not automatically cover their deficits. Inter-fund transfers include transfers from the: (i) Pension and Disability Fund to the Health Fund, to cover health insurance for pensioners (1.4 percent of GDP in 1997); (ii) Employment Fund to the Health Fund, to cover health insurance for all registered unemployed (0.5 percent of GDP in 1997); and, (iii) Transfers from the Employment Fund to the Pension Fund, to cover pension contributions for all recipients of unemployment benefits (0.5 percent of GDP in 1997).

²⁹Prior to 1998, the central government did not contribute to the financing of the Health Fund. However, with the introduction of the PfE, the central government will provide direct transfers to the Health Fund in the event of a shortfall in contributions.

The central government

129. The budget of the central government covers the expenditures of the 15 national ministries, 20 other government organizations and agencies, the courts and public prosecution offices, and various independent organizations such as schools, research institutions, and cultural organizations. Some 46 percent of all central government employees, are employed in the education sector. Other significant employers are the Ministry of Internal Affairs (15 percent), and the Ministry of Labor and Social Policy (8 percent).

The Pension Fund

- 130. The Pension Fund collects contributions towards old-age, survival, and disability pensions from all workers. It pays the corresponding pensions, provides pensioners with health coverage, gives monetary compensation to the bodily injured, and pays for the training of invalids with diminished working capacity. A new Pension Law was introduced in 1994 which provides for a gradual increase in the retirement age, a reduction in the replacement ratio, and a shift to a less generous method for computing the pension base.
- 131. In 1997, Pension Fund revenues amounted to 12.5 percent of GDP. Of this total, 72 percent came from contributions levied on enterprises' payrolls. The contribution rate is set at 20 percent of gross wages. An additional 20 percent of Pension Fund revenues, or 2.4 percent of GDP, consisted of transfers from the central government. About 86 percent of total 1997 expenditure was on pensions, with health insurance for pensioners, and benefits for the handicapped, accounting for another 13 percent. In 1997, the Pension Fund ran a surplus of 0.7 percent of GDP that financed arrears clearance and repayment of bank loans.

The Health Fund

- 132. FYRM inherited a highly decentralized and locally funded health system. The country was divided into 33 districts, each of which had its own network of facilities which were 'socially owned' by health workers and communities. In 1991, all the district health insurance funds were merged into a single, centralized Health Fund. In 1994, all the socially owned facilities were converted into a single network of public sector health facilities, under the supervision of the Ministry of Health. The various health care facilities depend on the Health Fund for most of their financing needs, but are autonomously administered.
- 133. In 1997, Health Fund revenues stood at 6.4 percent of GDP. Of this total, 63 percent came from payroll contributions, levied at a rate of 8.6 percent of gross wages. 23 percent of the revenues consisted of transfers from the Pension Fund, and 8 percent of transfers from the Employment Fund. The cash budget of the Health Fund was roughly balanced in 1997.

The Employment Fund

134. In 1997, Employment Fund revenues amounted to 2.4 percent of GDP. Of this total, 25 percent came from payroll contributions, levied at a rate of 1.5 percent of gross wages.

The remaining revenues consisted almost entirely of transfers from the central government. Unemployment benefits accounted for 53 percent of the Employment Fund's total expenditures. The Employment Fund also pays pension contributions on behalf of recipients of unemployment benefits; this accounted for a further 21 percent of total expenditures. Finally, the Employment Fund provides health insurance for all registered unemployed; this accounted for 22 percent of its total expenditures. The Employment Fund's budget was roughly balanced in 1997.

The Road Fund and local governments

- 135. The Road Fund is responsible for the construction and maintenance of roads. Its overall expenditure has decreased sharply, from 1.8 percent of GDP in 1995 to 0.8 percent in 1997, reflecting lower central government capital transfers for road building.
- 136. While the number of municipalities was increased from 35 to 124, in 1997, their operations continued to account for only 0.6 percent of GDP. Their responsibilities are limited to culture, sports, garbage collection, and the maintenance of parks. Even in these areas, local governments' autonomy is limited by standards and guidelines set by the central government, and by the fact that some expenses, such as teachers' wages, are paid directly by the central government.

C. General Government Revenues

- 137. Since independence, revenue collection has been buoyant and revenue to GDP ratios have remained high, relative to comparable transition economies. Specifically, between 1992 and 1997 FYRM's general government revenues only declined from 40.5 to 38.9 percent of GDP (see Tables 25 and 26) compared with, for example, a decline in Bulgaria from 38.5 to 31.1 percent of GDP, and in Romania from 37.3 to 29.7 percent of GDP.
- 138. The relatively high revenues reflect four main factors. First, FYRM relied on profit taxes less than other former socialist countries: only 4.3 percent of 1991 revenues came from this source. Hence, when profits collapsed throughout the region, reflecting a faster decline in output than in real wages and employment, the impact on FYRM was relatively modest. Second, there are high rates of mandatory withholding on labor income. Third, the BPO is very effective at withholding and collecting taxes given its monopoly on the execution of most financial transactions, and consequent information regarding tax-payers. Fourth, the tax system has been greatly simplified, reducing the scope for tax evasion. In particular, a sweeping reform in 1994 consolidated the nine different personal income taxes into a single tax, and eliminated a number of exemptions.
- 139. A heavy reliance on labor-based taxes—some 48 percent of total general government revenue in 1997, and 20 percent of GDP in 1997—despite the considerable shrinkage of employment since independence, implies that marginal labor taxes are very high. In particular, income taxes and social security contributions together amount to about 80 percent of take home pay. Such high taxation has adverse implications for competitiveness and labor demand

and thus provides a source of vulnerability to the overall tax base. Furthermore, a shift in the distribution of income from labor to profits, which might be expected to take place under the transition process, would lead to a significant decline in the tax to GDP ratio, given that the profits tax rate is only 15 percent (see Tables 25, 26 and 39 and Figures 8 and 9).

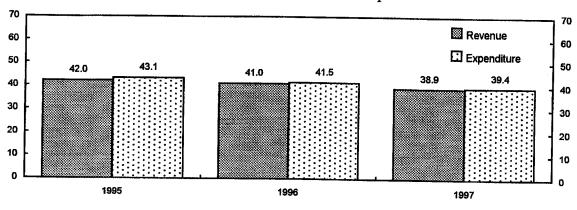
- 140. Indirect taxation accounts for just over 40 percent of general government revenues. The main components are excises (18 percent of the total in 1997), sales tax (14 percent), and trade taxes (9 percent). Excise duties on oil derivatives, tobacco, and alcoholic beverages had until recently been pushed to heights that were provoking considerable tax evasion, implying limits to the amount that can be raised from these sources. The standard sales tax rate on goods is 25 percent. However, there is a reduced rate, mainly for equipment and food, and the administration of sales tax is hampered by the presence of significant exemptions. To help preserve the indirect tax base, the authorities intend to introduce a VAT in 1999.
- 141. Certain government ministries and agencies raise significant amounts of revenue that are not recorded in the budget. These revenues are placed in so-called *special revenue accounts*, and are spent at the discretion of the organization concerned. Total flows into special revenue accounts, and their breakdown by organization, are given in Table 5. Overall, special revenues accounted for 4 percent of GDP in 1997. However, for most purposes this figure is misleadingly high, for two reasons. First, 29 percent of all special revenues stem from the commodity trading operations of the Strategic Reserve Fund. Such revenues are inextricably linked to, and in 1997 were fully offset by, the Fund's commodity trading expenditures. In addition, some special revenues consist of grants from the Science Ministry to scientific institutes, and therefore represent intra-government flows. Excluding these two items, special revenues account for 2.6 percent of GDP.
- 142. The authorities plan to include such revenues, and the expenditures which they finance, in future budget presentations and to monitor more closely the transactions involved. This will help to increase the budget's transparency and to allocate spending across sectors more efficiently. Under the current system, scarce resources may be misallocated, in so far as lower priority expenditures may enjoy better access to special revenues than higher priority projects. Further, there is scope for rationalizing government operations through privatizing several of the activities currently financed by these special revenues.

D. The Structure of Public Expenditure

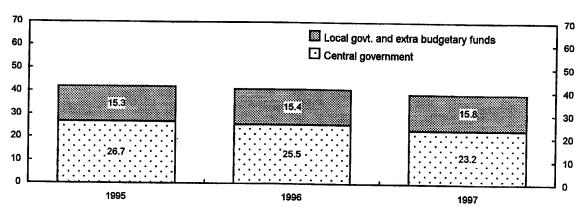
143. Public expenditures remain very high even though there has been some decline in general government expenditure from 43.1 percent of GDP in 1995, to 39.4 percent in 1997 (Figure 10 shows its composition). Non-discretionary expenditures consisting primarily of wages and salaries, social assistance, and social sector outlays, amount to 85 percent of total general government expenditures. The largest single component is "wages and salaries" at 9.1 percent of GDP in 1997 which reflects the fact that employment in the central government administration accounts for 2 percent of the population, almost twice the level in other lowand middle-income countries. A generous and comprehensive social safety net costs a further 3.5 percent of GDP (see Appendix II). Education spending of 5 percent of GDP is not

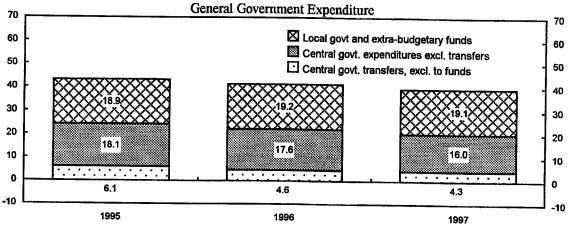
Figure 8. FYRM: General Government Operations, 1995-97
(Percent of GDP)

General Government Revenue and Expenditure



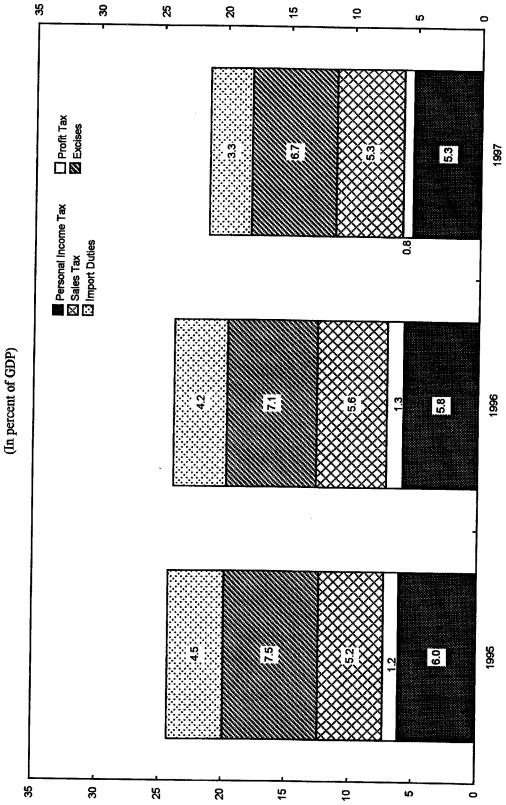
General Government Revenue





Sources: The authorities, and IMF staff estimates.

Figure 9. FYRM: Central Government Tax Revenue, 1995-97



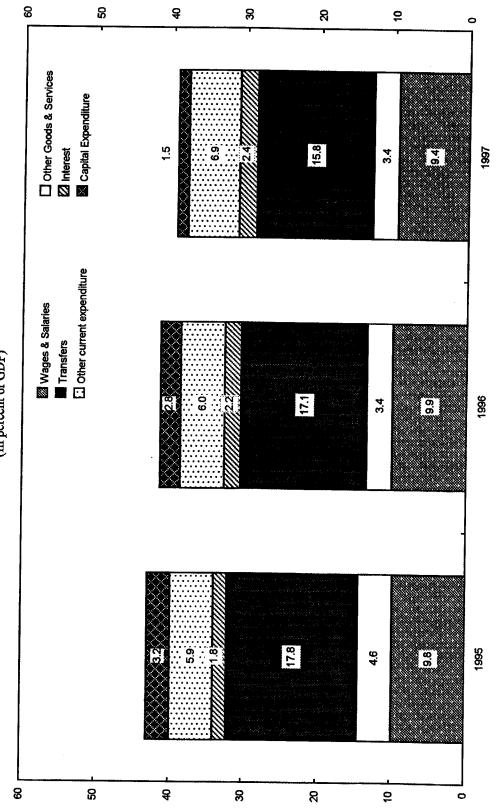
Sources: The authorities and IMF staff estimates.

Table 5. FYRM: Special Revenue Accounts, 1997

Organization	Main Source of Special Revenues	Amount (Denars)) Share of Total (percent)
Strategic Reserve Fund	Trading sugar, oil, medicines, wheat, cattle	1,919,252,851	29.2
Education Ministry	University Tuition. Renting out gym halls.	1,531,714,688	23.3
Sports Ministry	Private sponsorships of sports clubs	460,415,073	7.0
Defense Ministry	Renting out property & warehouses. Fees for civilians using the military hospital. Canteens.	370,395,139	5.6
Scientific Institutes	Grants, mainly from Science Ministry, partly from private sector	367,697,191	5.6
Agriculture Ministry	Fees for food safety checks & cattle health controls	335,836,511	5.1
Interior Ministry	Passports, birth certificates, driving licenses	313,812,478	4.8
Labor Ministry	Kindergarten and child care fees	244,575,943	3.7
Cultural Institutes	Fees for museums and libraries	232,161,155	3.5
Finance Ministry	Fines. Forms	121,844,548	1.9
Traffic & Communications Ministry	TV & radio stations. Airport landing fees	81,857,211	1.2
Social Protection Agency	Fees from institutes for old-age pensioners & the disabled	76,018,654	1.2
Civil Aviation	Airport fees	75,349,946	1.1
Health Ministry	Health inspections of businesses. Doctors' licences	48,299,192	0.7
Land cadastre	Cadastral fees	42,517,251	0.7
Maintenance Agency	Restaurants, resorts, airplane rentals	40,003,730	0.6
Others	n.a.	321,944,164	4.9
Total		6,583,695,725	100.0

Source: FYRM Ministry of Finance.

Figure 10. FYRM: General Government Expenditures, 1995-97 (In percent of GDP)



Sources: The authorities, and IMF staff estimates.

excessive by industrial country standards but is very inefficient. For instance, spending on supplies and investment is critically low while teacher-student ratios are well above those in countries of similar income levels, and the ratio of support staff to teachers is 45 percent higher than in OECD countries.

- 144. Little room is left for new investment and expenditure on necessary maintenance of existing facilities, as well as provision of standard government services. Expenditure on "other goods and services" for example, declined from 3.8 percent to 2.9 percent of GDP between 1995 and 1997 while capital expenditure declined from 3.2 percent to 1.5 percent of GDP in this period. It is noteworthy that both capital expenditures, and outlays on other goods and services (primarily for operations and maintenance), are well below the average for middle-and lower-income market economies, and less than 40 percent of the value in a sample of transition economies (see Table 6).
- In addition, the high share of non-discretionary expenditures makes the management of fiscal contingencies extremely difficult. A clear example are developments during the first half of 1997 when, as discussed earlier, general government revenue performance deteriorated dramatically. The immediate result was a sharp increase in government payment arrears. Later, across-the-board expenditure measures were imposed to help narrow the gap between the expected fiscal deficit outcome and the targeted surplus. These measures, which were incorporated in the supplementary budget, largely focused on cuts in needed maintenance outlays and the postponement of capital projects.

Pensions

- 146. Pension expenditure remains high, particularly given the relatively young population. From a cross-country perspective, four aspects of the current pension system stand out. First, replacement rates continue to be high. The pension base for calculating old-age pensions is determined by the average wage earned during the entire working career. The maximum replacement ratio is 80 percent; it applies to beneficiaries who have worked and paid contributions for at least 40 years for men, and 35 years for women. For every year less than this minimum, the replacement ratio is decreased by 2 percent. Before the 1994 reforms, the maximum replacement ratio was 85 percent, and when assessing the pension base only the best 10 years were taken into account. Following these reforms, the ratio of the average old age pension to the average wage, which peaked at 80 percent in 1993, fell to 62 percent by January 1998.
- 147. Second, the current retirement age still remains low. While, minimum retirement ages were increased from 60 to 63 years for men and from 55 to 60 years for women, transitional rules apply until January 1999 for men, and January 2003 for women. During this period, the

³⁰Wages earned prior to January 1970 are not used in the calculation of the pension base given the lack of complete earnings records.

Table 6. FYRM: Government Expenditures for Selected Countries, 1995

Expenditure by Economic Type	Middle-Income Countries 1/	Low-Income Countries 2/	FYRM 3/	Selected Transition Countries 4/
Total expenditures	27.7	25.6	00.4	
Current expenditure	21.9	18.6	39.4	45.6
Goods and services	11.5	12.6	37.9 12.8	35.5
Wages	7.9	6.7		17.0
Other goods and services	3.6	5.9	9.4 3.4	6.9
Interest	2.5	3.2	3.4 2.4	10.1
Transfers	7.9	2.8	15.8	1.7
Capital expenditures and net lending	5.8	7.0	1.5	15.3 10.1
Number of countries	26	11	1	8

Sources: IMF Government Finance Statistics Yearbook; 1995; FYRM Ministry of Finance; Staff Estimates.

^{1/}Barbados, Botswana, Chile, Colombia, Costa Rica, Cyprus, Dominican Republic, Egypt, El Salvador, Fiji, Hungary, Iran, Jordan, Malta, Mauritius, Morocco, Panama, Paraguay, Peru, Romania, Swaziland, Thailand, Tunisia, Turkey, Uruguay, and Zimbabwe.

^{2/}Burkina Faso, Cameroon, Ghana, Kenya, Lesotho, Malawi, Mali, Sierra Leone, Sri Lanka, Zaire, and Zambia.

^{3/}Data for 1997. In these accounts, total wages do not include the wage component of total Health Fund outlays. Including the best available estimate of the latter, total wages would rise to about 14 percent of GDP.

^{4/} Armenia, Estonia, Latvia, FYRM, Mongolia, Romania, Slovak Republic, and Tajikistan.

minimum retirement age will gradually rise to its new level. Currently, the actual average retirement age is 61 for men and 58 for women.

- 148. Third, payments on survival and disability pensions are extremely high. 31 The basic survivors' pension is 70 percent of the old-age pension. It is increased by an additional 10 percent of the old-age pension for each surviving child less than 26 years old, up to a maximum of 100 percent of the old-age pension. The disability pension depends on the working age of the insured person. In 1997, the average survival pension was 70 percent of the average old age pension; the average disability pension stood at 72.8 percent of the average old age pension. In 1997, payments on these pensions equaled 7.8 percent of contributors' gross wages. In countries where survival and disability insurance is provided under a competitive private system, the required contribution rate is 1 to 1.5 percent of gross wages. This high level of disbursement reflects several factors. Disability pensions may be awarded with insufficient verification of the real medical condition of the injured. For instance, there is no follow-up check on those collecting disability pensions. Also, the replacement rate for survival pensions is very high, and there are few checks to ensure that recipients are still alive.
- 149. Fourth, payments for workers' accidents, covering both monetary compensation and health services, are also high. In 1997, they equaled 3.1 percent of contributors' gross wages. In countries where workers' accident insurance is provided under a competitive private system, the required contribution rate is around 1.5 percent of gross wages.
- 150. Overall, the current pay-as-you-earn (PAYE) system could be considered in short-term balance, since current pension contributions roughly equal the amount of pensions paid. As unemployment rates drop, the PAYE system may even briefly run surpluses. However, deficits will soon emerge, since the population is rapidly aging. Specifically, the old-age dependency ratio³² is projected to rise from 13.9 percent in 1997 to 18.4 percent in 2010, and to 24.5 percent by 2020. As a result, the PAYE system will move towards a steady-state deficit of about 6.5 percent of GDP.

Health

151. Health spending is high and while the number of doctors and nurses per capita is on a par with advanced economies, the quality of service is poor. Neither the Health Fund nor the Ministry of Finance exercise effective control over spending by the autonomously administered health-care facilities. This has had two results. First, the health sector has seen the emergence of sizable, if largely unquantified, payment arrears. Second, health facilities have acted to protect employment at the expense of real wages, working capital and operating

³¹Out of about 225,000 pensioners, 59,000 received survival pensions, and 48,000 received disability pensions.

³² The number of people aged 65 years or more, to those aged from 15 to 64.

and investment expenditures. Hence, the structure of health expenditure has become extremely inefficient. On the one hand, as shortages of drugs, supplies and equipment have emerged, the quality and availability of primary health care has deteriorated severely, particularly in rural areas.³³ On the other hand, staffing ratios and inpatient capacity in the health-care sector are on a par with more advanced market economies. Indeed, there are signs of over-capacity: by international standards, hospital occupancy rates are low while the average length of hospital stays is high.³⁴

- 152. The cost of medicines is very high by international standards.³⁵ This differential reflects three factors. First, a lengthy registration process, which requires cumbersome testing even for generic equivalents of registered drugs. Second, the prohibition on generic substitution by pharmacists, and third, the lack of competition at the wholesale and retail levels. In turn, retail competition is weak partly because, except for the co-payment, there is no limit on Health Fund reimbursements for a particular product. This practice induces a relatively inelastic demand for drugs, and hence reduces the incentive for retailers to lower drug costs. These factors are behind the 3 percent of national income spent on drugs—half of it financed by the public sector—which is an extremely high share by international standards.
- 153. To tackle these problems, during 1998 the government intends to replace the Health Protection Law with two new Laws: a Health Insurance Law, and a Drug Law. The Health Insurance Law will establish a basic benefits package for national health insurance coverage, revise and generally increase co-payments, set up a capitation payment mechanism for primary health care, and introduce a referral system for specialized care. The Drug Law will streamline the registration of drugs, implement reference pricing based on generic products, adopt a list of essential drugs for reimbursement purposes, and introduce competitive bidding procedures for public-sector drug procurement.

³³For instance, in a survey of 247 rural primary health-care centers (PHC), virtually every center lacked some basic equipment for routine examination, minor surgical intervention, sterilization and waste disposal. Around 30 percent lacked blood pressure gauges and stethoscopes, 70 percent lacked infant scales and refrigerators, and 90 percent lacked an otoscope. PHC staff was also narrowly trained, and lacked a broad preventive and curative approach to family medicine.

³⁴In 1995, the occupancy rate was 61.9 percent in general hospitals, 74.7 percent in clinics, 82.2 percent in specialized hospitals, and 22.7 percent for inpatient facilities. Contrasting FYRM with the UK, the average length of a hospital stay in days was as follows: for infectious and parasitic diseases, 22 versus 7.3; for neoplasms, 18 versus 9.5; for complications of pregnancy and childbirth, 16 versus 3.5.

³⁵For instance, a recent World Bank mission found that market prices for a sample of essential primary care drugs were 5 to 20 times the world market level.

E. Public Expenditure Management

- 154. The expenditure management system suffers from three main weaknesses. First, the Ministry of Finance lacks the resources to analyze the policies and operations of spending units. As a result, it has to accept their budget estimates and apply an overall ceiling on their spending. In meeting fiscal targets it must then rely on across-the-board spending cuts, with little consideration for the policy and operational consequences. Second, the control of budget execution relies on cash rationing. The execution of the budget relies extensively on cash releases from the Ministry of Finance, which are guided by the day-to-day availability of receipts. The result is an excessive emphasis on subjecting discretionary expenditures to cash rationing and sequestration. This can be highly disruptive to the smooth flow of government operations, and makes it difficult to avoid the accumulation of arrears. Third, the existence of the special revenue accounts discussed earlier, detracts from the transparency of the budget.
- 155. In order to better match cash outflows and inflows, greater financial planning is needed. In turn, this requires two changes. First, a better staffed and better trained macroeconomic analysis unit is required. Second, a treasury system must be developed to enable the recording and reporting of financial commitments. This will help anticipate future funding requirements. The BPO is currently preparing the software for such a system.

THE SOCIAL SAFETY NET

Unemployment Benefits

- 156. Unemployment benefits account for 1.3 percent of GDP, or over one-third of all expenditure on social programs. As of end-1997, there were 258,000 registered unemployed, accounting for 32.2 percent of the estimated active working population. Of these, only 49,881, or 19 percent of the total, received unemployment benefits as only the unemployed with a work history are eligible for unemployment benefits and the eligibility period is time bound. As described before, recipients of unemployment benefits also have pension contributions paid on their behalf. As all registered unemployed receive free health insurance, it is widely suspected that a significant number of these individuals actually do work in the private sector.
- This replacement rate was raised in 1995 to 50 percent, a value higher than in most other transition economies. In July 1997 a new Unemployment Law was enacted, whose main provisions are as follows: (i) the replacement rate falls to 40 percent after receiving benefits for 12 consecutive months; (ii) the maximum duration of cash benefits for persons with 20-25 years of insurance is 18 months, while the previous law gave 24 months to persons with over 22 years of insurance; (iii) unemployed workers receiving cash benefits must register monthly with the Employment Fund—all the other unemployed must register every 6 months. Further, the special one-time payment to the unemployed who claimed a pension, of 40 percent of the average monthly net wage, was abolished.
- 158. Any employer who hires an unemployed person receives, as a wage subsidy, any unpaid unemployment benefits, for up to a maximum of 18 months. On balance, this incentive may facilitate the re-employment of the unemployed, at little budgetary cost. However, wage subsidies are in general easier to justify if targeted at the long-term unemployed.

Social Assistance Program

159. About 1.7 percent of GDP is spent on the Social Assistance Program (SAP). This provides financial support to the disadvantaged through four distinct schemes. First, the SAP provides Social Assistance Benefits to persons who are able-bodied but 'materially endangered', that is, do not receive sufficient income from other sources (such as wages, pensions, or unemployment benefits), and own few assets. This scheme, which had 64,000 recipients at end-1997, accounts for most users of the SAP and 85 percent of its 1997 expenditures. Typical recipients include: (i) any unemployed who are ineligible for unemployment benefits, submit documentation of their poverty, and have their indigence confirmed by site visits; (ii) employed persons whose wages have not been paid for more than 3 months; (iii) pensioners receiving the minimum pension. Each recipient receives the

difference between the national poverty line³⁶ and his 'potential income'. The latter is defined as the recipient's net income, excluding any government compensation for handicaps or natural disasters; examples of such excluded items are civil disability pensions, allowances for disabled children, and disaster relief compensation.

160. Second, the SAP provides Cash Compensation for Care of the Disabled to anyone who regularly helps the disabled with assistance in everyday life. This scheme accounts for 8 percent of SAP expenditures. Third, the SAP provides Permanent Cash Compensation to anyone who is incapable of work and is materially endangered. Examples include people with mental or physical disabilities, and orphaned children. This scheme covered over 10,000 people at end-1997, and accounts for 4.5 percent of SAP expenditures. Finally, the SAP provides One-Time Assistance for emergency purposes. This includes disaster relief compensation, as well as assistance to people who are eligible for but have not yet received Social Assistance Benefits. On average, this scheme is used by 6,000 people every year and accounts for 2.5 percent of SAP expenditures.

Withdrawals from Frozen Foreign Currency Deposits for Social Needs

161. For the last four years individuals have been able to make withdrawals from frozen foreign currency deposits on the grounds of 'social need'. Such withdrawals amounted to 0.5 percent of GDP in 1997. Three distinct types of withdrawals are allowed. First, individuals who are 'materially endangered', and present a certificate to this effect from the Center for Social Affairs, can withdraw up to DM 100 per month. This accounts for the vast majority of withdrawals. Second, one-off withdrawals of DM 1,000 are allowed in connection with family weddings or deaths. Finally, unlimited withdrawals are allowed to finance the education abroad of one's children.

³⁶Until late 1997, there were two separate poverty lines, one for rural and one for urban residents. The rural poverty line was set at a lower level, allegedly reflecting the lower rural cost of living.

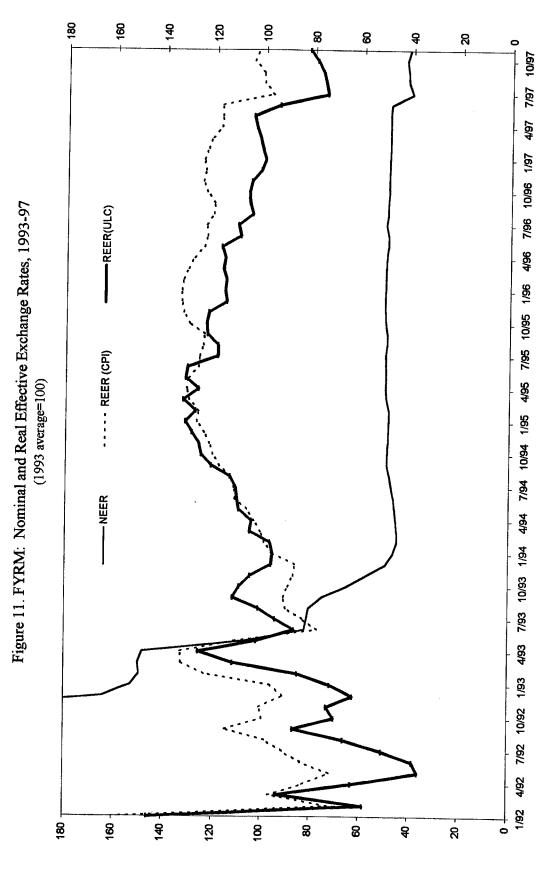
VIII. RECENT BALANCE OF PAYMENTS DEVELOPMENTS

A. Overview

- 162. At the time of independence in 1991, FYRM was cut off from its traditional markets and the federal transfers it previously enjoyed as part of the former SFRY. Since then, its external sector has faced a series of negative shocks and pressure on the trade sector arising from the transition process. At the same time, the balance of payments has been burdened by the servicing of former SFRY debt without enjoying the counterpart share of the SFRY's foreign assets, while foreign direct investment has been deterred by the regional situation. Nevertheless, the authorities stabilized the economy from 1994 on through the use of an exchange rate anchor and have normalized relations with external creditors.
- 163. The balance of payments remains fragile. In particular, after the end of the UN sanctions on FRY in the second half of 1995, the external sector came under increasing pressure from a large trade deficit and the loss of exceptional financing. In response, the authorities devalued the denar by 14 percent in July 1997, in conjunction with measures to strengthen the fiscal position and neutralize the inflationary impact of higher import prices. Since then, exports and private transfers have rebounded, but import growth has remained high. The gross international reserve position of the NBM has strengthened somewhat, but reserve cover remains weak.

B. Competitiveness

- Reflecting the use of an exchange rate anchor, the denar remained virtually unchanged against the deutsche mark between the beginning of 1994 and June 1997 (Table 38). Given the limited volatility in exchange rates with other large trading partners (Figure 11), the nominal effective exchange rate (NEER) was thus also rather stable. After the 14 percent devaluation in July 1997, stability against the deutsche mark has continued.
- Through mid-1995, and carrying on a trend that began in 1992, both the consumer price based (REER-CPI) and the unit labor cost based (REER-ULC) real effective exchange rate appreciated rapidly as the inflation differential between the FYRM and partner countries was significant, albeit falling over time. Both indices peaked around June 1995, once convergence of the inflation rate was achieved, and have been depreciating since. The rate of decline of the REER-ULC has been significantly faster than the CPI-based index, suggesting that structural changes in the economy have provided for improvements in the relative competitiveness of the FYRM's wage structure. Because it did not spark a revival of high inflation, the devaluation in July 1997 was almost fully reflected in a decline in the real exchange rate.
- 166. As in other transition economies, competitiveness is hard to assess, given that price movements partly reflect ongoing structural adjustments in the economy. Deciding on an appropriate reference point for analyzing the level of the exchange rate is particularly difficult as the short history of the FYRM is punctuated with external shocks. One highly tentative



Sources: The authorities, and IMF staff estimates.

choice for a reference period would be 1993, when the current account was close to balance. Before then, the exchange rate was perhaps undervalued as it had depreciated sharply in real terms immediately after independence.³⁷ Since 1993, the balance of payments has been running an *underlying* overall deficit, although the deficit was not apparent in 1994–95 owing to income from trade related to UN sanctions. At end-1997, while the REER-CPI was close to its average 1993 level, the REER-ULC was 22 percent lower, suggesting that the level of competitiveness is now more than adequate. However, this conclusion is optimistic, given the use in the reference period of official exchange rates, which were more appreciated than rates in the parallel market.³⁸ Moreover, the results are quite sensitive to the choice of reference period: moving the reference period back a year to 1992 would suggest that both the REER-CPI and the REER-ULC are currently overvalued by about 10 percent.

A comparison of average dollar wages across transition economies corroborates the 167. view that, even after the devaluation, further improvements in wage competitiveness may be needed (Table 27). In particular gross dollar wages are significantly higher than in other relatively low per capita income transition economies like the Baltic republics, Bulgaria and Romania. However, high gross wages largely reflect the extremely high level of taxation on labor and net wages are not out of line with those in other transition economies. In this regard, while the distribution of net wages across countries was fairly uniform in 1993, by 1997 three groups of countries could be identified (Figure 12): (A) high productivity economies (Poland, Croatia and Czech Republic); (B) medium productivity economies (Hungary, Estonia, the FYRM and Lithuania); and (C) low productivity economies (Romania and Bulgaria). Assuming the FYRM is correctly grouped—and it inherited a capital stock and economic system that in many ways were more sophisticated than in other former communist countries—the July 1997 devaluation brought FYRM wages back into line with the average wage rate in group B countries, after recording the highest wage rate in the group for the previous two years.

C. The Balance of Payments

Current account developments

168. While conclusions are tempered by the poor quality of the official data, the current account deficit increased from 5.7 percent of GDP in 1995 to over 7 percent of GDP in 1996 and the first half of 1997, following the normalization of relations with trading partners in the region (Table 29 and Figure 13). The rising deficit reflected a stagnation of exports, in part due to earlier competitiveness losses, and higher imports which were stimulated by tariff reductions. A deteriorating trade balance was partly offset by an increase in net receipts of non-factor services due to lower transportation costs following the lifting of UN sanctions on

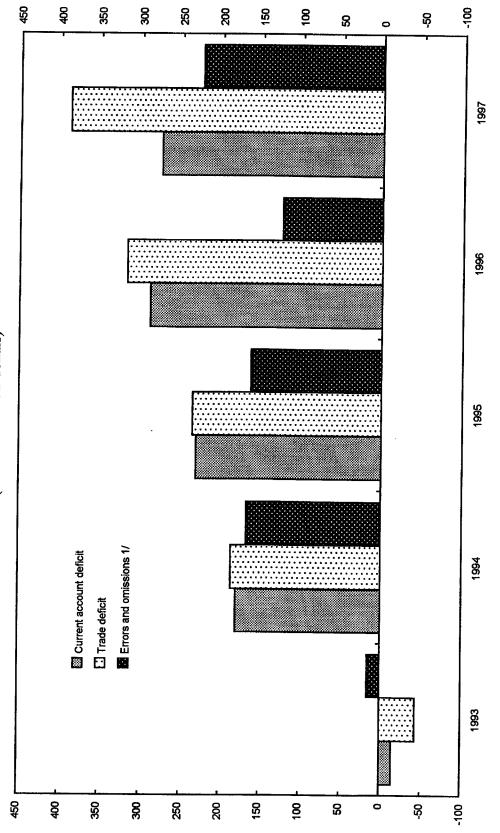
³⁷An initial undershooting of the equilibrium real exchange rate was a phenomenon observed in many other transition economies. See Halpern and Wyplosz (1997).

³⁸There has been no parallel market in more recent years.

Czech Republic Lithuania Estonia FYRM Romania Bulgaria ¥ Hungary Poland Croatía 1997 Figure 12. FYRM: Average Net Dollar Wages in Selected Transition Economies, 1993-97 1996 1995 1994 1993 9 320 8 280 200 150 -100 20 Ó

Sources: The authorities and IMF staff estimates.

Figure 13. FYRM: Developments in the Balance of Payments, 1993-97 (In millions of US dollars)



Sources: The authorities; and IMF staff estimates.

1/ Including short-term capital.

FR Yugoslavia, although private transfers declined by 20 percent. Since the devaluation, export growth and transfers have rebounded but import growth has remained strong.

Exports

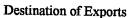
- 169. The analysis of trade flows is particularly difficult due to the effects of UN sanctions on FRY over the period 1992–95 and inconsistencies in the trade data prior to 1997 (see Appendix III below for details).³⁹ These issues notwithstanding, exports have stagnated since the time of independence. While export growth has been hampered by the slow recovery of traditional export markets, the erosion of competitiveness in 1994 and 1995 also dampened growth of exports to new markets. Exports declined by 5 percent in 1996 and grew by a mere 2 percent on an annual basis in the first half of 1997.⁴⁰ After the July devaluation, export growth rebounded to 7 percent.
- 170. In the last two years, with the exception of FRY, exports have lost market share in the countries of the former SFRY and the former Council for Mutual Economic Assistance (CMEA) area, and have gained ground in the European Union (EU) and other countries (Table 31 and Figure 14). Exports to the latter groups of countries accounted for about 56 percent of the total in 1996–97, compared to an average 50 percent in 1994–95. This suggests a process of continuing trade integration with advanced economies at the expense of traditional trading partners.
- 171. One exception to the general weakness of exports in recent years has been the growth of agricultural exports and live animals. Despite an EU ban on lamb imports from the FYRM imposed in 1996 for public health reasons, export growth in this sector has averaged 12 percent since 1995. Exports of tobacco, the traditional crop, have been particularly strong, recovering from US\$64 million in 1994 to US\$106 million in 1997. Beverage exports growth has also been notable, rising from US\$18 million in 1994 to US\$61 million in 1997.
- 172. In 1997, the FYRM mainly exported industrial supplies (52 percent of the total) and consumption goods (45 percent) (Tables 30 and 34). Exports of clothing, iron and steel, non-ferrous metals, textiles, and footwear, accounted for 53 percent of total exports in 1997. Exports of agricultural products accounted for nearly 20 percent.

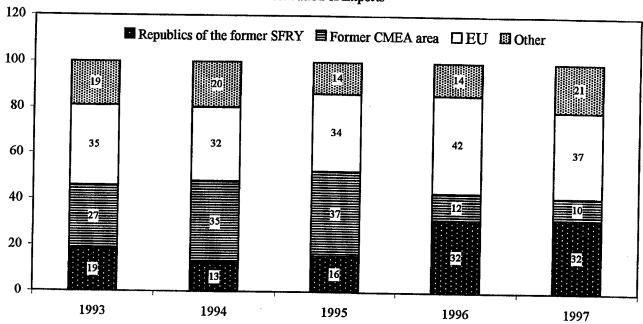
³⁹The sanctions included a trade embargo which was first imposed in May 1992 and then intensified in November 1992 and April 1993. The embargo was lifted in November 1995 as part of the Dayton Peace Accord.

⁴⁰These growth numbers should be taken with caution since the authorities are in the process of reviewing the quality of the data before 1997.

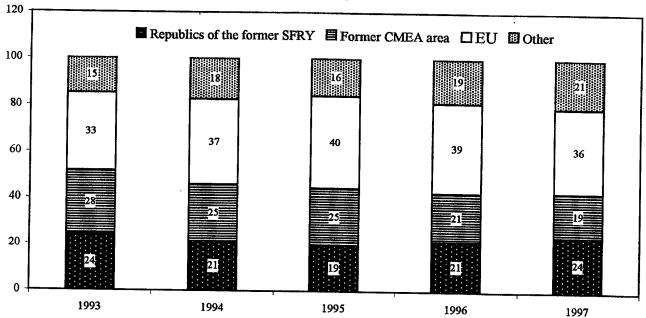
⁴¹The destination of exports was considerably distorted in 1992-95 by the effects of sanctions, with a sharp increase in exports to Bulgaria partly displacing a decline in exports to Serbia. More normal shares of exports to these countries were restored in 1996-97.

Figure 14. FYRM: Destination of Exports and Origin of Imports, 1993-97 (In percent of total)





Origin of Imports



Sources: The authorities

Imports

- 173. According to official data, import growth has averaged about 10 percent a year since independence. While import growth was subdued in 1996 (2 percent), it picked up to 9 percent in 1997 in response to the liberalization of the trade system and increased economic activity in the second half of the year. ⁴² The recent strength of imports has also partly reflected one-time factors including a US\$13 million shipment of wheat (0.4 percent of GDP) in the fourth quarter of 1997 tied to external financing and heavy oil imports in early 1998. In line with the pickup in industrial activity and improved competitiveness, the share of industrial supplies increased from 56 percent of the total in 1996 to 61 percent in 1997. The share of consumption goods fell correspondingly from 30 to 28 percent (Table 34).
- 174. It is possible to discern a gradual move away from historical import sources, that parallels the shift in the destination of exports (Table 33 and Figure 13).⁴³ Imports from other former SFRY countries (excluding FRY) have remained virtually unchanged but imports from former CMEA countries have fallen steadily as a share of total: from 25 percent in 1994 to 19 percent in 1997.⁴⁴ A corresponding increase in imports from industrial countries has reflected sizable increases in imports from the United States and the United Kingdom that have more than offset a decline in imports from Germany. The share of imports from the EU has remained roughly stable over the last four years.
- 175. In 1997, the majority of imports were industrial supplies (61 percent of total) and consumer goods (28 percent) (Table 34). Manufactured goods accounted for 20 percent of the total, food and livestock for 14 percent, and mineral fuels and lubricants for 11 percent. The largest single categories were petroleum and derivatives (9.6 percent), clothing (6.7 percent), iron and steel (6.4 percent), and vehicles (5.1 percent). Imports for humanitarian aid and social assistance purposes amounted to US\$34 million in 1997.

⁴²Year-to-year changes are subject to potentially large measurement errors. In addition to possible compilation errors, the level of imports in 1995 is probably overstated due to the re-export activity under the UN sanctions implying stronger underlying growth in 1996.

⁴³The distortion of the shares of imports from Bulgaria and Serbia in 1992-95 is also similar to the distortions to the destination of exports.

⁴⁴Against this trend, imports from Albania doubled between 1996 and 1997, partly due to better monitoring of trade flows at the border.

Capital account and reserves

176. Identified capital inflows have been small in net terms over the last four years. Direct foreign investment has been notably small in relation to that received by other countries in the region, while sizable lending by multilateral institutions has largely been offset by the servicing of debt to official creditors. Much of the financing of the large current account deficits is thus unidentified—although it does not appear to have been debt creating. Foreign reserves rose sharply in 1994-95, but have stagnated in the last two years.

Medium- and long-term flows

- 177. Since independence, the FYRM has received little foreign direct investment (FDI) owing in large part to the political situation in the Balkans. Foreign direct investment was only 0.9 percent of GDP in 1997 (Table 28). As has been the case for the last five years, this was a lower level than in practically all other transition economies. The sale of shares in the largest bank and the telecommunications company should boost FDI in 1998–99.
- 178. The servicing of debt obligations, mostly inherited from the former SFRY, is a significant burden on the balance of payments, accounting for average net outflows (including interest) of US\$130 million per year (9.6 percent of exports and 3.5 percent of GDP) between 1995 and 1997. Amortization payments averaged US\$64 million over the three-year period and US\$40 million in 1997: US\$18 million was paid to multilateral institutions, US\$16 million to Paris Club creditors, and US\$6 million to commercial creditors.
- 179. The FYRM has normalized credit relations with Paris Club members, commercial banks, and multilateral institutions. In 1995, an agreement was signed under the Paris Club to reschedule the portion of bilateral debt of the former SFRY inherited by the FYRM. This agreement was then pursued with each bilateral creditor, with the last agreement being signed in January 1998. In March 1997, the FYRM agreed with the London Club to accept about 5 percent of the commercial bank debt of the former SFRY. The FYRM began servicing new tradable bonds at the end of 1997. In September 1997, the FYRM repaid arrears to the European Investment Bank (EIB), thereby normalizing relations with the European Union and clearing the way for a Trade and Cooperation Agreement that was signed in November 1997.
- 180. The main official inflows have come from multilateral institutions. In 1997, public sector disbursements accounted for US\$129 million. Of this, the World Bank disbursed US\$48 million in adjustment lending and project financing, the EBRD disbursed US\$30 million in project financing, the European Union US\$28 million in balance of payments support, and US\$7 million were disbursed from other bilateral creditors.

⁴⁵The terms of the tradable bonds are: 15 years maturity, with a four-year grace period, and an interest rate of LIBOR plus 0.8125, of which only 3.5 percent will be paid for the first four years, while the remainder is capitalized.

Errors and omissions and short-term capital

- 181. Errors and omissions, together with short-term capital, accounted for roughly 4 percent of GDP of net inflows in 1995–96, and 7 percent of GDP in 1997 (Figure 13). Official statistics attribute much of the inflows to trade credits: export credits were estimated at US\$289 million in 1997, a 22 percent increase compared to 1996, while import credits fell by US\$130 million to US\$158 million, implying net trade credits grew by US\$186 million (5.5 percent of GDP). However, the data is not collected directly, but inferred from the difference between trade flows and trade receipts. While it is reasonable to expect that access to trade credit has improved following the normalization in the region, the size of the increase is questionable. A more likely explanation is that a large part of the inflows reflect unrecorded remittances, the drawdown of foreign exchange held abroad, or an undervaluation of trade (see the attached appendix on statistical issues). They therefore partly reflect an overestimation of the current account deficit as well as non-debt-creating capital inflows. Consistent with this interpretation, there was a surge of unidentified inflows following the July 1997 devaluation that probably reflected a portfolio shift of domestic residents.
- 182. After increasing by about US\$100 million in 1994–1995, official foreign exchange reserves broadly stagnated in 1996–1997. Reserves declined by US\$8 million in 1996 and losses continued in the first half of 1997. These were more than reversed after the devaluation implying an increase for the full year of US\$13 million. Reserve cover at end-1997 was equivalent to 1.9 months of merchandise imports. Commercial bank NFA declined by US\$55 million between 1995 and 1997.

External debt

183. Compared to other countries in Eastern Europe, the FYRM has followed a conservative external debt policy. As of end–December 1997, total external debt amounted to US\$1.1 billion, or 34 percent of GDP (Table 36). The debt stock increased by US\$61 million in 1996 and US\$20 million in 1997. Of the total debt at end–1997, 43 percent was owed to multilateral institutions, 33 percent to bilateral creditors, and 24 percent to commercial creditors. Liabilities to the Fund amounted to US\$103 million (3 percent of GDP) and debt to the World Bank amounted to US\$491 million (15 percent of GDP).

IX. TRADE AND EXCHANGE SYSTEM

A. Trade System

184. The authorities overhauled the trade system in July 1996 and have since then followed a policy of gradual reform through the adoption of free trade agreements with neighboring countries and a trade and cooperation agreement with the European Union. In 1995, the FYRM received observer status in the WTO and in the same year it submitted its trade policy for review under the procedures for accession to the WTO. Following the trade reforms, the

trade system is now classified as "open", according to the recently developed classification scheme for trade restrictiveness (CSTR).⁴⁶

The old trade regime

- 185. The trade system inherited from the former SFRY was geared toward the protection of domestic producers. As well as 18 tariff bands, ranging from 0 to 25 percent, a statistical charge of 1 percent and two import taxes of 7.5 percent were levied on the cif value of imports. Some products were exempted (computers and machinery) while others enjoyed a lower tax rate of 2 percent (e.g. pharmaceuticals). The average unweighted statutory tariff rate, including the administrative duty and import taxes, was 28 percent.
- 186. Import quotas were set for some 100 goods, including live poultry, confectionary, wine and spirits, tobacco and cigarettes, cement, iron and steel products, and buses. Of these 100, 30 products were actually banned from import. On the export side, apart from export bans by destination country, some 90 goods were under export restrictions or bans, including animals, grains, flours, vegetable, oils, fuels, hides, wool, and aluminum scrap. Export incentives were also applied to lamb, veal, fruit and vegetables.
- 187. Under the CSTR system, the previous tariff system was classified as restrictive, given that the average unweighted tariff rate was above 25 percent. The non-tariff barriers (NTBs) affected less than 25 percent of trade and production in the economy, hence they would be classified as moderate. The overall trade restrictiveness of the previous trade regime was quantified as 8 in the classification index.

⁴⁶ The CSTR index is used by IMF staff to quantify the overall trade restrictiveness in a specific country (see Box). See Annex I, International Monetary Fund (1998).

Box. Classification Scheme for Overall Trade Restrictiveness

The IMF has adopted a new system for the classification of the overall trade restrictiveness of a country. The new system is based on two dimensions: a) the unweighted average statutory tariff rate; and b) the extent that non-tariff barriers affect trade or production in the economy. Based on these two dimensions, a index number from 1 to 10 is then determined for each level of restrictiveness, with 1 being the lowest and 10 the highest level of restrictiveness. The index is summarized in Table 7.

		Non-tariff Barriers	
	Open	Moderate	Restrictive
Tariffs			
Open	1	4	7
Relatively open	2	5	8
Moderate	3	6	9
Relative restrictive	4	7	10

8

10

Table 7. Classification Scheme for Overall Trade Restrictiveness

The tariff system is classified as *open* if the unweighted average statutory rate is between 0 and 10 percent, *relatively open* if the rate is between 10 and 15 percent, *moderate* if the rate is between 15 and 20 percent, *relatively restrictive* if the rate is between 20 and 25 percent, and *restrictive* if the rate is above 25 percent. The system of nontariff barriers (NTBs) is classified as *open* if NTBs are either absent or affect less than 1 percent of trade or production in the economy, *moderate* if the NTBs cover at least one important sector in the economy (e.g. agriculture or textiles) or affect between 1 and 25 percent of overall trade or production, and *restrictive* if the NTBs affect entire stages of production (e.g. consumer goods) or account for more than 25 percent of overall trade or production.

5

The new trade regime

Restrictive

- 188. The trade reforms that took effect in July 1996 rationalized the tariff structure and dismantled import and export quotas. The number of tariff bands was reduced from 18 to 7. The range of tariff rates was increased from 0 to 60 percent, but the great majority of items fall into rates below 35 percent. In addition, the statistical charge of 1 percent and the two import taxes of 7.5 percent each were eliminated. The new tariff structure implies an unweighted average statutory tariff rate of 15 percent, substantially less than the previous average tariff, particularly if other ad valorem taxes are taken into account.
- 189. Import quotas and bans were also eliminated in August 1996. There remain only phyto-sanitary standards (principally for food and agricultural products) and other safety and

quality standards (petroleum derivatives, iron and aluminum products, and buses). ⁴⁷ The 90 export items previously under quota have also been freed up, with the exception of a few items (feed grains and seeds, and petroleum products). As of January 1998, a 100 percent duty drawback system came into effect for import goods to be re–exported. The system provides for stricter controls against fraudulent claims.

190. The changes in the tariff regime imply that the restrictiveness of tariffs has now been lowered from restrictive to moderate, whereas non-tariff barriers have been virtually eliminated, implying a reclassification from moderate to open. The overall trade restrictiveness of the current trade regime can therefore be quantified as 3 in the classification index.

Free trade agreements

- 191. Since the trade reform took effect, the government has pursued bilateral trade agreements with neighboring countries. So far, four agreements have been signed: Slovenia (February 1996), FRY (October 1996), Bosnia (January 1997), and Croatia (March 1997). With the exception of the agreement with Slovenia and FRY, all other agreements imply preferential access of bilateral imports at a zero tariff rate and a 1 percent statistical charge. In the case of Slovenia, the reduction in tariff rates on industrial goods will be implemented gradually, with final elimination by the year 2000. In the case of FRY, the trade agreement implies the same preferential access of bilateral imports for most products under a certain quantitative limit beyond which the import rates applied to other countries come into effect. In 1997, trade with these four countries accounted for 32 percent of total FYRM exports, and 24 of total FYRM imports.
- 192. In November 1997, the authorities signed a cooperation agreement with the European Union which simplifies the customs clearance system between the FYRM and the EU, and provides for financial assistance in the development of the FYRM transportation system through the EIB. It also sets the foundations for a possible future association agreement between the FYRM and the EU, which would imply a gradual bilateral lowering of tariffs.

B. Foreign Exchange System⁴⁸

Foreign exchange market

193. The current exchange system came into effect with the passage of the Law on Foreign Currency Operations in 1993 and has been amended by a number of resolutions of the NBM since then. The foreign exchange market in the FYRM is very segmented with noncash and cash transactions taking place in separate markets. The noncash market includes transactions

⁴⁷ Additional information is being collected on these standards to assess whether they are consistent with internationally accepted standards.

⁴⁸Ms. Sosa (MAE) and Ms. Weeks (LEG) contributed to this section.

among enterprises through their banks, between commercial banks and enterprises, among banks, and between the NBM and banks. The cash market consists of transactions between individuals and foreign exchange bureaux.

- 194. In the noncash market each commercial bank facilitates the functioning of an "exchange market" among its clients; since 1993 the share of transactions among enterprises in total noncash foreign exchange transactions has ranged between one quarter and one third of the total. Each morning, usually between 8 and 9 a.m., banks receive bids from the enterprises wishing to buy foreign exchange indicating currency, volume and exchange rate and offers from enterprises wishing to sell, also stating currency, volume and rate. Enterprises may only buy foreign exchange for payment of obligations falling due within the next 48 hours, with the exception of oil importers who, due to the large size of their payments, are allowed to accumulate foreign exchange during a period of up to 90 days until they build up the needed amount. Enterprises who are earners of foreign exchange must decide within four days of the receipts of their earnings how they want to use them, i.e. whether they wish to make external payments, sell them in the market, or deposit them in foreign currency accounts. Unused balances in these account existing at the end of 90 days must be sold for denars to the bank at which the account is maintained or to the NBM.
- 195. Each bank compiles all bids and offers in a table, a copy of which is sent to the NBM. The larger banks provide a dealing room for their clients where the table is made available to participants to enable them to negotiate the desired transactions. The smaller banks provide the information on bids and offers to their clients by phone or by fax. The enterprises are free to agree on any exchange rate, as the initial bids and offers are not binding. Once two enterprises agree on a transaction they give the relevant bank a contract, which the bank then processes. Banks charge a commission of about 0.3 percent for their services.⁴⁹
- 196. If the enterprises are unable to reach an agreement among themselves, and still wish to make the transaction, the bank may accommodate their needs if its foreign exchange position so allows. ⁵⁰ If a bank cannot provide all the foreign exchange demanded, it may obtain the needed foreign exchange from another bank or, as a last resort, from the NBM. Enterprises and individuals are free to deal with whichever bank offers the most attractive exchange rate. Transactions among enterprises and banks take place at exchange rates that each bank establishes for dealing with its clients at the beginning of each dealing day. Some banks, as a

⁴⁹All transactions must be completed by 11 a.m. to allow for the timely processing of the payment order; all "large" payment orders (denar 5 million, equivalent to about US\$ 90,000) have to be processed by noon.

⁵⁰In addition to prudential limits on their open foreign exchange position, banks are subject to minimum and maximum foreign exchange liquidity limits, which the NBM sets quarterly for each bank in relation to its capital and volume of foreign exchange transactions.

matter of policy, adopt the indicative exchange rate list⁵¹ prepared by the NBM, while others produce their own list. In practice, the latter lists have been close to the NBM's. Transactions between banks take place at the seller's exchange rates whenever the lists of the banks transacting differ, and transactions between the NBM and banks take place at the NBM's indicative rates.

- 197. In the cash market there are three types of exchange bureaus: (i) those that operate on their own account and are free to set their exchange rates; (ii) those that operate on behalf of the NBM and must apply the NBM list of exchange rates for bureaus; and (iii) those connected with commercial banks. The latter must apply the corresponding bank's exchange list for bureaux operations. Every 10 days, the bureaus must sell any foreign exchange position exceeding their net purchases during the previous 10 days, either to the NBM or to the bank with which they have an agreement. Bureaus may make daily sales if they so wish. Enterprises are not allowed to buy or sell foreign exchange at the bureaus.
- 198. The exchange rate system is officially defined as a managed float, with NBM intervention aimed at smoothing out fluctuations of the rate. In practice, the structure of the foreign exchange market including the use of NBM indicative rates has contributed to stability in the exchange rate, without much variability in foreign exchange reserves. In addition to intervention to achieve the international reserve target, the NBM also intervenes to ensure the supply of certain goods considered essential (crude oil and petroleum derivatives) and to avoid sharp fluctuations arising from the lumpiness of these payments.
- 199. The NBM is in the early stages of drafting a new foreign exchange law, with a view to reducing the degree of segmentation in the foreign exchange market and providing greater flexibility to market participants.

⁵¹The NBM sets the indicative rates for each day on the basis of the weighted average of DM/denar rates obtained in transactions among enterprises, between enterprises and banks, among banks, and between banks and the NBM during the previous dealing day. The average rate constitutes the middle exchange rate, from which a buying and a selling rate are calculated by applying a margin of 0.3 percent. Once the DM/denar rate is thus calculated, the cross rates for 22 other currencies are calculated on the basis of quotations in Frankfurt.

BALANCE OF PAYMENTS STATISTICAL ISSUES

200. The compilation and coverage of balance of payments data has improved over the last four years. The customs offices were fully computerized in 1996 following the ASYCUDA system, while the NBM redesigned the international transactions reporting system (ITRS) in 1994 and has since then continued to strengthen the methodology to estimate the current account. Nevertheless, errors and omissions and unidentified flows have remained high, accounting for as much as 7 percent of GDP in 1997.

Revisions in trade data

- 201. Responsibility for balance of payments data is shared by the SO, Customs Administration (CA), and the NBM. The SO publishes trade data on a monthly basis and provides additional data to the Ministry of Development and the NBM for the compilation of the balance of payments statistics.
- 202. A number of errors were discovered in the external trade data in 1996 and 1997, prompting substantial revisions and a review of procedures. A committee comprising officials of the SO, the CA, and the NBM was set up in June 1997 to oversee the collection and the compilation of balance of payments statistics, implement a single customs documentation for reporting exports and imports, and revise, where appropriate, the methodology used to compile the trade statistics. A lack of experience in data collection, ⁵² and lack of appropriate human and technical resources are being addressed with financial assistance through the EU PHARE program and technical assistance from the Fund. New quality controls have been introduced for the processing of data at the SO and the NBM is also providing technical assistance in the formulation of a new data processing software at the SO to computerize the compilation of trade statistics under the new single customs documentation. The SO, NBM, and CA will shortly sign a binding protocol that will ensure the quality of the collection, transfer and processing of trade data in the future.
- 203. While the revisions to the trade data for 1997 were implemented, data prior to 1997 have not yet been revised implying a potential discontinuity in the time series.

Errors and omissions

204. The balance of payments also suffers from large errors and omissions which reflect an incomplete coverage of current and capital account transactions. Three areas of the external sector have been identified where coverage is particularly weak: remittances; the drawdown of foreign exchange held; and the valuation of trade.

⁵²In the former SFRY, the bureau of statistics in Belgrade collected and processed all balance of payments data.

- 205. There are an estimated 500,000 citizens from the FYRM living abroad, compared with a total population within the FYRM of 2 million. As in other cases, it is customary for ex-patriots to remit some of their foreign earnings to relatives at home, either in the form of foreign currency or goods. In 1996, out of 4,800 registered traders that were solely importers, 4,000 imported less than US\$75,000 each, for a total of US\$73.8 million (about one—third the size of errors and omissions). A large part of these imports are thought to have been financed directly by family members living abroad by drawing down foreign exchange deposits in the country of export. These transactions would imply an under recorded level of remittances in the balance of payments, contributing to an overestimated current account deficit.
- 206. Anecdotal evidence suggests that citizens living within the FYRM hold large foreign currency deposits abroad. The international transaction reporting system used by the NBM does not record changes in foreign currency deposits held abroad, implying that any movements in these assets that are used to finance the current account are not reflected in the capital account. They thus accrue to errors and omissions. Without further information, it is not possible to tell though whether this would imply a higher or lower capital account balance.
- 207. In addition, there is anecdotal evidence that FYRM citizens hold an unusually high level of foreign currency outside of the banking system. Unofficial estimates put the amount of foreign currency circulating in the economy as high as US\$800 million (25 percent of GDP). This level of *currency substitution* has clear implications for the balance of payments: as in the case of other transition economies, ⁵³ any reversal in currency substitution would be reflected in large unidentified financing of the current account, leading to high errors and omissions. An example of this phenomenon may have actually taken place after the July 1997 devaluation, when private transfers doubled in the second half of that year, and errors and omissions jumped to 7 percent of GDP from 4 percent a year earlier.
- 208. Finally, there is anecdotal evidence that trade flows are undervalued. A number of exporters, for example, are reported to understate export volumes in customs declaration, particularly when barter trade is involved, so as to meet the requirement that a fixed percentage of the barter be transacted in cash. There is also evidence of unrecorded cross-border trade with FRY and Albania, which is thought to result in additional net exports. Similar unrecorded cross-border trade is reported to occur with Bulgaria and Turkey, but is thought to lead to additional net imports. On balance, it is hard to assess whether unreported trade would increase or reduce the trade deficit in FYRM.

⁵³See for example the case of Croatia in 1994, or Georgia in 1995.

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Table 8. FYRM: Gross Domestic Product by Economic Activities, 1992-97

	1992	1993	1994	1995	1996	199′ Prel
		(In millions of cu	rrent denars)		
Mining and industry	3,464	14,832	26,226	29,468	20.504	01.514
Agriculture and fisherics	1,702	5,783	14,132	16,371	30,724	31,615
Forestry	95	455	919	837	17,310 85 6	17,968
Water management	59	324	637	691	696	852
Construction	594	3,333	6,954	7,820	8,041	703
Transport and communication	832	4,257	8,264	9,542	9,700	6,971
Trade	205	4,712	14,737	17,478	18,612	9,758
Tourism and catering	198	1,014	2,350	2,479	2,937	19,934
Personal services and crafts	233	1,352	3,378	3,132	3,525	2,823
Utilities and public services	131	915	2,339	3,547	3,830	3,525
Financial and business services	258	9,188	30,498	9,604	7,467	3,845
Education, science, culture and information	655	3,967	8,805	9,436	7,407 9,969	7,467
Health care and social security	689	3,620	7,546	8,216	_	9,887
Public administration	78 6	3,748	8,805	10,535	8,162	8,199
Others	1,893	1,664	444	23,975	11,237 20,067	11,552 22,204
Total GDP	11,794	59,165	136,034	153,132	157,302	165,989
		(In	millions of cons	ant denars at 19	90 prices)	·
Mining and industry	114	98	91	0.4	0=	
Agriculture and fisheries	41	32	35	84	87	90
Forestry	4	4	4	37	36	37
Water management	3	3	3	4	4	4
Construction	29	26	22	3	3	3
Transport and communication	25	24	22	21	22	19
Trade	24	24	22 27	21	22	22
Tourism and catering	9	9	8	28	29	31
Personal services and crafts	8	ģ	8	8	8	8
Utilities and public services	9	7	7	8 7	9	9
Financial and business services	20	19	20	•	7	7
Education, science, culture and information	31	31	31	20	17	17
Health car and social security	31	31	30	32	33	32
Public administration	22	22	23	30	30	30
Others	64	55	56	22 58	22 58	22 60
otal GDP	433	394	387	382	385	391
			(In percent of		303	391
Mining and industry	20.4			•		
Agriculture and fisheries	29.4	25.1	19.3	19.2	19.5	19.0
Forestry	14.4	9.8	10.4	10.7	11.0	10.8
Water management	0.8	0.8	0.7	0.5	0.5	0.5
Construction	0.5	0.5	0.5	0.5	0.4	0.4
Transport and communication	5.0	5.6	5.1	5.1	5.1	4.2
Trade	7.1	7.2	6.1	6.2	6.2	5.9
Tourism and catering	1.7	8.0	10.8	11.4	11.8	12.0
Personal services and crafts	1.7	1.7	1.7	1.6	1.9	1.7
Utilities and public services	2.0	2.3	2.5	2.0	2.2	2.1
Financial and business services	1.1	1.5	1.7	2.3	2.4	2.3
Education, science, culture and information	2.2	15.5	22.4	6.3	4.7	4.5
Health car and social security	5.6	6.7	6.5	6.2	6.3	6.0
Public administration	5.8	6.1	5.5	5.4	5.2	4.9
Others	6.7	6.3	6.5	6.9	7.1	7.0
- LIVES	16.0	2.8	0.3	15.7	12.8	13.4
otal GDP	100.0	100.0	100.0	100.0	100.0	100.0

Source: Ministry of Development.

Table 9. FYRM: Industrial Output, 1992-97

(Index 1991=100)

	Weights	1992	1993	1994	1995	1996	1997
Totai	1000	8	£	9,		,	
Generation. Transmission and distribution of electricity.	17.4	t 0.	7 5	6 ;	28	9	9
Extraction of coal	† - -	ဥ ဒ	6 8	102	107	115	114
Detrolonm mendinds indiretes	7.7		<u>8</u> 6	66	104	103	106
Tourseast products moustry	0.5	28	105	17	13	72	47
Iron and steel industry	4.3	2	4	25	26	36	42
Non-terrous mining	1.8	06	93	82	62	2 82	2 %
Non-ferrous metal production	3.0	8	85	73	71	6 & 8	8 8
Non-terrous metal processing	0.5	99	\$	61	51	25.	3 4
Extraction of non-metal minerals	8.0	99	39	43	43	48	£ 52
Processing of non-metal minerals	1.5	9/	48	4	40	3.5	3 6
Manufacture of metal products	3.2	63	20	42	78	28	5 8
Infacrine industry	0.8	28	38	21	14	13	=
Manutacture of transport equipment	1.4	20	40	33	25	30	78
Manuacure of electrical equipment	5.1	80	89	55	52	20	55
Dasic chemical industry	5.5	82	99	65	58	52	\$
Chemical products industry	6.1	62	48	56	57	52	; Ç
Stone, gravel, and sand quarrying	1.5	86	79	69	09	26	8 8
Building materials industry	5.1	98	79	7.1	70	6	3 2
Lumber industry	0.2	87	77	70	20	45	£
Finished wood products industry	1.1	78	22	4	31	52	<u>∞</u>
raper and paper products	9.0	83	99	58	27	37	2
Lexuse liber and labric industry	2.3	84	73	89	51	20	. 4
rinished textile products industry	6.0	82	81	69	59	52	45
Leather and fur industry	9.0	88	89	19	99	99	47
Leather tootwear and accessories manufacturing	1.8	91	26	39	78	28	32
Kubber industry	0.1	2	11	55	30	29	28
Food products industry	11.9	91	80	80	79	70	&
Beverage industry	5.9	96	62	69	62	: 58	8 8
Feed industry	0.4	84	85	9/	77	78	
l obacco industry	8.9	102	95	86	76	2 19	3 2
Printing	1.4	118	113	8	52	4	5 4
Collecting and recycling of industrial waste	0.1	70	59	43	33	7	. 0
Miscellaneous manufacturing	0.2	112	8	70	62	73	46
						!	2

Sources: Statistical Office; and Ministry of Development.

Table 10. FYRM: Output of Specific Industrial Products

	1993	1994	1995	1996	1997
Electricity (MWHrs)	5,590,922	5,923,666	6,132,601	6,629,485	6,718,754
Petroleum products (k tons)	196	46	22	140	97
Sheet steel (tons)	156,087	73,045	40,878	113,777	164,418
Buses-manufacture of frames (tons)	4,362	2,792	612	608	718
Refrigerators (units)	98,478	95,192	50,726	21,729	11,974
Micro motors (KW)	17,312	10,300	15,025	31,600	48,940
Sulphuric acid (tons)	88,814	72,106	82,619	99,545	10,539
Detergents (tons)	20,095	19,614	21,522	20,229	22,885
Cement (tons)	499,093	486,450	523,499	490,861	610,763
Wool yarn (tons)	5,858	4,856	3,863	3,951	4,358
Cotton fabric (k m2)	24,497	27,548	15,525	16,538	9,834
Leather footwear (k pairs)	2,076	1,510	1,120	1,244	1,509
Cigarettes (millions)	9,614	13,538	10,615	7,851	9,691

Sources: Statistical Office and Ministry of Development.

Table 11. FYRM: Agricultural Output, 1992-97

	1992	1993	1994	1995	1996	199° Estimate
Droduction of calcuted assess 199		(In thousands	of tons)		
Production of selected commodities Wheat						
Corn	299.5	249.8	336.1	381.2	269.3	293.8
Sugar beets	130.2	101.0	133.2	165.6	142.4	157.7
Sunflowers	61.4	55.1	54.1	54.6	78.3	72.3
	37.7	18.9	17.9	22.3	20.6	15.0
Tobacco	26.5	21.1	18.9	15.7	15.4	23.3
Meat	34.1	34.0	33.7	29.4	28.0	28.0
Of which:						
Beef	7.5	8.4	7.5	6.9	7.0	7.0
Pork	10.4	9.6	9.7	9.3	9.5	9.5
Poultry	2.3	1.9	2.1	1.9	2.0	2.0
Lamb/mutton	12.4	12.9	13.0	10.0	9.5	9.5
Milk (million liters)	175.8	178.0	177.1	197.8	186.6	180.0
		(Vo	lume index 1	991=100)		
Total agricultural production:	100.4	79.9	86.1	89.6	90.7	05.7
Socialized sector	96.1	68.9	73.3	69.3		95.7
Private sector	101.9	83.8	90.9	97.1	•••	•••
Production of selected commodities:		03.0	70.7	37.1	•••	•••
Wheat	87.9	73.3	98.6	111.9	70.1	05.5
Corn	96.4	74.8	98.7	122.6	79.1 105.3	85.7
Sugar beets	75.2	67.5	66.2	66.8	95.9	116.7
Sunflowers	97.4	48.8	46.3	57.5	53.9 53.2	88.5
Говассо	105.1	83.7	74.8	62.1	53.2 61.1	38.8
Meat	96,6	96.3	95.8	83.2		92.4
Of which:		70.5	22.0	63.2	79.1	79.1
Beef	91.4	102.6	92.3	04.4	105.0	
Pork	105.1	97.0	97.2	84.4	125.9	125.9
Poultry	95.9	79.1	88.9	93.9	115.2	115.2
Lamb/mutton	94.6	98.4		77.8	79.1	79.1
Milk (million liters)	98.0	99.2	99.2	75.8	66.9	66.9
(),	20.0	99.2	98.7	110.2	104.0	100.3
		(Share o	f agricultural	production)		
ocialized sector	24.3	21.9	23.1	20.8		
rivate sector	75.7	78.1	76.9	79.2	•••	***

Source: Data provided by the Ministry of Development.

Table 12. FYRM: Gross Domestic Product and Aggregate Demand, 1992-97

	1992	1993	1994	1995 1/	1996 1/	1997 1/
		(In	millions of c	urrent denars)		
Private consumption	8,245	42,313	90,965	110 100		
Public consumption	2,302	12,472	-	110,180	117,004	130,296
Gross investment	2,286	9,878	25,406	18,660	19,292	19,837
Growth in stocks 2/	459	416	19,637	24,704	26,485	28,333
Foreign balance 3/	-117	-4,700	5,717	6,294	3,755	3,962
Exports of goods and services	6,409	-4,700 27,659	-14,036	-16,047	-18,829	-26,564
Goods	6,104	27,639 24,901	57,926	51,729	51,983	66,344
Services	305	-	46,738	45,841	45,822	59,942
Imports of goods and services	6,292	2,758	11,188	5,888	6,161	6,402
Goods	6,140	32,359	71,962	67,776	70,812	92,908
Services		30,662	65,569	54,782	58,461	79,291
	152	1,697	6,393	12,994	12,351	13,617
GDP demand side estimate	12,491	50 5 4 T	107 (00			
Statistical discrepancy 4/	12,491 -697	59,547	127,689	143,791	147 ,7 07	155,864
GDP		-382	8,344	9,341	9,595	10,125
	11,794	59,165	136,033	153,132	157,302	165,989
			(In percent o	of GDP)		٠
Private consumption	69.9	71.5	66.9	72.0	74.4	70. 7
Public consumption	19.5	21.1	18.7	12.2	74.4	78.5
Gross investment	19.4	16.7	14.4		12.3	12.0
Growth in stocks 2/	3.9	0.7	4.2	16.1	16.8	17.1
Foreign balance 3/	-1.0	-7.9		4.1	2.4	2.4
Exports of goods and services	54.3	46.7	-10.3	-10.5	-12.0	-16.0
Goods	51.8		42.6	33.8	33.0	40.0
Services	2.6	42.1	34.4	2 9.9	29.1	36.1
Imports of goods and services	53.3	4.7	8.2	3.8	3.9	3.9
Goods	53.3 52.1	54.7	52.9	44.3	45.0	5 6.0
Services		51.8	48.2	35.8	37.2	47.8
	1.3	2 .9	4.7	8.5	7.9	8.2
Statistical discrepancy 4/	-5.9	-0.6	6.1	6.1	6.1	6.1
Memorandum items:						
Average exchange rate						
denar/U.S. dollar	* •					
GDP implicit deflator	5.1	23.2	43.3	38.1	39.9	49.9
anphon denam	1,291.6	451.9	134.1	13.9	1.9	4.0

Sources: Statistical Office and IMF staff estimates.

^{1/} IMF staff estimates.

^{2/} Data up to 1994 are not adjusted for the effect of inflation on the value of stocks.

^{3/} For 1992, 1995, 1996 and 1997 data are calculated using average annual exchange rates. For 1993 and 1994 data are calculated using daily exchange rates.

^{4/} Statistical discrepancy for 1995-1997, as a share of GDP, is assumed to be equal to that in 1994.

Table 13. FYRM: Investment in Fixed Assets, 1994-96

	1994	1995	1996	1994	1995	1996
	(In millions of	(In millions of current denars)		(Indices 1994 = 100)	94 = 100)	
Social Sector 1/ Private Sector 2/	10,683 8,954	13,080 11,624	13,603 12,882	100.0 100.0	122.4 129.8	127.3 143.9
Industry and mining Agriculture and fishing	3,964 1,157	4,202 1,288	4,370	100.0		110.2
Forestry Water resources management	96	190	87	100.0		87.9
Construction Transport and communications	452	600	684	100.0		86.4 151.3
Trade Catering trade and tourism	1,363	2,057	6,823 2,325	100.0		234.7 170.6
Crafts and trade Other production activities	271 1 737	348 349	362 377	100.0 100.0		118.3 139.1
Non-productive crafts and trade Housing, utilities and mublic sector	78	1,868	2,054 118	100.0		118.2 151.3
Education, culture, information Healthcare and social protection	231 366	0,434 387 276	6,691 141 200	100.0 100.0	116.3 167.5	120.9 61.0
Central and local government institutions, political parties, social organizations and associations				700.0		4.4.
Financial and other services	532 420	558 578	625 682	100.0 100.0	104.9 137.6	117.5 162.4
Total	19,637	24,704	27,203	100.0	125.8	138.5

Sources: Statistical Office and IMF staff estimates.

1/ The Social Sector includes investments in the cooperative, mixed and public sector.

2/ The Private Sector includes the investments of private enterprises and investments of agents that do not have a status as legal entities.

Table 14. FYRM: Average Nominal and Real Net Wage 1992-98 1/

		ninal net wage	Average rea	al net wage
	Denars per	Percent	Index	Percent
	month	change 2/	1995=100	change 2/
1992	637	991.5	95.6	-31.7
1993 3/	3,815	498.9	114.5	19.8
1994	7,775	103.8	105.5	-7.9
1995	8,582	10.4	100.0	-5.2
1996	8,822	2.8	100.3	0.3
1997	9,068	2.8	101.8	1.5
1996				
January	8,560	1.4	95.0	1.0
February	8,572	2.6	95.0	0.0
March	8,581	1.4	95.6	0.6
April	8,695	2.6	97.5	1.9
May	8,97 9	2.6	102.6	5.3
June	8,762	1.6	100.8	-1.7
July	8,865	3.7	103.3	2.5
August	8,959	2.5	105.7	2.3
September	8,874	1.3	104.2	-1.4
October	9,065	3.5	102.7	-1.4
November	9,015	4.2	101.1	-1.5
December	8,931	5.9	100.2	-0.9
1997				
January	9,051	5.7	100.3	0.1
February	9,066	5.8	100.9	0.7
March	9,041	5.4	101.2	0.2
April	8,106	4.7	104.7	3.5
May	9,351	4.1	107.3	2.5
June	8,976	2.4	101.9	-5.1
July	9,144	3.1	103.8	1.9
August	8,993	0.4	102.2	-1.6
September	8,773	-1.1	99.8	-2.3
October	9,069	0.0	100.1	0.3
November	9,155	1.6	99.8	-0.2
December	9,096	1.8	99.5	-0.3
1998				
January	9,337	3.2	101.4	1.9
February	9,139	0.8	99.0	-2.3

Source: Data provided by the Statistical Office.

^{1/} Actual take home pay of employees, net of taxes and social security contributions.

^{2/} Change from corresponding period of preceding year.

^{3/} On May 15, 1993, the denar was re-denominated and 100 denars was equal to 1 new denar.

Table 15. FYRM: Average Net Wage, By Sector, 1993-97 1/

	1993	1994	1995	1996	1997	1993	1994	1995	1996	1997
		(Denars	Denars per month)	₽			(Annual percentage change)	rcentage c	change)	
Total	3,815	7,775	8,582	8,822	890'6	499.0	103.8	10.4	2.8	2.8
Industry (including mining)	3,623	7,456	8,286	8,588	8,782	454.0	105.8	11.1	3.6	2.3
Agriculture	2,782	6,022	9/8/9	7,256	7,720	440.2	116.5	14.2	5.5	6.4
Construction	2,716	5,727	5,388	6,529	6,552	444.3	110.9	11.5	2.2	0.4
Transport	4,272	8,816	9,604	9,957	10,230	548.3	106.4	8.9	3.7	2.7
Trade	3,118	7,454	9,034	9,903	10,716	462.8	139.1	21.2	9.6	8.2
Catering, tourism	3,114	6,568	6,948	7,515	7,770	539.4	110.9	5.8	8.2	3.4
Handicrafts	3,296	6,751	7,710	7,773	7,857	474.2	103.7	14.8	0.8	
Public utilities, housing	3,937	8,082	9,361	9,686	9,740	640.0	105.3	15.8	3.5	9.0
Financial, other services	5,768	12,407	13,228	12,128	13,167	629.9	115.1	9.9	.8 .3	9.8
Education and culture	4,866	8,841	9,217	9,241	9,231	549.7	81.7	4.3	0.3	-0.1
Health, social security	4,753	8,945	9,333	9,423	9,377	528.7	88.2	4.3	1.0	-0.5
Government and other	5,067	9,478	9,760	9,900	10,126	520.2	87.1	3.0	1.4	2.3
Memorandum item: Cost of living (percentage change)	5	: t	: 6	: 5	: ;	338.4	126.5	16.4	2.5	1.3
Livi wago	7/0	/87	523	332	312	:	÷	:	:	፥

Sources: Data provided by Statistical Office, and Ministry of Development.

1/ Actual take home pay of employees, net of taxes and social security contribution.

Table 16. FYRM: Labor Force, Employment, and Unemployment, 1992-97

(Annual averages)

	1992	1993	1994	1995	1996 1/	1997 1/
Emmless at 1			(In thous	sands)		
Employment by sector						
Industry, including mining	176.6	167.5	157.7	136.6	155.5	140.4
Agriculture and fishing	34.1	30.4	30.3	23.9	95.3	90.4
Forestry, water supply	6.4	6.5	6.1	5.9	7.5	6.7
Construction	39.7	36.5	33.4	31.4	35.8	32.0
Transportation	22.5	21.2	20.9	21.1	26.7	24.8
Trade	45.2	39.5	29.9	22.0	62.5	55.2
Catering, tourism	10.0	9.0	8.2	7.9	14.9	16.6
Arts and crafts	6.0	5.8	5.2	4.2	14.3	16.7
Public utilities, housing	7.9	8.0	7.9	8.1	9.1	10.7
Financial and other services	12.9	12.4	11.4	10.9	14.9	16.6
Education and culture	35.1	34.8	35.3	36.1	43.0	41.4
Health and social services	34.3	34.2	33.9	33.2	30.4	33.1
Government sector	15.3	15.2	15.5	15.3	27.9	28.1
Total employed	446.0	421.0	395.7	356.6	537.6	512.3
Unemployment 2/	172.1	174.8	185.9	216.2	251.5	288.2
Economically active population	•••	•••	•••	•••	789.1	800.5
Memorandum items:						
Unemployed						
(as percent of economically active population)	•••	•••	•••	•••	31.9	36.0

Sources: Data provided by the authorities. Statistical Yearbook and Labor Force Survey (Statistical Office).

^{1/}Data for 1993-1995 are based on census. Data for 1996 and 1997 are from the more accurate labor force survey.

^{2/}Data for 1992-1995 are for registered unemployed. Data for 1996 and 1997 are based on ILO definition of unemployed.

Table 17. FYRM: Enterprises Experiencing Liquidity Problems, 1992-97 (End-of-period)

		Illiquid Enterprises 1/	Number of Employees 2/
1992			
	March	873	25,264
	June	784	51,121
	September	761	39,467
	December	768	46,576
1993			
	March	1,108	62,684
	June	1,129	81,225
	September	1,440	54,112
	December	1,521	44,733
1994			
	March	1,759	62,450
	June	2,012	82,676
	September	2,016	78,695
	December	1,871	98,647
1995			
	March	2,212	88,780
	June	2,082	77,196
	September	2,278	94,188
	December	2,458	61,985
1996			
	March	2,875	95,593
	June	2,974	101,822
	September	4,324	91,311
	December	5,994	98,446
1997			
	March	6,452	103,740
	June	6,291	101,169
	September	11,476	121,936
	December	12,754	106,516

Source: Data provided by the Ministry of Development.

^{1/} Those enterprises whose giro accounts with the Bureau of Payments Operations do not contain sufficient funds to cover payment obligations as at the last day of the period.

Table 18. FYRM: Profit Performance of the Enterprise Sector, 1996-97
(In percent of GDP)

	1994	1995	1996	1997
Loss-makers				····
Operating loss	4.6	8.1	-6.5	6.3
Net financing costs of loss-makers	8.1	1.7	-1.3	3.7
Loss after financing costs	12.6	9.7	-7.8	10.0
Profitable firms				
Operating profit	6.0	3.1	0.2	3.7
Net financing costs of profitable firms	-2.2	-3.1	-0.1	1.1
Profit after financing costs	8.3	6.2	0.1	4.8
Extraordinary items	-4.6	-1.7	-1.6	2.2
Net profit before tax	-9.0	-5.3	2.8	4.8
Depreciation	11.6	10.4	8.5	8.9
Net operating surplus	13.0	5.5	11.2	13.7
Memorandum items:				
Gross wage arrears				
as percent of wage costs		23.5	29.0	25.8
Gross wage arrears in loss-making firms				
as percent of wage costs	•••	47.0	53,4	54.8

Source: Enterprise income statements as reported by Bureau of Payments Operations (BPO).

Table 19. FYRM: Price Indices, 1992-98

(Percent change)

			er Prices	Indus Produce		Agricu Produce		GDP Deflator
		12-month Change 1/	Monthly Change 2/	12-month Change 1/	Monthly Change 2/	12-month Change 1/	Monthly Change 2/	Annual Growth
1992		1,935.0	1,664.4	2,149.3	2,198.2	1,858.1	1,698.0	1,291.6
1993		241.8	338.4	177.8	258.3	191.9	273.9	451.9
1994		55.0	126.5	28.5	84.6	14.6	2.0	134.1
1995		9.0	16.4	2.2	3.9	14.3	1.1	134.1
1996		-0.6	2.5	-0.6	-0.2	-8.4	0.3	
1997		2.6	1.3	8.6	4.5	179.6	73.2	1.9 4.0
1996	January	6.1	0.5	1.9	0.3	5.1	1.1	
	February	6.1	0.1	0.0	-0.7	12.1	-6.7	•••
	March	4.0	-0.5	0.4	0,7	2.6	18.2	•••
	April	3.1	-0.6	-0.4	-1.4	6.0	-0.3	•••
	May	1.1	-1.9	0.0	0.5	19,9	299.9	
	June	3.4	-0.7	-0.4	-0.4	-6.0	-62.6	***
	July	2.6	-1.3	-0.8	-0.5	-13.8	-42,5	***
	August	1.4	-1.2	1.3	-0.1	3.1	-9.5	•••
	September	1.2	0.5	-1.7	-0.9	12.1	12.2	•••
	October	1.3	3.6	-0.1	2.1	24.2	5.5	•••
	November	0.4	1.0	-0.2	-0.1	-7.8	-18.6	***
	December	-0.6	0.0	-0.6	-0.1	-8.4	4.9	•••
1997	January	0.2	1.3	0.8	1.8	-4.4	3.8	•••
	February	-0.4	-0.5	2.3	0.7	-0.4	-1.6	•••
	March	-0.4	-0.5	1.7	0.2	-14.3	6.7	•••
	April	-2.5	-2.7	1.5	-1.7	9.3	19.2	•••
	May	-0.4	0.2	0.7	-0.2	-17.8	369.7	•••
	June	1.4	1.1	1.0	-0.2	4.7	-47.9	•••
	July	2.7	0.0	1.7	0.3	172.5	-47.9 -5.8	***
	August	3.8	-0.1	6.2	4.2	231.8	-5.8 5.4	•••
	September	3.2	· -0 .1	8.6	1.4	4.5	-65.8	•••
	October	2.7	3.1	8.5	2.0	72.2	-63.8 81.3	•••
	November	2.9	1.2	8.4	-0.2	188.6	81.3 -1.0	***
	December	2.6	-0.3	8.6	0.1	179.6	-1.0 0,5	***
1998	January	2.0	0.7	7.5	0.8			•••
	February	2.7	0,2	5.8	-0.9	***	•••	•••
	March	2.8	-0.4	6.2	0.6	***	•••	•••
	April	3.8	-1.8			***	•••	•••
	-			•••	•••	***	•••	***

Sources: Ministry of Development and IMF staff estimates

^{1/} Annual figures refer to December-on-December inflation. 2/ Annual figures refer to annual average inflation.

Table 20. FYRM: Monetary Survey, 1994-97 1/

(In million of denars, end of period)

	1994	1995		199	6			199	7	
	Dec.	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.
Net foreign assets	-6,010	15,297	13,077	13,015	11,893	12,111	11,372	12,775	16.610	16.50
National Bank 2/	5,917	8,841	8,003	7,858	7,405	8,342	7,735	8,372	16,512 11,094	16,500
Assets	6,714	10,732	10,253	10,760	10,305	11,274	10,771	11,969	15,276	10,903
Liabilities	797	1,891	2,250	2,902	2,900	2,932	3,036	3,597	4,182	15,785 4,882
Domestic money banks	-11,927	6,456	5,074	5,157	4,488	3,769	3,637	4,403	5,418	5,597
Assets	9,458	9,670	8,574	9,378	9,890	9,512	9,675	11,152	14,380	15,892
Liabilities	21,385	3,214	3,500	4,221	5,402	5,743	6,038	6,749	8,962	10,295
Net domestic assets	29,320	8,075	9,034	9,450	11,581	11,373	11,205	10.505		
Domestic credit	76,080	59,082	60,007	63,417	51,738	52,303	50,166	10,737	9,880	11,633
of which to government	10,836	7,376	7,430	9,067	8,752	4,543	4,881	51,185	53,948	55,872
Domestic money banks	74,522	59,645	60,528	63,868	51,950	53,573	51,171	823 49,430	823	823
Denar	57,014	52,919	53,602	56,854	48,849	49,941	46,983	44,521	51,473	52,734
Government	845	4,958	4,970	6,537	6,963	6,306	6,386		45,588	46,277
Credit	59	4,924	4,938	6,502	6,934	6,291	6,368	3,059	2,146	1,781
Accrued interest	786	34	32	35	29	15	18	3,042 17	2,133	1,768
Social and private	56,169	47,961	48,632	50,317	41,886	43,635	40,597		13	13
New credit	20,600	16,792	16,475	20,076	20,373	20,848	16,744	41,462	43,442	44,496
Accrued interest	35,569	31,169	32,157	30,241	21,513	22,787	23,853	17,580	18,772	19,703
Foreign currency	17,508	6,726	6,926	7,014	3,101	3,632	4,188	23,882	24,670	24,793
Government	8,433	2,981	2,981	2,981	0	0	4,100	4,909 0	5,885	6,457
Non-government	9,075	3,745	3,945	4,033	3,101	3,632	4,188	4,909	6 005	0
NBM credit to government, net	1,558	-563	-521	-451	-212	-1,270	-1,005	1,755	5,885	6,457
Other assets net	-46,760	-51,007	-50,973	-53,967	-40,157	-40,930	-38,961	-40,448	2,475	3,138
Accrued interest	-36,355	-31,203	-32,189	-30,276	-21,542	-22,802	-23,871	-23,899	-44,068	-44,239
Claims for frozen FOREX	2,642	0	0	0	0	0	-25,671	-23,699 0	-24,683 0	-24,806
Other	-13,047	-19,804	-18,784	-23,691	-18,615	-18,128	-15,090	-16,549	-19,385	-19,433
M1	11,964	12,533	11,321	11,568	12,228	12,178	11,154	11,267	12,831	14 057
M1, non-government	10,508	12,533	11,321	11,568	12,038	12,143	11,069	11,184	12,365	14,257
Currency in circulation	4,786	5,965	5,182	5,445	5,500	6,698	5,523	5,396	5,824	13,985
Demand deposits	7,178	6,568	6,139	6,123	6,728	5,480	5,631	5,871	7,007	7,130
Banks	7,071	5,677	5,303	5,296	5,743	4,947	4,998	5,241	6,144	7,127 6,552
Non-government	5,615	5,677	5,303	5,296	5,553	4,912	4,913	5,158	5,678	6,332
Government	1,456	0	0	0	190	35	85	83	466	272
Demand deposits with NBM	107	891	836	827	985	533	633	630	863	575
M2	19,308	18,785	17,675	17,976	18,759	18,7 61	18,054	19,072	21,678	22.264
M2, non-government	17,852	18,785	17,675	17,976	18,340	18,490	17,594	18,386	20,540	23,364
Quasi money - non-government	7,344	6,252	6,354	6,408	6,302	6,345	6,525	7,202	8,175	22,726
Denar	3,772	3,187	3,682	3,575	3,491	3,639	3,777	3,925	3,982	8,741
Foreign currency	3,572	3,065	2,672	2,833	2,811	2,706	2,748	3,277	3,982 4,193	3,887
Government	0	0	0	0	229	236	375	603	672	4,854
Denar	0	0	0	0	119	131	335	574	659	366
Foreign currency	0	0	0	0	110	105	40	29		355
NBM quasi deposits	0	0	0	0	0	2	0	0	13 0	11
M3	23,310	23,372	22,101	22,465	23,474	23,484	22,577	23,513		0
M3, private sector	21,541	22,654	21,383	21,747	22,298	22,439	21,390	22,100	26,347 24,462	28,092
Non-monetary deposits	4,002	4,587	4,426	4,489	4,715	4,723	4,523	4,441		26,707
Domestic banks	4,001	4,473	4,367	4,458	4,714	4,722	4,523	4,441 4,440	4,669	4,728
Denar	2,883	3,418	3,341	3,324	3,445	3,592	3,371	3,610	4,668 3,680	4,726
Social and private	2,570	2,700	2,623	2,606	2,688	2,818	2,644	2,883	3,680	3,640
Government	313	718	718	718	757	774	727	727	2,933	2,893
Foreign currency	1,118	1,055	1,026	1,134	1,269	1,130	1,151	830	747 988	747
NBM (non-government)	1	114	59	31	1	1	1,151	1		1,086
Denar	1	1	1	1	i	î	1	1	1	2
Foreign currency	0	113	58	30	ō	ô	0	T	1	2

Source: National Bank.

^{1/} As reported by the Research Department of the NBM, at current exchange rates. Excludes frozen foreign currency deposits. Does not reflect various adjustments for program purposes.

2/ Data on NFA sometimes differ from data provided by the Foreign Reserves Department, which are used for program purposes.

Table 21 . FYRM: National Bank Accounts, 1994-97 1/

(In million of denars)

Period Ending	1994	1995		1996	9			1997	7	
	Dec.	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.
Net foreign assets	5,917	8,841	8,003	7,858	7,405	8,342	7,735	8,372	11,094	10,903
Net domestic assets Banks Credits	-415 1,262 2,021	-2,571 2,690 4,045	-2,617 2,628 4,235	-2,170 3,022 4 3 1 4	-1,586 3,501 4,505	-1,227 4,299	-1,914 4,094	-2,670 1,227	4,934	-3,348
Instruments 2/	-759	-1,355	-1,607	-1,292	-1,004	-561	4,6/1 -777-	2,134 -927	1,624 -1,439	2,720 -1,778
Government Credit Deposit Credit for external operations Other, net 3/	1,558 1,621 -63 0 -3,235	-563 1,860 -2,083 -340 -4,698	-521 1,860 -2,438 57 -4,724	451 1,857 -2,742 434 4,741	-212 1,850 -3,084 1,022 -4,875	-1,270 2,348 -3,828 210 -4,256	-1,005 2,361 -4,106 740 -5,003	1,755 5,877 4,617 495 -5,652	2,475 6,006 4,985 1,454 -7,594	3,138 6,010 -5,077 2,205 -7,428
Reserve money Currency Other 4/	5,502 4,786 716	6,271 5,965 306	5,386 5,182 204	5,688 5,445 243	5,819 5,500 319	7,115 6,698 417	5,821 5,523 298	5,702 5,396 306	6,160 5,824 336	7,556 7,130 426

Sources: Data provided by the authorities.

^{1/} At current exchange rates.

^{2/} Mandatory reserves and holdings of National Bank instruments. 3/ Includes non-financial sector deposits with the NBM. 4/ Vault cash and banks' excess reserves.

Table 22. FYRM: Deposit Money Bank Accounts, 1994-97 1/

(In million denars)

	1994	282		1990				1997		
	Dec.	Dec.	Mar.	Jun.	Sep.	Dec.	Маг.	Jun.	Sep	Dec.
Net foreign assets	-11,927	6.456	5.074	5157	4 100	3.760	100 6			
Assets	9,458	9,670	8.574	9.378	068 6	9,769	5,057 97.5	4,403	5,418	5,597
Liabilities	21,385	3,214	3,500	4,221	5,402	5,743	6,038	6.749	8.962	15,892
Net domestic assets	68,144	9.945	10.960	11 005	12 500	13 461	200 67			
In denar	\$7.014	52,919	53 602	26.954	40 040	12,461	12,783	13,083	14,241	14,784
1.Government	845	4 058	7,007	50,634	48,849	49,941	46,983	44,521	45,588	46,277
Credits	Ç£6	4,736	4,970	6,337	6,963	6,306	6,386	3,059	2,146	1,781
Of which overdise claims	35	4,924	4,938	6,502	6,934	6,291	6,368	3,042	2,133	1,768
Accrised interest	C è	⊋ ;	97	-	0	4	0	0	0	0
Cooled and minister	786	34	32	35	53	15	18	17	13	<u> </u>
2. Social and private sector	56,169	47,961	48,632	50,317	41,886	43,635	40,597	41.462	43 442	44 496
	20,600	16,792	16,475	20,076	20,373	20,848	16,744	17.580	18 777	10.703
Of which overdue claims	6,376	4,219	5,092	4,391	4,299	4,680	5.204	5 483	5 814	5,703
Accrued interest	35,569	31,169	32,157	30,241	21,513	22.787	73.853	73.887	24 670	3,910
In foreign currency	17,508	6,726	6.926	7,014	3 101	3 637	4 100	799,67	0/9,47	24,793
1. Government	8,433	2,981	2,981	2,981	, C	2005	*,100 O	4,909	5,885	6,457
Of which overdue claims	0	0			· c	•	•	.	.	0
Social and Private sector	9,075	3.745	3.945	4 033	2 101	, ,	0	0	0	0
Of which overdue claims	1.709	1.744	1 758	1,692	2,101	760°C	4,188	4,909	5,885	6,457
) it	•	1,100	1,080	43/	354	344	421	673	633
Other items net	-6,378	49,700	-49,568	-52,863	-39,450	-41,092	-38,388	-36,347	-37,232	-37,950
Total liabilities	56,217	16,401	16,034	16,162	16,988	16,250	16,420	17,486	19,659	20.381
Demand deposits	7,071	5,677	5,303	5,296	5.743	4.947	4 992	1703		
Social and private	5,615	5.677	5.303	\$ 29K	5 553		200	2,641	0,144	0,552
Of which self-management funds	204	68	111	273	666,0	4,712	4,913	5,158	5,678	6,280
Government deposits	1,456	0	•	i	901	,	2	ָרָר פּ	-	0
Sight and short term time deposits	21,051	6.251	7529	¢ 408	1637	33	Ç Ç	S	466	272
Denar	3.772	3.186	3,683	2,576	9,551	0,381	6,900	7,805	8,847	9,103
Foreign currency	17,279	3,105	2,002	5,573	3,491	3,639	3,777	3,925	3,982	3,887
New	3.572	3.065	7,012	7,633	2,811	2,706	2,748	3,277	4,193	4,854
Frozen	13,707	3	410,4	2,633	2,811	2,706	2,748	3,277	4,193	4,854
Grovernment	13,101	> 0	.	>	-	0	0	0	0	0
The state of the s	>	>	0	0	223	236	375	603	672	362
Non-monetary deposits	28,095	4,473	4,377	4,458	4,714	4.722	4.577	4 440	977 7	700
Jenar 1	2,570	2,700	2,623	2,606	2,688	2,818	2 644	3 662	80°F	4,700
Foreign currency	25,212	1,055	1,036	1,134	1.269	1.130	1 151	620	2,733	2,893
New	1,118	1,055	1,036	1,134	1.269	1.130	1,151	630	700	1,086
Frozen	24,094	0	0	0	0	0	1,171	000	788	1,086
Government	313	718	718	718	757	774	, ,	9 6	9 ;	o !
					:	+111	14,	171	/4/	7

Source: National Bank.

1/In current exchange rates. Includes frozen foreign currency deposits until June 1995.

Table 23. FYRM: Interest Rates, 1992-97

(Percent, monthly average)

	1992	1993	1994	1995	1996		19	1997	
	Dec.	Dec.	Dec.	Dec.	Dec.	Mar.	Jun.	Sep.	Dec.
NBM interest rates:		-							
Discount rate	250.0	295.0	33.0	15.0	9.2	∞			0
Interest on regular liquidity credit	719.0	848.0	0.99	30.0	18.4	13.4			0.0 C 6.1
Default interest rate	813.0	959.0	99.0	45.0	27.6	26.7	26.7	76.7	24.7
Interest on required reserves								•	7.07
 sight dep. up to 3 years 	75.0	89.0	12.8	5.8	3.6	3.4		3.4	3.4
- over 3 years	175.0	207.0	12.8	5.8	3.6	3.4	3.4	3.4	3.4
Commercial bank interest rates: Deposit rates									
Household sight dep.	81-152	50-78	6-13	2-5	3-6	34		3-6	3-6 1
Household time dep. (3-6 months)	435-885	322-418	32-49	9-21	9-21	9-20.5	9-20.5	9-20.5	9-20.5
Enterprises sight dep.	61-152	42-78	6-13	2-5	4-7	2.4-8	•	2.5-7.6	25-76
Enterprises time dep. (3-6 months)	435-885	207-418	33-49	9-21	5-21	4.9-20.5		5-20.6	5-20.6
Lending rates: 'Short-term rates	:	;		25-30	19-30	18.30		ţ	ţ
Long-term working capital	1,100-2,355	474-675	88.08	25-30	10.20	00-01	10-20	7 5	1/-4/
	1 100	267 600	07 00	00-07	00-61	05-4		17-27	17-27
	1,100 30	700-/00	6/-/9	72-30	20-30	20-26.7		20-36	20-36

Source: Data provided by the National Bank.

Table 24. FYRM: Non-Government Sector Monetary Aggregates, 1992-97 1/

(In millions of denars, end of period)

	Denar M1	Currency in Circulation	Demand Deposits	M2	Denar Saving and Time Deposits	Foreign Currency Sight Deposits	M3	Denar non-monetary Deposits	Foreign Currency Time Deposits
1992 Q4	1,661	893	768	2,049	388	0	2.204	1.55	
1993 Q1	2,049	908	1,141	2,810	641	120	2,204	155	
Q2	3,093	1,480	1,613	4,979	1,308	578	3,064	254	***
Q3	4,306	1,980	2,326	7,559	2,302	951	5,397	418	***
Q4	5,591	2,703	2,888	13,539	3,560	4,388	8,241	682	
1994 Q1	6,296	2,715	3,581	15,279	4,596		15,142	1,603	• •••
Q2	7,881	3,370	4,511	17,175	4,837	4,387	16,889	1,610	•••
Q3	8,715	3,911	4,804	17,639	4,502	4,457	19,099	1,924	•••
Q4	10,508	4,786	5,722	17,852		4,422	19,609	1,970	•••
1995 January	9,258	4,069	5,722	17,852	3,772	3,572	20,422	2,570	•••
February	9,405	3,936	5,469	17,207	4,361	3,648	19,813	2,546	•••
March	9,667	4,241	5,426	16,991	4,403	3,192	19,488	2,488	•••
April	10,410	4,688	5,722	17,814	4,028	3,296	19,394	2,403	•••
May	10,431	4,465	5,966	17,614	4,010	3,394	20,201	2,387	•••
June	10,588	4,713	5,875		4,189	2,879	21,065	2,424	1,142
July	11,373	5,062	6,311	17,331	4,053	2,690	20,866	2,421	1,114
August	11,826	4,928	6,898	18,354	3,890	3,091	21,912	2,420	1,138
September	11,458	4,856	6,602	19,032	3,828	3,378	22,520	2,411	1,077
October	11,922	4,790	7,132	18,388	3,880	3,050	21,917	2,422	1,107
November	11,950	5,017	6,933	18,525	3,836	2,767	22,219	2,400	1,294
December	12,533	5,965	6,568	18,090	3,391	2,749	21,798	2,459	1,249
1996 January	11,990	5,163	6,827	18,785	3,187	3,065	22,654	2,701	1,168
February	11,582	5,134		18,455	3,368	3,097	22,213	2,627	1,131
March	11,382	5,134	6,448	18,248	3,610	3,056	22,064	2,669	1,147
April	11,970	5,182	6,139	17,675	3,682	2,672	21,393	2,624	1,094
Мау	11,400		6,152	18,125	3,458	2,697	22,016	2,612	1,279
June	11,568	5,361 5,445	6,039	17,701	3,511	2,790	21,665	2,616	1,348
July	11,762	•	6,123	17,976	3,575	2,833	21,747	2,607	1,164
August	12,277	5,499	6,263	18,137	3,486	2,889	21,879	2,588	1,154
September	12,277	5,501	6,776	18,735	3,570	2,888	22,730	2,665	1,330
October		5,500 5,501	6,538	18,341	3,491	2,812	22,299	2,689	1,269
November	12,349	5,591	6,758	18,615	3,515	2,751	22,336	2,649	1,072
December	11,698	5,741	5,957	18,363	3,783	2,882	22,055	2,733	959
997 January	12,143	6,698	5,445	18,502	3,641	2,718	22,451	2,819	1,130
•	11,432	6,027	5,405	18,086	3,855	2,799	21,850	2,787	977
February	11,253	5,788	5,465	18,091	3,928	2,910	21,869	2,714	1,064
March	11,069	5,523	5,546	17,594	3,777	2,748	21,390	2,645	1,151
April	11,032	5,692	5,340	17,448	3,668	2,748	20,941	2,584	909
May	10,841	5,308	5,533	17,597	3,663	3,093	21,310	2,870	843
June	11,184	5,396	5,788	18,386	3,925	3,277	22,100	2,884	830
July	11,740	5,906	5,834	19,644	3,811	4,093	23,992	2,924	1,424
August	12,088	5,838	6,250	19,862	4,048	3,726	23,809	2,929	1,424
September	12,365	5,824	6,541	20,540	3,982	4,193	24,462	2,934	988
October	12,865	6,136	6,729	21,137	3,926	4,346	25,285	2,899	1,249
November	12,481	5,593	6,888	21,385	3,817	5,087	25,534	2,855	
December	13,985	7,130	6,855	22,726	3,887	4,854	26,707	2,934 2,895	1,195 1,086

Source: National Bank.

^{1/} Excludes frozen foreign currency deposits.

Table 25. FYRM: General Government Operations, 1996-98

	1996	19	97	1998	1996	199	97	1998
		Budget	Actual	Proj.	•	Budget	Actual	Proj.
		(Millions	of denars)			(Percent o	f GDP)	
Total revenue and grants	64,445	65,7 7 9	64,650	66,492	41.0	39.6	38.9	37.2
Total revenue	64,346	65,579	64,650	66,492	40.9	39.5	38.9	37.2
Current revenue	63,700	65,379	64,565	66,440	40.5	39.4	38.9	37.2
Tax revenue	59,688	61,587	59,877	61,549	37.9	37.1	36.1	34.5
Taxes on income and profits	11,191	11,549	10,049	10,347	7.1	7.0	6.1	5.8
Social security contribution	20,785	21,399	22,701	21,766	13.2	12.9	13.7	12.2
Local taxes	411	418	944	1,016	0.3	0.3	0.6	0.6
Domestic taxes on goods and services	20,654	21,250	20,599	21,928	13.1	12.8	12.4	12.3
Sales tax	8,777	9,225	8,816	9,283	5.6	5.6	5.3	5.2
Excises	11,877	12,025	11,783	12,644	7.6	7.2	7.1	
Import duties	6,647	6,971	5,525	6,430	4.2	4.2	3.3	7.1
Other taxes	0	•	59	63	0.0	0.0	0,0	3.6
Non tax revenue	4,012	3,793	4,688	4,891	2.6	2.3	2.8	0.0
Capital revenue	646	200	85	52	0.4	0.1	2.8 0.1	2.7
Foreign grants	99	200	0	0	0.1	0.1	0.0	0.0 0.0
Total expenditure	65,281	63,293	65,357	67,681	41.5	38.1	39.4	37.9
Current expenditure	60,943	59,795	62,898	64,351	38.7	36.0	37.9	36.0
Goods and services	21,048	21,688	21,189	22,071	13.4	13.1	12.8	12.4
Wages and salaries	15,629	15,659	15,604	16,003	9.9	9.4	9.4	9.0
Other goods and services	5,419	6,029	5,585	6,068	3.4	3.6	3.4	3.4
Transfers	26,975	26,274	26,210	26,460	17.1	15.8	15.8	14.8
Subsidies		•	475	648			0.3	0.4
Social Programs	5,818	5,635	6,234	6,033	3.7	 3.4	3.8	3.4
Unemployment benefits	2,049	1,725	2,114	2,109	1.3	1.0	1.3	1.2
Others	3,769	3,910	4,120	3,924	2.4	2.4	2.5	2.2
Pensions	16,330	16,584	16,873	17,143	10.4	10.0	10.2	9.6
Others		• • • •	2,629	2,636			1.6	1.5
Interest	3,509	3,613	4,020	4,048	2.2	2.2	2.4	2.3
Domestic	2,030	1,543	1,488	1,501	1.3	0.9	0.9	0.8
Foreign	1,479	2,070	2,532	2,546	0.9	1.2	1.5	1.4
Unclassified	9,412	8,220	11,478	11,772	6.0	5.0	6.9	6.6
Health	9,412	8,220	10,211	10,420	6.0	5.0	6.2	5.8
Local government .			947	1,021			0.6	0.6
Others			320	332			0.2	0.0
Capital expenditure	4,338	3,499	2,466	3,230	2.8	2.1	1.5	1.8
Reserves		0	9 9	100	0.0	0.0	0.1	0.1
turrent balance	2,855	5,785	1,667	2,089	1.8	3.5	1.0	1.2
alance	-836	2,486	-706	-1,189	-0.5	1.5	-0.4	-0.7
ash balance	248	1,587	-223	-975	0.2	1.0	-0.1	-0.5
otal financing	836	-2,486	706	1,189	0.5	-1.5	0.4	0.7
Domestic financing	356	-3,187	220	-1,672	0.3	-1.3 -1.9	0.4	0.7 -0.9
National Bank, net	-1,013	-1,416	4,059	-2,051	-0.6	-0.9	0.1 2.4	
Domestic operations 1/	-1,248	-2,400	2,252	-1,466	-0.8	-0.9 -1.4	2.4 1.4	-1.1
Foreign operations 2/	235	984	1,807	-585	0.1	0.6	1.4	-0.8
Commercial banks, net 1/	-37	-872	-4,857	-35	0.0	-0.5	-2.9	-0.3
Other	322	0	535	200	0.0	0.0		0.0
Interest arrears on frozen forex deposits	1,300	1,160	1,160	1,160	0.2		0.3	0.1
Payment arrears	-216	-2,059	-6 7 7	-946	-0.1	0.7	0.7	0.6
Financing abroad, net	480	701	485	2,861	-v. 1	-1.2	-0.4	-0.5

Sources: The authorities, and IMF staff estimates and projections.

 ^{1/ 1997} figures reflect Stopanska Banka's repayment, using government bonds, of its denar 3.5 billion debt to the National Bank.
 2/ Includes exceptional lending to clear EIB arrears in 1997.

Table 26. FYRM: Central Government Operations, 1996-98

Total revenues and grants Tax revenues Personal income tax Profit tax Sales tax Excises Import duties Other taxes Non-tax revenues Capital revenue Foreign grants Total expenditures Current expenditure Goods and saleries Other goods and saleries Other goods and services Transfers	40,189 37,715 9,161 2,030 8,777 11,100 6,647 0 2,369 6 99 41,397 36,894 19,970 15,245 4,725 13,712 3,419	Hudget 41,520 38,981 9,202 2,348 9,225 11,235 6,971 2,139 200 200 41,316 37,719 20,678 15,205 5,473	Actual 38,502 35,501 8,754 1,295 8,816 11,052 5,525 5,92 2,964 37 0 40,787 38,189 19,951	41,036 38,000 8,710 1,637 9,283 11,877 6,430 63 3,036 0 0	25.5 24.0 5.8 1.3 5.6 7.1 4.2 0.0 1.5 0.0 0.1	25.0 23.5 5.5 1.4 5.6 6.8 4.2 0.0 0.1 0.1	Actual 23.2 21.4 5.3 0.8 5.3 6.7 3.3 0.0 1.8 0.0 0.0	23.0 21.3 4.9 0.9 5.2 6.6 3.6 0.0 1.7 0.0
Tax revenues Personal income tax Profit tax Sales tax Rxcises Import duties Other taxes Non-tax revenues Capital revenue Foreign grants Total expenditures Current expenditure Goods and services Wages and salaries Other goods and services	37,715 9,161 2,030 8,777 11,100 6,647 0 2,369 6 99 41,397 36,894 19,970 15,245 4,725 13,712 3,419	41,520 38,981 9,202 2,348 9,225 11,235 6,971 2,139 200 200 41,316 37,719 20,678 15,205	38,502 35,501 8,754 1,295 5,816 11,052 5,525 59 2,964 37 0	38,000 8,710 1,637 9,283 11,877 6,430 63 3,036 0 0	24.0 5.8 1.3 5.6 7.1 4.2 0.0 1.5 0.0 0.1	25.0 23.5 5.5 1.4 5.6 6.8 4.2 0.0 1.3 0.1	23.2 21.4 5.3 0.8 5.3 6.7 3.3 0.0 1.8	21.3 4.5 0.9 5.2 6.6 3.6 0.0 1.7 0.0
Tax revenues Personal income tax Profit tax Sales tax Rxcises Import duties Other taxes Non-tax revenues Capital revenue Foreign grants Total expenditures Current expenditure Goods and services Wages and salaries Other goods and services	37,715 9,161 2,030 8,777 11,100 6,647 0 2,369 6 99 41,397 36,894 19,970 15,245 4,725 13,712 3,419	38,981 9,202 2,348 9,225 11,235 6,971 2,139 200 200 41,316 37,719 20,678 15,205	35,501 8,754 1,295 8,816 11,052 5,525 59 2,964 37 0	38,000 8,710 1,637 9,283 11,877 6,430 63 3,036 0 0	24.0 5.8 1.3 5.6 7.1 4.2 0.0 1.5 0.0 0.1	23.5 5.5 1.4 5.6 6.8 4.2 0.0 1.3 0.1	21.4 5.3 0.8 5.3 6.7 3.3 0.0 1.8 0.0	21.3 4.5 0.9 5.2 6.6 3.6 0.0 1.7 0.0
Personal income tax Profit tax Sales tax Excises Import duties Other taxes Non-tax revenues Capital revenue Foreign grants Total expenditures Current expenditure Goods and services Wages and salaries Other goods and services	9,161 2,030 8,777 11,100 6,647 0 2,369 6 99 41,397 36,894 19,970 15,245 4,725 13,712 3,419	9,202 2,348 9,225 11,235 6,971 2,139 200 200 41,316 37,719 20,678 15,205	8,754 1,295 8,816 11,052 5,525 59 2,964 37 0 40,787 38,189	8,710 1,637 9,283 11,877 6,430 63 3,036 0	5.8 1.3 5.6 7.1 4.2 0.0 1.5 0.0 0.1	5.5 1.4 5.6 6.8 4.2 0.0 1.3 0.1	21.4 5.3 0.8 5.3 6.7 3.3 0.0 1.8 0.0	21.3 4.5 0.9 5.2 6.6 3.6 0.0 1.7 0.0
Profit tax Sales tax Excises Import duties Other taxes Non-tax revenues Capital revenue Foreign grants Total expenditures Current expenditure Goods and services Wages and salaries Other goods and services	2,030 8,777 11,100 6,647 0 2,369 6 99 41,397 36,894 19,970 15,245 4,725 13,712 3,419	2,348 9,225 11,235 6,971 2,139 200 200 41,316 37,719 20,678 15,205	1,295 8,816 11,052 5,525 59 2,964 37 0 40,787 38,189	1,637 9,283 11,877 6,430 63 3,036 0	1.3 5.6 7.1 4.2 0.0 1.5 0.0 0.1	1.4 5.6 6.8 4.2 0.0 1.3 0.1	5.3 0.8 5.3 6.7 3.3 0.0 1.8 0.0	4.9 0.9 5.2 6.6 3.6 0.0 1.7 0.0
Sales tax Excises Import duties Other taxes Non-tax revenues Capital revenue Foreign grants Total expenditures Current expenditure Goods and services Wages and salaries Other goods and services	8,777 11,100 6,647 0 2,369 6 99 41,397 36,894 19,970 15,245 4,725 13,712 3,419	9,225 11,235 6,971 2,139 200 200 41,316 37,719 20,678 15,205	8,816 11,052 5,525 59 2,964 37 0 40,787 38,189	9,283 11,877 6,430 63 3,036 0 0	5.6 7.1 4.2 0.0 1.5 0.0 0.1	5.6 6.8 4.2 0.0 1.3 0.1	5.3 6.7 3.3 0.0 1.8 0.0	5.2 6.6 3.6 0.0 1.7 0.0
Excises Import duties Other taxes Non-tax revenues Capital revenue Foreign grants Total expenditures Current expenditure Goods and services Wages and salaries Other goods and services	11,100 6,647 0 2,369 6 99 41,397 36,894 19,970 15,245 4,725 13,712 3,419	11,235 6,971 2,139 200 200 41,316 37,719 20,678 15,205	11,052 5,525 59 2,964 37 0 40,787 38,189	11,877 6,430 63 3,036 0 0	7.1 4.2 0.0 1.5 0.0 0.1	6.8 4.2 0.0 1.3 0.1 0.1	6.7 3.3 0.0 1.8 0.0	6.6 3.6 0.0 1.7 0.0
Import duties Other taxes Non-tax revenues Capital revenue Foreign grants Total expenditures Current expenditure Goods and services Wages and salaries Other goods and services	6,647 0 2,369 6 99 41,397 36,894 19,970 15,245 4,725 13,712 3,419	6,971 2,139 200 200 41,316 37,719 20,678 15,205	5,525 59 2,964 37 0 40,787 38,189	6,430 63 3,036 0 0	4.2 0.0 1.5 0.0 0.1 26.3	4.2 0.0 1.3 0.1 0.1	3.3 0.0 1.8 0.0	3.6 0.0 1.7 0.0
Other taxes Non-tax revenues Capital revenue Foreign grants Total expenditures Current expenditure Goods and services Wages and salaries Other goods and services	0 2,369 6 99 41,397 36,894 19,970 15,245 4,725 13,712 3,419	2,139 200 200 41,316 37,719 20,678 15,205	59 2,964 37 0 40,787 38,189	63 3,036 0 0	0.0 1.5 0.0 0.1 26.3	0.0 1.3 0.1 0.1	0.0 1.8 0.0	0.0 1.7 0.0
Non-tax revenues Capital revenue Foreign grants Total expenditures Current expenditure Goods and services Wages and salaries Other goods and services	2,369 6 99 41,397 36,894 19,970 15,245 4,725 13,712 3,419	200 200 41,316 37,719 20,678 15,205	2,964 37 0 40,787 38,189	3,036 0 0 42,656	1.5 0.0 0.1 26.3	1.3 0.1 0.1	1.8 0.0	1.7 0 .0
Capital revenue Foreign grants Total expenditures Current expenditure Goods and services Wages and salaries Other goods and services	6 99 41,397 36,894 19,970 15,245 4,725 13,712 3,419	200 200 41,316 37,719 20,678 15,205	37 0 40,787 38,189	0 0 42,656	0.0 0.1 26.3	0.1 0.1	0.0	0.0
Foreign grants Total expenditures Current expenditure Goods and services Wages and salaries Other goods and services	99 41,397 36,894 19,970 15,245 4,725 13,712 3,419	200 41,316 37,719 20,678 15,205	0 40,787 38,189	0 4 2, 656	0.1 26.3	0.1		
Current expenditure Goods and services Wages and salaries Other goods and services	36,894 19,970 15,245 4,725 13,712 3,419	37,719 20,678 15,205	38,189			240		
Goods and services Wages and salaries Other goods and services	19,970 15,245 4,725 13,712 3,419	37,719 20,678 15,205	38,189				24.6	22.0
Wages and salaries Other goods and services	15,245 4,725 13,712 3,419	15,205	-	,	23.5	22.7	24.6 23.0	23.9 22.1
Other goods and services	4,725 13,712 3,419	-		20,769	12.7	12.5	12.0	
	13,712 3,419	5 473	15,148	15,540	9.7	9.2	9.1	11.6 8.7
Transfers	3,419	2,712	4,803	5,229	3.0	3.3	2.9	8./ 2.9
		13,765	14,282	14,803	8.7	8.3	8.6	2.9 8.3
Pension Fund		4,300	4,066	2,854	2.2	2.6	2.4	1.6
Social programs	•••		7,101	8,660		0.0	4.3	4.8
Social Assistance Program	2,661	2,650	2,822	2,457	1.7	1.6	1.7	1.4
Employment Fund	2,885	2,549	2,981	2,936	1.8	1.5	1.8	1.6
Program for Employment	0	0	0	1,800	0.0	0.0	0.0	1.0
Others	•••	***	1,298	1,467	•••	0.0	0.8	0.8
Subsidies			475	648		0.0	0.3	0.4
Other transfers Localities	4,747	4,266	2,641	2,641	3.0	2.6	1.6	1.5
Other institutions	18	30	12	5	0.0	0.0	0.0	0.0
Refugees	1,370	1,574	1,795	2,023	0.9	0.9	1.1	1.1
Strategic reserves	31	24	23	24	0.0	0.0	0.0	0.0
War veterans	670	516	431	215	0.4	0.3	0.3	0.1
Bank rehabilitation	355 20	384	380	374	0.2	0.2	0.2	0.2
Interest	3,212	0 3,276	2056	0	0.0	0.0	0.0	0.0
Domestic	2,030	1,543	3,956	3,978	2.0	2.0	2.4	2.2
Frozen foreign currency deposits	1,300	1,160	1,488 1,160	1,501	1.3	0.9	0.9	0.8
Other	730	383	328	1,160 341	0.8 0.5	0.7	0.7	0.6
Foreign	1,182	1,733	2,468	2,477	0.3	0.2	0.2	0.2
Capital expenditure	4,338	3,499	2,504	3,006	2.8	1.0 2.1	1.5	1.4
Fixed investment	1,440	1,796	1,292	1,550	0.9	1.1	1.5	1.7
Net lending	15	0	73	0	0.0	0.0	0.8 0.0	0.9 0.0
Equity	16	30	16	68	0.0	0.0	0.0	0.0
Capital transfers, incl. railways	2,867	1,673	1,123	1.388	1.8	1.0	0.7	0.8
Reserves	95	100	99	100	0.1	0.1	0.1	0.1
Balance	-1,208	204	-2,285	-1,620	-0.8	0.1	-1.4	-0.9
Cash balance	277	1,364	-1,070	-700	0.2	0.8	-0.6	-0.4
otal financing	1,208	-204	2,285	1,620	0.8	-0.1	1.4	0.9
Domestic financing	582	-953	1,625	-1,241	0.4	-0.6	1.0	-0.7
National Bank, net	-1,013	-1,416	4,059	-2,051	-0.6	-0.9	2.4	-1.1
Domestic operations 1/	-1,248	-2,400	2,252	-1,466	-0.8	-1.4	1.4	-0.8
Foreign operations 2/	235	984	1,807	-585	0.1	0.6	1.1	-0.3
Commercial banks, net 1/ Other	-212	-697	-4,184	-310	-0.1	-0.4	-2.5	-0.2
Interest arrears on frozen forex deposits	322	0	535	200	0.2	0.0	0.3	0.1
Payment arrears	1,300	1,160	1,160	1,160	0.8	0.7	0.7	0.6
Financing abroad, net	185 625	0 749	55 660	-240 2,861	0.1 0.4	0.0 0.5	0.0 0.4	-0.1 1.6
Iemorandum items:						=	•	
Transfers to social funds	6,304	£ 940	7.045	5 A05				
Pension Fund	6,304 3,419	6,849	7,047	5,790	4.0	4.1	4.2	3.2
Employment Fund	2,885	4,300	4,066	2,854	2.2	2.6	2.4	1.6
Social Assistance Program	2,885 2,476	2,549	2,981	2,936	1.8	1.5	1.8	1.6
Interest expenditure	3,212	2,650 3,276	2,767 3,956	2,697 3,978	1.6 2.0	1.6 2.0	1.7 2.4	1.5 2.2

Sources: The authorities and IMF staff estimates and projections.

 ^{1/ 1997} figures reflect Stopanska Banka's repayment, using government bonds, of its denar 3.5 billion debt to the National Bank.
 2/ Includes exceptional lending to clear BIB arrears in 1997.

Table 27. FYRM: Dollar Wages in Selected Transition Economies, 1993-97

	1993	1994	1995	1996	1997
Gross Wages					
Bulgaria	180	139	180	138	123
Croatia	265	369	617	663	627
Czech Republic	283	340	437	506	464
Estonia	83	130	208	248	249
Hungary	308	320	321	326	325
Latvia	7 7	138	187	199	
Lithuania	43	91	129	172	213
Macedonia, FYR	300	327	413	402	330
Poland	352	370	490	557	551
Romania	100	109	138	137	117
Net Wages					
Bulgaria	106	85	106	81	72
Croatia	154	214	357	384	363
Czech Republic	208	250	321	372	341
Estonia	64	100	160	191	192
Hungary	206	220	211	207	213
Latvia	58	104	141	150	
Lithuania	34	71	99	128	 156
Macedonia, FYR	165	180	227	221	181
Poland	238	250	331	376	372
Romania	78	84	106	104	88
		···			

Source: IMF staff estimates.

Table 28. FYRM: Foreign Direct Investment in Selected Transition Economies, 1993-97

	1993	1994	1995	1996	1997
	4	(In per	cent of GDP)		
Latvia	2.4	4.3	5.2	7.1	7.2
Hungary	6.0	2.6	10.0	4.9	5.0
Bulgaria	0.4	1.1	0.6	0.9	4.6
Estonia	9.7	8.7	5.6	2.5	2.8
Poland	0.7	0.6	1.0	2.0	1.9
Czech Republic	1.6	1.9	5.0	2.5	1.8
Croatia	0.7	0.7	0.4	1,5	1.6
Romania	0.4	1.2	1.2	1.2	1.5
Lithuania	0.9	1.4	0.9	1.2	1.2
Macedonia, FYR	***	0.8	0.3	0.3	0.9

Source: World Economic Outlook.

Table 29. FYRM: Balance of Payments, 1993-97

(In millions of U.S. dollars)

	1993	1994	1995	1996 Rev.	1997 Prel.
Current Account	15	-180	-230	-288	-275
Trade balance (fob) 1/	43	-186	-235	-317	-388
Exports	1,056	1,086	1,204	1,147	1,201
Imports (including aid)	1,013	1,272	1,439	1,464	1,589
Non-factor services (net)	-154	-156	-187	-155	-145
Income, net (including net interest)	-57	-61	-3 6	-30	-33
Transfers (net)	183	223	228	213	290
Official	28	44	27	52	8
Private	155	179	201	161	283
Capital account	-108	53	56	113	50
Public sector	- 91	100	20	40	61
Disbursements	0	149	103	110	101
Amortization	91	49	83	69	40
Private sector	-17	-46	36	72	-11
Errors/omissions and short-term capital 2/	16	167	162	124	224
Overall balance	-77	40	-12	-51	-1
Financing	77	-40	12	51	1
Net foreign assets (increase:-)	-60	-30	-61	19	20
IMF/EU (net change)	0	16	37	14	52
Change in arrears	137	-11	-252	-4	-106
New arrears	137	100	66	28	-100 8
Repayment of arrears	0	111	318	32	114
Rescheduling	0	0	326	37	87

Sources: The authorities, and IMF staff estimates.

^{1/} Changes in the coverage of trade data during the period result in discontinuities in the trade series, and related ratios, which are particularly evident in 1996 and 1997.

^{2/} Includes unidentified short-term capital, such as trade credits, imports paid by drawdown of foreign held accounts, and higher than recorded remittances.

Table 30. FYRM: Commodity Composition of Exports, 1992–97

(In percent of total imports)

	1992	1993	1994	1995	1996	1997
Exports	100	100	100	100	100	100
Food and live animals	15	11	10	11	2	_
Beverages and tobacco	12	10	6	7	10	6
Crude materials, inedible, exept fuels	5	6	7	,	13	14
Chemicals	4	5	/	8	6	6
Manufactured goods classified chiefly by materi	•	_	4	6	6	6
Machinery and transport and transport	30	33	35	3 5	30	34
Machinery and transport equipment	8	16	12	13	8	7
Miscellaneous manufactured articles	25	18	22	18	28	26
Other	1	1	3	2	2	20

Source: The authorities.

Table 31. FYRM: Destination of Exports, 1992-97

(In percent of total exports)

	1992	1993	1994	1995	1996	1997
TOTAL	100	100	100	100	100	100
Republics of the former SFRY Of which:	22	19	13	16	32	32
Serbia	6	5	4	7	21	23
Bosnia	5	2	0	0	2	2
Croatia	5	4	3	3	3	3
Slovenia	7	8	6	6	6	5
Former CMEA area Of which:	19	27	35	37	12	10
Bulgaria	5	8	21	21	3	3
Albania	2	3	2	2	3	3
Ukraine	0	1	2	2	0	0
Russsia	8	11	7	7	3	2
Czech	2	2	1	í	1	0
Other	2	3	3	3	î	1
European Union Of which:	42	35	32	34	42	37
Germany	20	14	13	13	19	16
Italy	7	9	11	10	4	4
Netherlands	3	1	1	2	4	3
Austria	2	1	1	2	3	3
Greece	2	2	2	3	2	2
UK	3	5	1	1	9	8
Other	4	3	3	3	2	8 2
Other	18	19	20	14	14	21
Of which:			20	17	14	21
Switzerland	3	3	3	3	3	_
US	6	6	4	3	3 6	5
Turkey	1	4	3	3		10
Japan	2	1	0	0	2	2
Korea	1	1	3		0	0
Other	5	4	3 7	2 3	0 3	0 4

Table 32. FYRM: Commodity Composition of Imports, 1992–97

(In percent of total imports)

	1992	1993	1994	1995	1996	1997
Imports	100	100	100	100	100	100
Food and live animals	14	17	19	16	13	14
Beverages and tobacco	2	3	2	10	13	14
Crude materials, inedible, exept fuels	9	6	5	ı F	1	1
Mineral fuels, lubricants and related materials	12	16	_	5	3	4
Animal and vegetable oils and fats	12		11	12	9	11
Chemicals	1	0	0	0	1	1
	13	16	13	12	10	11
Manufactured goods, classified by material	17	17	13	16	19	19
Other	13	3	10	10	9	19

Table 33. FYRM: Origin of Imports, 1992-97
(In percent of total imports)

	1992	1993	1994	1995	1996	1997
TOTAL	100	100	100	100	100	100
Republics of the former SFRY	13	24	21	19	21	24
Of which:				17	21	24
Serbia	1	5	7	9	10	12
Bosnia	0	1	0	Ó	0	0
Croatia	4	4	4	3	3	4
Slovenia	8	14	11	7	8	8
Former CMEA area	34	28	25	25	21	19
Of which:					21	1)
Bulgaria	14	11	16	15	7	6
Albania	0	1	1	0	ó	0
Ukraine	0	0	1	2	2	5
Russsia	14	12	3	4	8	4
Czech	2	1	2	i	1	1
Other	4	3	3	3	3	3
European Union	38	33	37	40	39	36
Of which:				••		50
Germany	14	13	17	16	15	13
Italy	10	6	7	10	7	5
Netherlands	3	1	3	3	2	2
Austria	1	1	1	1	1	1
Greece	2	2	3	3	2	2
UK	4	4	2	2	5	7
Other	4	5	5	5	5	4
Others	15	15	18	16	19	21
Of which:				10	17	21
Switzerland	1	2	2	1	1	1
US	2	2	3	3	4	5
Turkey	3	3	3	3	3	3
Japan	1	1	1	1	1	1
Korea	0	0	1	1	1	1
Other	8	7	8	6	8	11

Table 34. FYRM: Exports and Imports by Final Use, 1992–1997

(In percent of total)

	1992	1993	1994	1995	1996	1997
Exports	100	100	100	100	100	100
Industrial supplies	43	47	50	54	51	52
Investment goods and spare part	3	7	5	4	31	
Consumption goods	51	40	41	37	46	3
Other	3	5	4	5	0	45 0
Imports	100	100	100	100	100	100
Industrial supplies	69	62	55	58	56	61
Of which: oil and derivatives	11	15	10	11	8	10
Investment goods and spare part	7	11	13	11	13	10
Consumption goods	24	26	32	31	30	28
Other	1	1	1	1	1	1

Table 35. FYRM: Services Account, 1992-97
(In millions of U.S. dollars)

	1992	1993	1994	1995	1996	1997
Travel, net	4	0	6	-8	-6	-13
Receipts	11	13	29	19	21	14
Payments	- 7	-13	-23	-27	-26	-27
Transportation, net	-6	-115	-127	-138	-100	-78
Receipts	6	23	39	54	48	54
Payments	-12	-138	-166	-192	-149	-132
Other Services, net	32	-39	-35	-41	-49	-54
Receipts	43	48	104	81	85	60
Payments	-11	-87	-139	-122	-134	-114
Total services,						
excluding interest, net	30	-154	-156	-187	-155	-145
Receipts	60	84	172	155	154	128
Payments	-30	-238	-328	-341	-309	-273
Income, net	-72	-56	-61	-36	-30	-33
Receipts	0	5	9	20	44	39
Payments	-72	-61	-70	-57	-74	-71
Total services, net	-42	-210	-217	-223	-185	-177
Receipts	61	89	181	175	199	167
Payments	-102	-299	-398	-398	-383	-344

Sources: The authorities, and IMF staff estimates.

Table 36. FYRM: External Debt Stock, 1992–97 1/
(In millions of U.S. dollars)

	1992	1993	1994	1995	1996 Rev.	1997 Prel.
TOTAL 1/2/	758	818	844	1,060	1,121	1,141
Multilateral	261	296	288	398	467	491
IMF	0	15	33	69	4 07 8 0	103
IBRD/IDA	161	175	131	178	206	237
IFC	10	10	10	5	200	237
EIB	58	59	70	82	76	37
Council of Europe	7	7	8	10	6	5
EBRD	0	0	1	15	69	83
EUROFIMA	26	30	35	40	29	25
Bilateral creditors 2/	255	277	318	412	402	377
Commercial creditors	242	245	238	251	252	273
Commercial Bank Creditors	229	229	229	229	229	241
Other	13	17	10	22	24	33
Total, not including IMF	758	803	811	991	1,041	1,037
Memorandum items:						
External Debt (share of total)	100	100	100	100	100	100
Multilateral creditors	34	36	34	38	42	43
Bilateral creditors	34	34	38	39	36	33
Commercial creditors	32	30	28	24	22	33 24
External Debt (as percent of GDP	34	32	27	2 4 26	28	24 34

Sources: The authorities, and IMF staff estimates.

^{1/} Medium- and long-term debt only. Includes interest in arrears and late interest.

^{2/} Including debt guaranteed or insured by the government or government agencies only.

Table 37. FYRM: Official Gold and Convertible Foreign Exchange
(In millions of U.S. dollars; end-of-period)

		Gold 1/	SDR Holdings	Reserve Position in the Fund	Foreign Exchange	Total
1993	Q1	7.1	0.2	0.0	58.2	65.5
	$\widetilde{\mathrm{Q2}}$	11.5	0.3	0.0	96.4	108.2
	Q3	13.8	0.2	0.0	118.1	132.1
	Q4	14.7	0.2	0.0	104.6	119.5
1994	Q1	14.7	0.6	0.0	88.7	104.0
	Q2	15.3	0.3	0.0	140.7	156.3
	Q3	16.4	1.0	0.0	146.6	164.0
	Q4	16,4	0.0	0.0	149.0	165.4
1995	Q1	16.4	0.0	0.0	162.4	178.8
	Q2	16.4	0.0	0.0	193.5	209.9
	Q3	16.4	0.0	0.0	223.3	239.7
	Q4	17.6	0.0	0.0	257.3	274.9
1996	Q1	19.7	0.0	0.0	232.2	251.9
	Q2	22.2	0.0	0.0	237.6	259.8
	Q3	22.2	0.0	0.0	231.5	253.7
	Q4	27.9	0.0	0.0	239.5	267.4
1997	Q1	26.6	0.0	0.0	209,7	236.3
	Q2	25.4	0.0	0.0	230.4	255.8
	Q3	25.9	0.0	0.0	249.5	275.5
	Q4	23.5	0.0	0.0	256.6	280.1

Sources: The authorities, and the IMF Treasurer's Department.

^{1/} At national valuation.

Table 38: FYRM: Exchange Rate Developments 1/

(period averages)

	Official Excha			
	Denar/US\$ D	enar/DM	Consumer Prices	Deflated by Relative Unit Labor Costs
1992	5.1	3.4	96.8	70.3
1992 May-Dec.	6.9	4.6	93.8	60.4
1993	23.3	14.0	100.0	100.0
1994	43.3	26.6	110.4	112.2
1995	38.1	26.5	128.5	125.0
1996	39.9	26 .6	126.0	110.5
1997	49.9	28.8	111.0	89.4
1996				
January	38.7	26.5	133.5	116.0
February	39.0	26.5	132.9	115.4
March	39.2	26.5	130.8	116.8
April	39.9	26.6	128.7	115.9
May	40.7	26.6	124.6	117.4
June	40.6	26.6	123.2	109.7
July	39.5	26.6	123.8	110.8
August	39.4	26.6	120.8	104.8
September	40.0	26.6	120.5	106.1
October	40.7	2 6.6	123.5	106.3
November	40.2	26 .6	125.2	105.4
December	41.3	26.6	124.1	101.6
1997	-			
January	42.6	26.6	124.9	99.9
February	44.5	26.6	123.3	101.1
March	45.2	26.6	121.6	102.2
April	45.5	26.6	117.8	103.6
May	45.4	26.6	117.7	104.7
June	46.1	26.7	117.7	94.3
July	53.1	29.7	97.0	74.8
August	55.9	30.9	100.7	75.7
September	54.5	30.9	100.9	76.7
October	54.4	30.9	105.0	76.7 79.1
November	54.5	30.9	102.8	82.2
December	54.9	30.9	103.1	78.6
1998				
January	56.1	30.9		
February	56.1	30.9	•••	•••
March	56.4	30.9	***	••••
April	56.2	30.9	•••	•••

Sources: Data provided by the authorities, and IMF staff estimates.

^{1/} The former SFRY denar was the official currency prior to monetary independence on April 26, 1992, whe the official currency became the FYRM denar. In May 1993, a currency reform took place with the introduction of a new denar equal to 100 old denars. All exchange rates shown are expressed in terms of the new denar.

^{2/} IMF staff estimates. Average 1993=100. An increase in the index indicates an appreciation.

Table 39. FYRM: Tax Summary as of April 1, 1998

Rates		Standard rate: 15 percent (Prior to 1997 the standard rate was 30 percent) For remitted dividends: 10 percent
Exemptions and Deductions	Central Government	Fixed assets used for: (i) Technological modernization, (ii) Structural adjustment, (iii) Protection of the environment, enjoy accelerated depreciation. Reinvested profits are deductible. (Prior to 1998 up to 30 percent deduction) Investments in economically undeveloped districts, border regions and certain mountain districts are deductible. The profits of: (i) Joint ventures with foreign partners, where the foreign partners hold at least a 20 percent share, (ii) Foreign enterprises, are exempt for the first three years of operation. Rehabilitation firms employing disabled persons are exempt.
Nature of Tax	Central G	A tax on annual aggregate business profits. Resident legal entities and physical persons are taxed on their global persons are taxed on their global profits. Nonresidents are taxed on profits earned in the FYRM. An entity is a resident of the FYRM if it was established and registered there. The taxable base is the difference between total revenues and expenses. Deductible expenses include business, financial, and extraordinary expenses, as well as depreciation. Taxpayers make monthly advance payments based on the previous year's profits, adjusted for inflation. Payments for the period July January are adjusted based on actual profits.
Tax		1. Taxes on Income and Profits 1.1 Profit Tax

domestic legal entity was reduced by Progressive tax rates are applied as resident employed as an expert by a (i) Employment, pension, economic copyright, patents, technical improvements, capital property and (ii) Income between two and five times AMW: (iii) Income over 5 times AMW: Withholding rates are as follows: (i) Income below two times the average monthly wage (AMW): (Prior to 1997, the tax of a non-(ii) Independent work contract, and professional earnings: Same as tax rates Rates 23 percent 27 percent 35 percent gambling earnings: 23 percent 50 percent). follows: Investment in land improvement or in **Exemptions and Deductions** deductible for up to 30 percent of the exempt (Prior to 1997 these were not All social security contributions are land consolidation are deductible by Distributed dividends are 50 percent 1/4 of the average salary amount is exempt (Prior to 1997 this was not Investment in farm buildings and Interest on demand deposits is 50 percent and 100 percent, agricultural implements are cadastral income. respectively. deductible. deductible. exempt). worldwide income. Nonresidents are taxed on income earnt in the FYRM. personal income from all sources. The tax is withheld at source on a A tax on annual aggregate net Nature of Tax Residents are taxed on their monthly basis. 1.2 Personal Income Tax Tax

Table 39 (continued). FYRM: Tax Summary as of April 1, 1998

Table 39 (continued). FYRM: Tax Summary as of April 1, 1998

Tax	Nature of Tax	Exemptions and Deductions	Rafac
2. Taxes on Goods & Services			COANA
2.1 Sales Tax	A tax on the transfer of goods and some services in their final state to	Exemption for these items:	Goods, standard rate: 25 percent
	the consumer. In particular, it applies to:	(i) Exports. (ii) Bread, milk, domestically	Goods, reduced rate: 5 percent.
	• Sale of all merchandise, unless otherwise stipulated in the law.	produced edible oil, lard, water. (iii) Medicine, orthopedic devices, automobiles purchased by	Reduced rate applies to: (i) Agricultural instruments, fertilizer, agricultural and fishing
	Retention of goods for own use or consumption.	handicapped persons, burial equipment.	goods; computers, equipment, used cars; electricity, gas, coal; industrial
	Importation of merchandise for consumption	airplanes, vessels.	and other waste. (ii) Food, cocoa, chocolate, salt, sugar, art goods, press, books; child
	Solo of homomorphisms	Exemption for these organizations:	clouning, soap, detergents.
	merchandise to caterers.	(i) Red Cross, Armed Forces, Police,	Services: 13 percent.
		Diplomatic and Consular missions. (ii) Companies where x percent of the	(Prior to 1997; Services, standard rate:
		workforce consists of persons who are disabled 'by nature' (i.e., not as a	10 percent.
		result of work injuries), and $x \ge 25$,	Services, increased rate:
		are exempt on x percent on their sales. Only applies to certain	25 percent. Applied to: leasing,
		products. (iii) Museums. Only applies to art works nurchased	brokerage, & representation services, agency commissions.
			Services, increased rate:
			35 percent.
			Applied to gambling).

Table 39 (continued). FYRM: Tax Summary as of April 1, 1998

				·								
Rates	Oil	Gasoline MF86 67 percent MF98 67 percent BMB95 63 percent	(Prior to 1997: MF86 69 percent MF98 69 percent BMB95 67 percent)	Diesel D1 59 percent D2 59 percent	(Prior to 1997: D1 62 percent D2 62 percent)	Heating Oil EL 34 percent Prior to 1907: El 38 2	LS 38.3 percent Jet fuel 17 percent	LPG: Standard Rate 5 percent LPG: For cars / vessels 40 percent Finel Oil	Mazut 10 percent (Prior to 1997: 11 percent) Others 11 percent	Alcohol Spirits (2 * percentage of alcohol) denars / liter (Prior to 1998.	Brandy 70 percent, Other spirits 130 percent ad	Beer 15 denars / liter (Prior to 1997: 60 percent ad
Exemptions and Deductions	Exports are exempt.											
Nature of Tax	A tax on the sale or import of goods.	Excises are generally imposed at the manufacturing and import stage. However, excises on luxuries are imposed at each distributional stage.	(Prior to 1997: excises on all alcoholic products and coffee were imposed at each distributional stage.)	Control marks are widely used to enforce payment of all excises.	(Prior to 1998: control marks only on tobacco.)							
Tax	2.2 Excise Tax											

Table 39 (continued). FYRM: Tax Summary as of April 1, 1998

Rates	Tobacco Cigarettes Licenced 35 percent Extra class 30 percent Class I-IV 23.5 percent Other 30 percent Other 30 percent Cigarettes Licenced 10 percent Extra class 60 percent Class I-IV 47 percent Class I-IV 47 percent Other 60 percent	Automobiles Up to 2-liter cylinder 25 percent Over 2-liter cylinder 55 percent	Luxury items 50 percent (Prior to 1997: 70 percent) Applies to ornaments, precious metals and stones, pearls, perfume, cosmetic products, hand-made rugs, reptile leather and fur products.	Coffee Unroasted 75 denars / kilo Roasted 85 denars / kilo Instant 90 denars / kilo (Prior to 1997: 50 percent ad valorem tax)	Others Periodicals, coal, books, chocolates: 3 percent. Banking Services 3 percent.
Exemptions and Deductions	II (b)	And the second s	TY coo	C. C	Oti F Cho
Nature of Tax	-				
Tax	2.2 Excise tax (Cont.)				

Tax	Nature of Tax	Exemptions and Deductions	Rates
2.3 Import Duties	Tax on imported goods.	Exemption for these items: (i) Re-exports. Must provide a bank guarantee for the amount of duty, in case re-export does not occur. (ii) Raw materials. Must pay duty, but after exporting finished product receive a duty-drawback. Exemption for these organizations: (i) Diplomatic and Consular missions.	Rates range from 0 percent to 25 percent. Lower rates on raw materials. No duty on cotton or crude oil. Preferential trade agreements, specifying 1 percent 'statistical charge' alone, apply to trade with: (i) Slovenia (Agreement signed 2/96). Exception: tariffs on industrial goods reduced gradually, with final elimination by 2000. (ii) Yugoslavia (Agreement signed 10/96). Beyond a specified quantitative limit, general tariff rates apply. (iii) Bosnia (Agreement signed 1/97). (iv) Croatia (Agreement signed 3/97). Exception: refined oil is subject to prohibitive tariffs.
3. Taxes on Property			1001 average taill fate, 0.3 percent.
3.1 Inheritance & gift tax	A tax on inheritance and gifts.	In general, recipients within the first degree of kinship (a spouse, child, or parent) are exempt.	For recipients within the second degree of kinship: 3 percent. (Prior to 1997; 5 percent)
		Recipients within the second degree of kinship (a grandchild, brother, or sister) are exempt only if they lived in the donor's household at the time of death or when the gift was given.	All others: 5 percent (Prior to 1997: 10 percent)

Table 39 (concluded). FYRM: Tax Summary as of April 1, 1998

Тах	Nature of Tax	Exemptions and Deductions	Rates
	Social Sec	Social Security Funds	
4. Social Security Contributions	All persons are liable to compulsory monthly social security contributions.		Rates are the same for employed and self-employed persons:
	For employed persons, the contributions, together with the income tax, are withheld at source.		
	Self-employed persons pay the contributions with their monthly income tax.	•	Employment Fund, 1.5 percent
	Local Go	Local Government	
5. Taxes on Property			
5.1 Property tax	A tax on the market value of: (i) Immovable property e.g. houses	Exemptions for:	0.10 percent
	apartments, business premises. (ii) Movable property, e.g., motor vehicles, houses.	 (i) Buildings used by government. (ii) Buildings used for education, health, sport, and cultural purposes. (iii) Buildings used for religious and humanitarian purposes. (iv) Farm land. (v) Buildings registered as historical monuments. (vi) Buildings housing foreign diplomatic or consular representatives, or international organizations. Residential buildings enjoy a 50 percent deduction. 	(Prior to 1997 the rate for movable property was 0.05 percent)
5.2 Property sales tax	A tax on the market value of sales of real estates and rights.		3 percent

				4
				1
		•		