CONSEIL DE L'ATLANTIQUE NORD
NORTH ATLANTIC COUNCIL

EXEMPLAIRE / COPY N° 169

ORIGINAL: ENGLISH
23rd January, 1969

NATO CONFIDENTIAL
WORKING PAPER
AC/89-WP/265

SUB-COMMITTEE ON SOVIET ECONOMIC POLICY

STUDY OF ECONOMIC TRENDS IN YUGOSLAVIA

Note by the United States Delegation

Note by the Secretary

Attached is a contribution made by the United States Delegation on the outlook for the Yugoslav economy. This contribution will be used in the course of the discussion on the Yugoslav economy which will take place on 30th January, 1969. Delegations are invited to forward to the Economic Directorate any comments they may have on this document.

(Signed) L. THIEBAULT

OTAN/NATO,
Brussels, 39.

OUTLOOK FOR THE YUGOSLAV ECONOMY

Introduction

1. Rich in resources and promising in potential, Yugoslavia has one of the least developed European economies. Its level of development and per capita gross product of about $750 are comparable to that of its neighbor, Greece, with a per capita GNP of about $800. However, the six Yugoslav republics and two autonomous regions present sharp contrasts in economic development. The per capita GNP of Slovenia, the richest area, is five times higher than that of Kosovo and Methohija, the most backward.

2. Yugoslavia under Tito has moved far from the Soviet model of a command economy. It has undergone a number of economic reforms to allow a freer play of market forces and a fuller involvement in world trade. Major institutional reforms were introduced in 1965 in connection with the organization of banking and credit, the financial structure of enterprises and foreign trade. The price structure was re-adjusted and price controls on about 50% of the commodities were subsequently lifted. Enterprises, managed jointly by workers' councils and appointed enterprise directors, are free of obligatory production plans and can act on their judgement of the "market". Direct federal investment was largely reduced and the economy further decentralized. On the basis of the measures taken in connection with the reform initiated in 1965, the Yugoslavs hope to achieve a convertible dinar in the early 1970's and to establish a capital market adapted to the specific conditions of their system.

3. Although the results achieved through recent reforms are difficult to evaluate, the record appears to be generally positive. Confidence in the dinar which was devalued in 1965 has been strengthened, a better balance between supply and demand has been achieved, inflation has been held to tolerable levels, the balance of payments has been improved and the system of foreign trade regulations has generally moved toward more liberalized trade, although some retreat has been made from the broad import and foreign exchange liberalization undertaken in early 1967.

4. The credit measures introduced in 1966 and 1967 to stabilize the internal economy and check inflationary trends proved to be too restrictive so that a general stagnation of growth resulted in 1967 which added to the problem of unemployment. Consequently measures were taken in 1968 to stimulate the economy and boost production. An upsurge of the economy has resulted but the dangers of another inflationary cycle are again present.

General Problems Facing the Yugoslav Economy

5. Progress towards a more balanced and freer economy has been limited by both economic and institutional factors. More sophisticated monetary and fiscal policy will be necessary to bring about a smoother-running economy coupled with balanced growth. Means must be found to keep wage rises in conformity with increases in real production. Industry must be further modernized, integrated and specialized, as well as further developed along lines of comparative advantage; a more effective internal capital market created and exports to hard currency markets substantially increased so as to more effectively close the trade gap.

6. Yugoslavia faces many of the problems shared by other semi-developed countries such as low reserves, balance of payments difficulties, and a heavy debt servicing burden. The current account was balanced for the first time since the war in 1965 and invisible earnings grew sufficiently in 1966 and 1967 to almost cover the trade gap with the West. With a heavy debt servicing burden in 1968, a deterioration in the balance of payments and a reduction of their low reserves were expected.

7. A bulge in debt repayments arising from past obligations and short-term credits from its main suppliers has plagued Yugoslavia since the inception of the last reform. Its heavy repayment schedule will not begin to level off until the early 1970's. Significant debt relief was granted by Western creditors in 1966, 1967 and 1968. It has been necessary for Yugoslavia to request further debt re-scheduling for 1969 and 1970 from the Governments of the US, Italy and the FRG in order to maintain the economic reform and strengthen the economy in the face of expected increases in military expenditures. The USG recently acted to re-schedule debt repayments arising from agricultural agreements due in 1968 and 1969 for total relief of $15.9 million.

8. Although the Yugoslavs need to substantially expand their exports to the convertible currency area and thereby decrease or close their trade gap, efforts in this direction have not been successful. This has been primarily due to import restrictions on their usual exports, i.e. agricultural and particularly meat products, to their traditional markets in the EEC. Although there was some increase in the export of industrial goods to the EEC in 1968, the export of agricultural products, particularly meat, fell significantly in this period. Efforts to conclude a commercial agreement with the EEC providing for better treatment for its traditional exports have thus far met with no success although negotiations are continuing. Better success has been made in expanding exports to the EFTA area and the US.

Problems Arising from Increased Defense Expenditures

9. Although always higher than desirable, the share of defense expenditures in the federal budget was decreased slightly in recent years and was originally to have made up 58.4% of the planned budget for 1968. After the invasion of Czechoslovakia, defense expenditures were immediately stepped up in the wake of an imagined or real threat of a Soviet thrust into Yugoslavia. On October 29 the Yugoslav Government submitted a record budget of $908 million (11.35 billion ND) for 1969. The total 1969 budget is 5.7% higher than expected 1968 expenditures while the defense portion is 8.2% higher. The proposed defense budget of $549 million (6.86 billion ND) represents 61.1% of the planned total federal spending.

10. Increased military expenditures present further problems for Yugoslavia, both for its domestic economy which the authorities have strived to stabilize and for its balance of payments. It is difficult to estimate the total effect of increased defense spending on the Yugoslav economy since it is unknown what amount of goods which could otherwise be exported for hard currency will now be diverted to the military and what military hardware will be purchased from the West nor can its inflationary impact be accurately evaluated. In addition, expanded defense spending probably will mean that the federal government will be unable to spend as much as it otherwise would for the economic development of the more backward areas of the country. That expanded domestic military expenditures presented an inflationary threat to the economy and would aggravate balance of payments problems is evident in measures taken by the Yugoslavs at the time of the submission of the new budget. Increased taxes were voted on certain imported luxury items such as coffee, cocoa and chocolate, as well as on cigarettes and candies; taxes were raised 50% on services performed by foreign trade firms and a new 15% tax was levied on personal income funds of commercial banks. The Yugoslav Government seeks to achieve a balanced budget in 1969 by these measures and has tried to keep the budget growth rate lower than the national income rise.

11. If the Yugoslav Government feels compelled by developments to increase defense expenditures beyond the higher level now budgeted for 1969, the adverse economic effects described above would be intensified.

The Strategy of Development

12. Yugoslavia's growth rates in past years have been among the most rapid in the world. In the 1950's, growth was propelled by massive government investment, financed by large increases in the domestic money supply and by a large volume of Western credit. Under the umbrella of subsidies and import controls, industrial output nearly tripled between 1950 and 1960.

13. In the early 1960's, inflationary pressures and balance of payments difficulties, together with heavy existing foreign debt payments and dwindling opportunities to obtain new credits, forced a re-evaluation of economic policy. By 1964, the leadership had become increasingly aware that the growth achieved had been partly illusory; much of the newly created capacity could be operated only under a continued policy of easy credit and broad import restrictions. Such growth would require the government to intervene more frequently in the economy to correct maladjustments. Also, the continued development of non-competitive lines of production would make Yugoslavia increasingly dependent on Communist countries for export markets. Forced economic expansion thus would lead away from the goals of a freer domestic market and a more independent position in trade between East and West.

14. A new strategy therefore was adopted in which growth would be subordinated to structural change, and productive efficiency would be promoted by changes in the domestic price structure and by a greater exposure of enterprises to foreign competition. In 1964, with a two-year-old boom in output already out of control, the government decided to put the brakes on growth. In the period 1965-1967, the leadership restricted consumer and investment spending, re-vamped the price structure, devalued the currency, and reformed the banking system, in preparation for a major cutback in government controls. In 1967, restrictions on about half of prices and imports were lifted.

15. By 1967, the deflationary program finally had succeeded in enforcing greater price and monetary stability. Industrial wholesale prices increased by only 2% in 1967, compared with 11% in 1966. The cost of living rose by 6% in 1967 compared with 24% in 1966; most of the increase in 1967 resulted from hikes in rent and in the prices of other services that took place at the beginning of the year. Banner years in agricultural production in 1966 and 1967 were reflected in a 3% decline in agricultural wholesale prices in 1967. About half of industrial prices at both the wholesale and retail levels were freed of control in mid-1967. Agricultural prices generally are still subject only to "minimum" prices set by the state to govern purchases by procurement enterprises.

16. Such progress as was made to improve the product mix, increase competitiveness of its industrial goods on the world market and stabilize the internal economy was bought at the price of an unforeseen collapse of growth in industrial output in 1967 rather than holding the line at a lower growth rate which was expected and desirable. Investment fell by almost 30% during 1965-1967 - far more than had been expected - with a resulting 30% drop in construction and a slowdown in the output of building materials, steel, and machinery. The

relaxation of restrictions on imports of industrial materials and of some machinery and consumer goods led to a substitution of foreign for domestic products and a shift away from imports from Communist countries to imports of higher quality goods from the West.

17. As shown in Table 1, the overall result was a sharp rise in inventories during 1965-1967 and a decline in the rate of industrial growth from 16% in 1964 to an actual drop in output in 1967. Employment in industry fell by 3% during 1965-1967 because of the need for industry to adjust to reform requirements. At the same time, the 1967 import liberalization contributed to an increase in the hard currency trade deficit from $299 million in 1966 to $436 million in 1967 which was larger than expected. As shown by quarterly data on industrial output, the recession seemed to have bottomed out in 1966 at a growth rate of 3%. Because there were still inflationary pressures in the economy, however, the government placed new restrictions on investment credit in the second half of 1966, and the downturn continued.

18. In late 1967 the government moved to stimulate the economy by easing controls on credits for exports, investment, and many types of consumer purchases. At the same time it gave in to demands for help from industries most affected by the recession and by foreign competition. Many imports were re-controlled, and tariffs were raised in order to assure markets to depressed industries.

19. The shift in policy began to take effect in the second quarter of 1968. Industrial output for the first 10 months of 1968 was up 5.4% over the same period in 1967, and the growth of inventories of industrial finished goods began to slow down appreciably in the second half of 1968. Employment continued to drop during most of 1968, but showed signs of revival toward the end of the year. The current upswing clearly shows the effect of relaxed credit restrictions and greater import protection given, for example, to the steel and chemicals industries. These industries, together with shipbuilding, construction materials, and electrical products have led the advance thus far. Demands for protection have been heard from other industries, notably the metal products industry, whose production has continued to drop since 1965. Hurt first by the cutback in investments, this industry since 1967 has been suffering from increasing imports of better quality equipment under favorable credit terms.

20. Although the added import controls have promoted production, Yugoslavia's foreign trade position has not substantially improved. This was due to the continuation or imposition of new EEC restrictions on Yugoslav exports and Yugoslavia's difficulties in trade with its Communist bilateral trade partners. Although imports rose by only 3% during the

first 10 months of 1968, exports fell by 1%, so that the overall trade deficit increased by 11% compared with the first 10 months of 1967. The hard currency trade deficit is running about the same as last year, when it amounted to 64% of Yugoslav hard currency exports. Increased hard currency earnings from tourism, transport, and other services were probably not sufficient to prevent a deficit on current account in 1968.

21. Trade with the USSR and Eastern Europe has continued to slip since 1967. In the first 10 months of 1968, exports dropped by 9%, while imports rose by 6%, reflecting Yugoslav efforts to wipe out large surpluses in trade in goods and services accumulated with this area since 1965. Although clearing surpluses have been reduced somewhat, they still amounted to about $100 million in October 1968. Yugoslavia has tried to reach agreements with the Communist countries to settle outstanding balances in convertible currencies. Such agreements reportedly have been concluded with Czechoslovakia and Hungary to take effect in 1969.

Prospects for 1969

22. Plans for 1969 call for a continued increase in the industrial growth rate to 7.5% of 8.5% over 1968. National income is expected to grow by 7-8%, gross investment by 10-12%, real personal consumption by 6-7%, and employment by about 2%. It is hoped that exports of goods and services can be increased 10-12% and that imports can be held to a 6-7% rate of growth.

23. The government expects these dynamic increases to be achieved without a further retreat from the liberalization of prices and imports carried out in 1967. If the current upswing continues at its present pace, however, it will eventually cause a heavy demand for imports. Given the already precarious balance of payments position, the critical task in 1969 will be to obtain the desired increases in exports.

24. Yugoslavia's trade with the Warsaw Pact countries has not been noticeably affected by the strain in political relations since the invasion of Czechoslovakia. The Yugoslavs have run into delays in arranging sales of ships (after 1971) and railway cars to the USSR and in concluding a co-operation agreement with the USSR in the field of automobile production. Meanwhile, trade under existing agreements and deliveries under Soviet credits have continued normally and new agreements recently signed for 1969 call for a sizeable increase in Yugoslav-Warsaw Pact trade. However, projected increases in past agreements have not been realized. According to a Yugoslav press report, the key pact, finally signed with the USSR on December 27, 1968 after a lengthy delay by that country in opening talks, envisions a two-way goods exchange of $400 million under the protocol and trade outside the protocol

will be approximately $100 million which would bring total trade to $500 million - almost 30% above the expected 1968 trade level. If this volume of two-way trade is actually planned, it would suggest that the USSR, at least for the time being, will not apply economic pressure in an attempt to subdue Yugoslav critics of Soviet policy. Such a step, as the USSR is aware, would only push Yugoslavia into closer involvement with the West. (Another report has indicated that 1969 bilateral trade with the USSR under the agreement will be $364 million which would represent a decrease over the target originally planned for 1968).

25. Excluding Romania, which has maintained friendly relations with Yugoslavia, the Warsaw Pact countries account for about one-fourth of Yugoslav imports and one-third of its exports, as shown in Table 2. These countries provide outlets for Yugoslav goods that cannot compete in Western markets, especially machinery, iron and steel products, and consumer manufactures. The Warsaw Pact area is the main destination for Yugoslav exports of ships, railroad rolling stock, tobacco, wire and cables. In return the Warsaw Pact countries are Yugoslavia's most important source for imports of fuels and other material inputs such as raw cotton and semi-finished iron and steel products. A major disruption in this trade would result in a temporary recession in output and a rise in unemployment. Moreover, added price and import controls would be needed for a time to preserve remaining export markets and to keep the hard currency trade balance from getting out of hand. With added assistance from the West, however, Yugoslavia could make a fairly rapid adjustment to a loss of trade with the Warsaw Pact countries.

26. The prospects for Yugoslav-Warsaw Pact trade which has decreased somewhat over the past few years to roughly 30% of Yugoslav total trade are not as bright as the new trade agreements for 1969 would suggest. An increase in Yugoslav trade with the Warsaw Pact countries may take place in 1969, if only because of the strong upswing now under way in the Yugoslav economy. However, it is unlikely that the share of this trade in Yugoslavia's total trade will increase. The Yugoslavs still carry a large surplus in their clearing accounts with the Warsaw Pact, and the government probably will continue efforts to hold exports to these countries to the amounts that importers can be induced to accept in return. This trade still is important as a source of supply of raw materials for Yugoslav industry and as a market for some inefficient or technologically backward Yugoslav industries. Thus, trade with the Warsaw Pact conflicts with the current Yugoslav objective of playing down the expansion of these industries and, instead, of re-structuring and modernizing production.

27. Inherent difficulties in trade stemming from differences in trade systems and the problems of bilateral clearing arrangements as well as the political situation may cause a further decrease in the share of Warsaw Pact trade with Yugoslavia. Still distrustful of Soviet intentions, the Yugoslavs probably will continue to discreetly step up contacts with the West as a hedge against any future rupture in relations with the Warsaw Pact. Already, Yugoslavia's aluminum producers have indicated a desire to reduce dependence on the USSR for aluminum ingots by increasing such imports from the US. Yugoslavia also is engaged in a new round of discussions with the EEC to try to lower barriers to Yugoslav exports - particularly of agricultural products. Kiro Gligorov, the Vice President of the Yugoslav Federal Executive Council, visited the US at the end of September 1968 to explore prospects for re-scheduling debt repayments, increasing Yugoslav exports, and obtaining further credits from the Export-Import Bank and the World Bank. Thus far, the US has agreed to re-schedule PL 480 debts, giving a total relief of $15.9 million. Yugoslavia also has approached the UK, Italy and West Germany for financial assistance. A $24 million credit has been obtained from the UK, and a West German credit of $75 million is under discussion. If such efforts bear fruit, economic contacts and trade with the West will increase considerably in the next few years, possibly at the expense of economic relations with the Warsaw Pact.

TABLE 1

Yugoslavia: Recession and Recovery
1964-1968

	Percentage change from previous year				Percentage change from January-September 1967 to January-September 1968(1)
	1964	1965	1966	1967	
Gross national product	11	2	8	2	N.A.
Industrial output	16	8	4	0	5
Industrial employment	9	3	-1	-1	-1
Inventories of finished industrial goods	-5	18	22	27	14
Real gross fixed investment	15	-14	-2	-13	18
Average real personal income	12	2	11	7	4
Industrial wholesale prices	5	14	11	2	0
Agricultural wholesale prices	24	43	16	-3	-3
Cost of living	12	33	24	6	5
Imports	25	-3	22	8	3
Exports	13	22	12	3	-1
Total Trade Deficit ($million)	-430	-196	-355	-455	-409
Hard Currency Deficit ($million)	-354	-270	-299	-437	-347

(1) Partial data available for 11 months of 1968 do not show any significant changes in the 9 month trends.

TABLE 2

Yugoslavia: The Share of the Warsaw Pact in Total Exports and Imports, 1967(1)

	Exports (million $US)		Imports (million $US)		Warsaw Pact as a per cent of total	
	Total	Warsaw Pact	Total	Warsaw Pact	Exports	Imports
Food, beverages and tobacco	336	45	182	34	13.4	18.7
Machinery and transport equipment	255	143	572	112	56.1	19.6
Metals and minerals	208	68	296	100	32.7	33.8
Fuels and power	22	1	85	37	4.5	43.5
Chemicals	74	37	167	35	50.0	21.0
Other industrial materials and semi-manufactures	183	43	335	80	23.5	23.9
Consumer and other light industrial products	174	91	70	23	52.3	32.9
	1,252	428	1,707	421	34.2	24.7

(1) The data cover trade with the USSR, Bulgaria, Czechoslovakia, Hungary, Poland and East Germany. Rumania is excluded.

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VALUATION OF YUGOSLAV GNP IN US DOLLARS

The most common figure for Yugoslav GNP in dollars - one given by the Yugoslavs themselves - is about $500 per capita in 1967. The US estimate for 1967 is about $750 per capita. The essential difference between the two figures lies in the treatment of "nonproductive" services. In the lower estimate, value added in these services in effect is converted to dollars at the same dinar/dollar ratio as that used to convert the material product or "social product". This method assumes that Yugoslav bankers, judges, doctors, etc. are no more productive relative to their US counterparts than are farmers, and industrial workers. The US procedure, on the other hand, assumes equal productivity in "nonproductive" services in the US and Yugoslavia, and therefore uses a much higher ratio to convert these services from dinars to dollars. Although not entirely satisfactory, this is the standard assumption used by Western economists in making international comparisons(1). The dinar/dollar ratio used is the ratio of average wages for these services in the two countries.

Illustrative Calculation

2. To demonstrate how the treatment of "nonproductive" services affects the dollar GNP figure, we are providing a rough calculation of Yugoslav GNP. This calculation does not use the laborious procedure that has been used by Western economists to obtain GNP figures for the other Eastern European countries.

3. The first step is to value in dollars the "material production" entering in the end uses of GNP by the use of dinar/dollar ratios for the various groups of goods and services included in the Yugoslav "social product". The data are taken from the Yugoslav input-output table for 1964(2) and cover the personal and public consumption component of "material production" plus deliveries to "nonproductive" service sectors, plus gross fixed investment, plus increase in inventories. Total GNP in dollars for 1964 is then obtained by adding to this total the value added in "nonproductive" services and an adjustment for foreign trade. According to standard procedure the next step should be to value US GNP in dinars and to take the geometric mean of the two percentage comparisons - one in dollars and the other in dinars. In lieu of undertaking this laborious task, the result given by a Soviet-US comparison of US GNPs was used for the Yugoslav case. The effect is to reduce the GNP for 1964 as calculated above by 20 percent.

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(1) See Milton Gilbert and Irving B. Kravits, An International Comparison of National Products and the Purchasing Power of Currencies, OEEC, Paris, 1954.
(2) Statistical Yearbook of the Federal Republic of Yugoslavia, 1967, p. 116-117.

4. The figure thus obtained for 1964 in 1964 dollars is then moved to 1967 by the use of a constant-price index for Yugoslav "social product" plus an index of employment for "nonproductive" services. The implicit price increase for US GNP from 1964 to 1967 (8 percent) is used to obtain Yugoslav GNP in 1967 dollars. The detailed calculation is given in the following table:

BASIC CALCULATION FOR YUGOSLAV GNP, 1964

million dinars

	Consumption(a)	Fixed Investment	Increase in Stocks	Total	Dinar/ dollar ratios	Million US dollars
Goods(b)	27,175	7,246	6,306	40,727	13:1(c)	3,133
Construction	325	10,878	21	11,224	7.5:1(d)	1,497
Transport and communications	2,184	90	41	2,315	2.1:1(e)	1,102
Trade and catering	5,557	567	87	6,211	3.1:1(e)	2,004
Other "productive" output	1,179	64	64	1,307	13:1(c)	101
Sub total	36,420	18,845	6,519	61,784(f)		7,837
Net housing rent	1,100(g)	-	-	1,100	3.1:1(h)	355
Other value added in "nonproductive" services(j)	6,400(i)	-	-	6,400(j)	0.8:1	8,000
Foreign trade adjustment	-	-	-	-1,465(k)	-	-273(k)
Total GNP and end uses	43,920	18,845	6,519	67,819	-	15,919
Adjusted GNP	-	-	-	-	-	12,735
1967 GNP	-	-	-	-	-	14,996
1967 GNP per capita	-	-	-	-	-	750

(a) Consumption includes both personal and government consumption.

(b) "Goods" include agricultural, forestry and industrial products. Handicraft production is included below in "other productive output" and is converted at the same dinar/dollar ratio.

(c) This ratio reflects the relation between exports in domestic prices as given in the input-output table (11,331.5 million new dinars) and exports at foreign trade prices (11,164.4 million new dinars or $893 million). The resulting ratio is very close to the new official exchange rate (12.5:$1) which has held up well in foreign exchange markets since the Yugoslavs devalued in 1965.

(d) The ratio for construction, in lieu of any relative purchasing power studies, was based on Pryer and Staller's work on relative production: The Dollar Values of the Gross National Products in Eastern Europe, 1955. Relative production in 1955 was brought to 1964 by constant price indexes. Yugoslavia emerged at an estimated 2.2 percent of the US, or $1.5 billion in terms of expenditure on construction.

(e) Two methods were tried to obtain the dinar/dollar ratio for Transport and Communications and for Trade and Catering. Both yielded the same result. One method was the same as used for construction. The other method was based on, first, a conversion of value added in each sector at dinar/dollar ratios for wages (.9:1 and .8:1, respectively) and second, a conversion of material inputs at the 13:1 ratio for goods explained in footnote (c) above.

(f) The figure of 61,784 million dinars for end use "material" product is very close to the official figure for social product in 1964, 61,001 million. The difference reflects differences in methods of calculation and coverage in the input-output table compared with the calculation of "social product", as well as the omission of some minor factors in our calculation.

(g) Net housing rent is gross rent payments, including imputed rent of owner-occupied dwellings, minus costs of maintenance, sewage, water, fuel, light and garbage pick-up. The figure for net rent was based on average rent per sq.m in 1964 (.61 dinars per month) which gave a total rent figure of 1,500 million dinars for 1964. This figure was reduced by data on costs of water, sewage, etc. found in household budget studies (Bulletin #360 of the Statistical Institute).

(h) The ratio for net housing rent is based on the estimate that per capita housing in Yugoslavia was 20 percent of that in the US in 1964. Net rent in the US in 1964 was $17.7 billion (from Economic Report of the President, January 1967, p. 231). Yugoslavia in dollar terms amounts to about 2 percent of this of $355 million.

(i) Other value added in "non-economic" services was obtained from Yugoslav data on personal incomes in these services given in Statistical Bulletin #427 of the Statistical Institute. Value added in defense was estimated as manpower times the average industrial wage in 1964. The same figure is obtained if it is assumed that the one-third share of the defense budget earmarked for "personnel costs" in 1967 held true in 1964.

(j) The ratios for other value added in non-economic services and defense is the ratio between average Yugoslav wages in "nonproductive" services (5,280 dinars) and the average wage in US government in 1964 ($6,700).

(k) The foreign trade adjustment in dinars is the difference between exports and imports given in the input-output table. The figure in dollars is the balance of payments on goods and services (excluding private transfer payments) which corrects the omission of tourist expenditures in the dinar import figure.