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TO PRIORITY FCO
TELNO 207 OF 5 JULY 1983
INFO PRIORITY WASHINGTON, UKDEL IMF/IBRD, BONN AND PARIS
AND SAVING TO UKDEL OECD, BERNE AND ZAGREB (BY BAG)

MY TELNO 163: YUGOSLAVIA: FINANCIAL PACKAGE

IN A TWO-DAY SESSION OVER THE WEEKEND, THE FEDERAL ASSEMBLY APPROVED A SERIES OF NEW LAWS WHICH, IN EFFECT, GIVE THE FEDERAL EXECUTIVE COUNCIL AND NATIONAL BANK THE POWERS THEY NEED IN ORDER TO CONCLUDE NEGOTIATIONS WITH THE COMMERCIAL BANKS.

2. THIS REMOVES THE LAST MAJOR OBSTACLE ON THE YUGOSLAV SIDE TO FINALISATION OF THE PACKAGE. IT MEANS THAT, SUBJECT TO FINAL NEGOTIATION WITH THE COMMERCIAL BANKS, THE AGREEMENT REACHED IN PRINCIPLE WITH THE IMF WILL NOW BE ABLE TO GO AHEAD (MY TELNO 164). AS FOR THE IBRD STRUCTURAL ADJUSTMENT LOAN, JANKO SMOLE TOLD THE MINISTER FOR TRADE WHEN I TOOK MR CHANNON TO SEE HIM ON 30 JUNE THAT THIS WOULD NOW BE SIGNED ON 7 JULY. AS YOU KNOW, THE FULL BIS CONTRIBUTION IS STILL IN BAULK, BUT DISCUSSIONS WITH GOVERNMENTS ARE GOING AHEAD WITHOUT MAJOR PROBLEMS. ALL IN ALL, IT LOOKS AS IF THE BULK OF THE PACKAGE WILL NOW BE IN PLACE BY AUGUST.

3. THE DEBATE IN THE FEDERAL ASSEMBLY WAS EVIDENTLY VERY DIFFICULT. THE MAIN QUESTION WAS HOW TO GIVE PRACTICAL EFFECT TO THE STATE GUARANTEE INSISTED ON BY THE COMMERCIAL BANKS, GIVEN YUGOSLAVIA'S DECENTRALISED BANKING SYSTEM AND THE LIMITED POWERS HITHERTO ENJOYED BY THE NATIONAL BANK. WHAT HAS BEEN AGREED, IN THE TEETH OF BITTER OPPOSITION FROM DELEGATES REPRESENTING CROATIA AND ESPECIALLY SLOVENIA, IS THAT WHEN A REPUBLIC OR PROVINCE IS UNABLE TO COVER REPAYMENTS IN FOREIGN CURRENCY BY ANY OF ITS BANKS OR ENTERPRISES, THE NATIONAL BANK WILL HAVE POWER TO SEIZE ALL FOREIGN CURRENCY ASSETS OF YUGOSLAV BANKS, WHEREVER SITUATED, IN ORDER TO MEET THE DEBT. THE TEXT OF THE NEW LAW WILL NOT BE PUBLISHED FOR SEVERAL DAYS. IT IS NOT CLEAR FOR INSTANCE HOW IT WILL AFFECT FOREIGN CURRENCY HOLDINGS OF PRIVATE INDIVIDUALS BUT THE FEDERAL SECRETARIAT FOR FINANCE TOLD US THIS MORNING THAT THE NEW POWERS EXTEND TO ALL EXISTING AND FUTURE FOREIGN CURRENCY DEBTS, NOT JUST THOSE COVERED IN THE CURRENT NEGOTIATIONS WITH THE ICC. (THIS SHOULD INCIDENTALLY SIMPLIFY ECGD'S CURRENT NEGOTIATIONS ON GUARANTEES FOR THEIR RE-FINANCING).

4. THE PRESIDENT OF THE FEDERAL EXECUTIVE COUNCIL, MRS PLANINC, MADE AN IMPRESSIVE SPEECH JUSTIFYING THE NEW ARRANGEMENTS. SOME OF THE DEMANDS MADE IN NEGOTIATIONS BY THE COMMERCIAL BANKS HAD,

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/ SHE SAID,

SHE SAID, BEEN IN CONFLICT WITH YUGOSLAV SOVEREIGNTY. THESE HAD BEEN REJECTED. THE CONDITIONS FOR THE ICC'S PARTICIPATION IN THE PACKAGE WERE STILL 'HARSH AND CRUDE', BUT THE ALTERNATIVE TO ACCEPTING THEM WOULD HAVE BEEN GENERAL RESCHEDULING OF YUGOSLAVIA'S FOREIGN DEBT. THIS WOULD HAVE MEANT, FOR A TIME, A COMPLETE WITHDRAWAL OF CREDIT FROM ABROAD, WITH SEVERE DAMAGE TO YUGOSLAV INDUSTRY, HIGHER UNEMPLOYMENT AND 'OTHER PROBLEMS'.

* THE PACKAGE WAS BY NO MEANS PERFECT. THE WEST HAD PROVIDED IT BECAUSE OF THEIR STRATEGIC INTEREST IN YUGOSLAV POLITICAL STABILITY. IT WOULD NOT GUARANTEE SUCCESS. MUCH FURTHER EFFORT WOULD BE NEEDED IF IT WAS TO DO THE TRICK. BUT IN AGREEING TO NEW LAWS, THE FEDERAL ASSEMBLY HAD ONCE AGAIN DEMONSTRATED THAT YUGOSLAVIA WAS CAPABLE OF SHOWING UNITY ON ESSENTIAL MATTERS. *

COMMENT

5. THIS WAS A GENUINELY DIFFICULT POLITICAL EXERCISE FOR THE FEDERAL GOVERNMENT. I SHALL SEND A FULLER ASSESSMENT AND COMMENTS BY THE NEXT BAG. THE KRAISHER COMMISSION ON ECONOMIC STABILISATION IS DUE TO PUBLISH ITS FINAL CONCLUSIONS WITHIN THE NEXT FEW DAYS. THESE WILL OF COURSE BE RELEVANT. MEANWHILE IT IS ENCOURAGING THAT, IN THE INTERESTS OF GETTING THE PACKAGE THROUGH, MRS PLATING AND HER TEAM HAVE HELD FIRM IN THE FACE OF STRONG PRESSURE AND CRITICISM FROM THE REPUBLICS AND PROVINCES. SUBJECT TO A STUDY OF THE ACTUAL TEXT OF THE NEW LAW, THE FEC SEEM TO HAVE SUCCEEDED IN PUTTING THE NATIONAL BANK BACK IN CONTROL OF IMPORTANT ASPECTS OF THE FOREIGN CURRENCY SYSTEM. A CRITICAL QUESTION WILL BE WHETHER THEY WILL BE ABLE TO BUILD ON THIS SUCCESS IN OTHER DIRECTIONS IN THEIR EFFORTS TO GET COOPERATION FROM THE REPUBLICS AND PROVINCES IN STABILISING THE ECONOMY.

6. FCO PSE PASS SAVING ADDRESSEES.

SCOTT.

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