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Federal Republic of Yugoslavia: 2002 Article IV Consultation, Third Review Under the Stand-By Arrangement, and Request for an Extended Arrangement—Staff Report; Staff Supplement; Public Information Notice and Press Release on the Executive Board Discussion; and Statement by the Executive Director for the Federal Republic of Yugoslavia

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of a combined discussion of the 2002 Article IV consultation with the Federal Republic of Yugoslavia and Third Review under the Stand-By Arrangement, and Request for an Extended Arrangement, the following documents have been released and are included in this package:

- the staff report for the 2002 Article IV consultation, Third Review Under the Stand-By Arrangement and Request for an Extended Arrangement, prepared by a staff team of the IMF, following discussions that ended on **March 22, 2002** with the officials of Federal Republic of Yugoslavia on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on April 26, 2002.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a supplement to the staff report of **May 10, 2002** updating information on recent economic developments.

- a Public Information Notice and a Press Release summarizing the **views of the Executive Board as expressed during its May 13, 2002 discussion** of the staff report.

- a statement by the Executive Director for the Federal Republic of Yugoslavia.

The documents listed below have been or will be separately released.
Letter of Intent by the authorities of the Federal Republic of Yugoslavia of April 26, 2002*
Memorandum of Economic and Financial Policies by the authorities of the Federal Republic of Yugoslavia*
Selected Issues and Statistical Appendix

*May also be included in Staff Report.

The policy of publication of staff reports and other documents by the IMF allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

FEDERAL REPUBLIC OF YUGOSLAVIA

Staff Report for the 2002 Article IV Consultation, Third Review Under the Stand-By Arrangement, and Request for an Extended Arrangement

Prepared by the European I and Policy Development and Review Departments

(In consultation with other Departments)

Approved by Carlo Cottarelli and Shigeo Kashiwagi

April 26, 2002

The staff discussions with the authorities of the Federal Republic of Yugoslavia (FRY) for (a) the 2002 Article IV consultation, (b) the last review under the current stand-by arrangement (SBA), and (c) a new extended arrangement (EA), were held in Belgrade and Podgorica during February 4–16 and March 13–22, 2002.

The staff team—Mr. E. Zervoudakis (head), Mr. J. Herderschee, Ms. X. Li, Ms. E. Ribakova (all EU1), Ms. Q. Kong (FAD), and Mr. H. Tadesse (PDR)—was assisted by Mr. J. Charap, the Fund's resident representative, and cooperated closely with MAE and World Bank staff. Mr. S. Antic, Advisor to the Executive Director for FRY, attended the discussions.

The FRY representatives included: (a) at the federal level, Deputy Prime Minister Labus (head of the FRY delegation) and National Bank of Yugoslavia (NBY) Governor Dinkic; (b) in Serbia, Finance Minister Djelic, Social Affairs Minister Matkovic, Labor Minister Milovanovic, Privatization Minister Vlahovic; and (c) in Montenegro, Prime Minister Vujanovic, Deputy Prime Minister Gvozdenovic, Finance Minister Ivanisevic, and Chairman of the Central Bank Council Krgovic. At the initial and concluding meetings in Belgrade, the FRY authorities were represented by a joint delegation of the federal, Serbian, and Montenegrin governments.

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I. INTRODUCTION

1. The Federal Republic of Yugoslavia (FRY) has cooperated closely with the Fund since late 2000, when reformists came to power in Belgrade.

- On December 20, 2000, upon FRY's succession to the former Yugoslavia's membership in the Fund, the Board approved a first-credit-tranche purchase, under the policy of **post-conflict emergency assistance**, in support of a short-term program to bring inflation under control, strengthen institutional infrastructure, and pave the way for an upper-tranche arrangement (Appendix I).

- On June 11, 2001, a **stand-by arrangement** (SBA) was approved—in the amount equivalent to SDR 200 million or 43 percent of quota—in support of a stabilization and reform program for 2001; following a two-month extension (EBS/02/53, 3/21/02), the SBA is due to expire at end-May 2002. Policy commitments under the SBA have been fulfilled satisfactorily. The last purchase of SDR 50 million would become available upon completion of the third review.

2. In the attached letter and the accompanying Memorandum on Economic and Financial Policies (MEFP), the FRY authorities outline policies for 2002–05 and propose performance criteria, indicative targets and structural benchmarks for 2002 (Appendix IV). On this basis, the authorities request completion of the third SBA review and approval of an Extended Arrangement (EA) in the amount of SDR 650 million or 139 percent of quota.

3. **Upon completing the second SBA review on January 11, 2002, Directors commended the FRY authorities for the progress in stabilization and structural reform over the previous year, while cautioning that the tasks ahead remained daunting.**

4. **The World Bank is closely involved in FRY's reconstruction efforts** (Appendix II). In December 2001, the Bank helped FRY settle arrears of US$1.8 billion to the Bank through 30-year consolidation loans at market-related interest rates. Contingent upon policy performance, additional lending of up to US$540 million is envisaged for FY 2002–04 under concessional terms (80 percent in adjustment credits). In 2002, a total of US$220 million in IDA resources is expected to be provided. In this context, an Interim Poverty Reduction Strategy Paper is currently being prepared by the authorities, with the assistance of the staffs of the World Bank and the Fund. The World Bank strategy also provides for advisory activities, including a Public Expenditure and Institutional Review now underway.

5. **The Belgrade agreement on a plan for a new constitutional framework recognizes, and aims to rationalize, the status quo.** The agreement provides for common defense and foreign polices for "Serbia and Montenegro" (the name of the prospective state union) on the basis of streamlined joint institutions; acknowledges the existence of different monetary, exchange, customs, and tax regimes (consistent with a *free trade area*);[1] and

[1] In December 2000, Montenegro adopted the euro as its sole legal tender, whereas Serbia continues to use the dinar.

envisages harmonization of the economic systems of Serbia and Montenegro with that of the EU. A draft Constitutional Charter—to be prepared by a joint Serbian-Montenegrin Commission—is to be submitted to the federal and republican parliaments by end-June 2002 for ratification by late 2002. The agreement implies the need for establishing customs controls to allow each republic to safeguard its custom and tax collections. Serbia and Montenegro would remain jointly responsible for each other's external liabilities. Under the program, the Serbian and Montenegrin authorities are to reach agreement, by end-June 2002, on how to resolve the issue of inter-republic trade regarding customs, excises and VAT.

6. **The quality of statistics, albeit much improved, remains weak** (Appendix III). With technical assistance from the Fund and others since late 2000, progress has been made toward ensuring that the monetary, external and fiscal accounts comply with internationally accepted norms. Nevertheless, considerable weaknesses remain. As a basis for further technical assistance, a multi-sector GDDS mission is scheduled for July 2002.

II. Economic and Policy Developments Since Late 2000

7. **The government that came to power in late 2000—after ten years of regional conflict, international isolation, and economic mismanagement—inherited extremely difficult starting conditions.**, Output stood at less than half its 1989 level, having recovered only partially from the devastation of the Kosovo war (Table 1, Figures 1–2). The recorded unemployment rate approached 30 percent, while 650,000 refugees and internally displaced persons lived under difficult conditions. Inflation exceeded 100 percent and confidence in the financial system had been shaken by the freezing of the population's foreign exchange deposits and a hyperinflation in the early 1990's. The country's infrastructure was in disrepair owing to neglect and war damage. The enterprise and banking sectors were both deeply insolvent and isolated from the outside world in the aftermath of international economic sanctions. And external debt, mostly in arrears, had risen to the equivalent of 140 percent of GDP.

8. **With the strong support of the international community, the authorities have been able to take major steps toward stabilizing and reforming the economy:**[2]

- **Inflation** has come down sharply from 113 percent at end-2000 to 33 percent in March 2002, with the annualized six-month inflation falling to 18 percent. In Montenegro, in spite of the adoption of the euro as legal tender, inflation has remained relatively high (around 25 percent), reflecting increases in administered prices and, given the dinar's stability vis-à-vis the euro, "imported" inflation from Serbia.

- **Real GDP** rose further by an estimated 5½ percent in 2001, but remained about one-half of its 1989 level. GDP growth is attributed to a rebound in agricultural output

[2] Montenegro accounts for about 7 percent of FRY GDP. All data from 1999 onwards—with the exception of external debt figures—refer to the territory of FRY excluding Kosovo.

after the previous year's drought, and increasing activity in services. Industrial production has been stagnant, reflecting capacity constraints after years of disinvestment and the ongoing economic restructuring. [3]

- The **balance of payments** improved even as the reliance on foreign savings increased. The current account deficit (before grants), estimated at US$1.2 billion (10.9 percent of GDP) in 2001, was lower than projected owing mainly to buoyant inflows of remittances (Table 2–3). Recorded exports rose by 10 percent in U.S. dollar terms in 2001 but remained almost 20 percent below their real level in 1998.[4] Recorded imports in the same period were 30 percent higher in U.S. dollar terms, reflecting largely the counterpart to in-kind foreign assistance. The **foreign exchange reserves** of the NBY more than doubled to US$1.2 billion (2.6 months of imports) by end-2001, and have risen further to US$1.5 billion by end-March 2002.

9. **The macroeconomic policies underlying these improvements have emphasized strict limits on bank credit and wage restraint in the public sector.**

- The **fiscal deficit** was 1.3 percent of GDP in 2001, against an original program target of 6.1 percent, with borrowing from the banking system limited to 0.7 percent of GDP, below the program ceiling. The fiscal overperformance is explained by revenue overperformance of 1¾ percent of GDP and a compression of spending of 3 percent of GDP (primarily foregone public investment) in response to delays in foreign financing and privatization proceeds.[5] Revenue collections benefited from a major

[3] Industrial output declined by 5½ percent in January-February 2002, year-on-year, largely reflecting exceptional factors. Services continued to grow.

[4] The rise in recorded exports in 2001 may overstate export growth owing to the elimination of multiple currency practices in late 2000 that should have reduced under-recording of exports. According to rough estimates that adjust for this factor, exports in 2001 grew by 4 percent in dollar terms. Recorded exports in January-February 2002 were 11 percent higher in dollar terms than in the corresponding period of the previous year.

[5] The *federal* government registered a small cash surplus, thanks to a strict wage policy and improved control over military spending. The consolidated *Serbian* government incurred a much-lower-than-expected deficit due to strong revenue measures and prudent expenditure execution in response to delays in financing and privatization proceeds that affected exclusively the Serbian budget. The consolidated *Montenegrin* government ended 2001 with a higher-than-budgeted deficit (after grants) owing to expenditure overruns. The latter—reflecting lax budgetary control and procedural weaknesses in budget financing—led to some borrowing from the central bank that was not provided for under the SBA. However, efforts to combat smuggling and tax evasion helped improve revenue collections in the second half of the year. Moreover, ongoing institutional reforms—the recent adoption of comprehensive new tax legislation that is to be implemented gradually in 2002 and the setting up of a Treasury with basic functions (see below)—should help address the budgetary weakness experienced during 2001.

simplification of the tax system (involving a substantial reduction in the number of taxes, a widening of the tax base and a lowering of the tax rates) and curtailment of tax evasion by fighting corruption and smuggling (Box 1).

- **Wage bills** in the public sector (including state-owned enterprises) were kept broadly unchanged in real terms.

- Growth in the **NDA** of the NBY was limited to 2 percent of end-2000 reserve money, against an original program target of 15 percent, reflecting fiscal over-performance and a partial sterilization of net foreign exchange purchases. Such purchases accounted for an almost 90 percent increase in reserve money, in an environment of declining inflation and nominal market interest rates, and apparently reflected a stronger demand for dinars (Figure 3).

- Against the background of a persisting BOP surplus, the NBY has kept the **exchange rate** of the dinar broadly unchanged against the euro since the adoption of a managed float at the beginning of 2001.[6] The resulting real appreciation of the dinar—by over 30 percent since end-2000—has restored its real value close to the level reached in 1997–98 (a sanctions-free period when exports had reached a peak level).

Box 1. Combating Corruption

The policies of the previous regime had enriched the political elite. Large amounts of resources were diverted through an over-valued official exchange rate and directed credits; state allocation of exclusive rights to sell key imports, such as oil derivatives and cigarettes; and ad hoc tax exemptions and waivers of tax liabilities. The reformist government immediately redressed the most obvious abuses in the old system: the exchange rate was unified at a market-clearing level; directed credits were curtailed; the trade regime was liberalized; and major tax reforms were introduced. In Serbia, there have been credible efforts to crack down on illegal activities including the arrest of several hundred senior officials and "leading businessmen" of the former regime.[1] Moreover, additional anti-corruption legislation has been prepared or enacted, including reform of the budgetary system and tax administration, and regulations regarding tobacco, games of chance, and public procurement. Nevertheless, continued efforts will be required to redress entrenched corruption and to reform the civil service.

[1] These efforts have yielded international recognition: In a January 2002 report by Transparency International analyzing institutional mechanisms in the fight against corruption, Serbia ranks third among 21 countries.

10. **Macroeconomic policies were complemented by equally impressive progress in structural reform, with technical assistance from the Fund and the Bank.** Soon after coming to power, the new authorities in Belgrade: (a) freed most prices with the exception of public utilities; (b) unified a system of multiple exchange rates; (c) abolished most import

[6] The dinar depreciated by about 1½ percent against the euro during 2001 and by another 1 percent during the first quarter of 2002.

quotas and lowered average import tariffs to under 10 percent; (d) simplified the tax system and improved the transparency of the budgetary accounts by bringing most extrabudgetary and quasi-fiscal operations on the budget; and (e) substantially liberalized employment contracts and wage determination.[7] In addition, legal and institutional frameworks for bank restructuring and enterprise privatization were put in place, allowing important progress in this area (¶4).[8] In Montenegro—where reforms were initiated in 1999 with the support of bilateral donors—the authorities focused on fiscal reforms and privatization through a Mass Voucher Scheme. FRY's observance of structural program conditionality has been generally good. While a number of structural benchmarks in late 2001 and early 2002 were not observed, this mainly reflected technical delays and capacity constraints, which are being addressed (¶4).

11. **The strengthened performance also reflected the international community's support of FRY through foreign assistance and debt relief.** In June 2001, a donor conference generated pledges of US$1.3 billion. Based in part on these pledges, grant and loan disbursements amounted to US$0.8 billion (8 percent of GDP) in 2001, compared with US$0.3 billion in the previous year (Table 3).[9] In November 2001, agreement was reached on restructuring Paris Club debt (roughly 40 percent of total external debt), involving a two-phase 66 percent write-off. [10] The first phase (51 percent) will enter into force with the approval of the proposed EA, while the second phase (the remaining 15 percent) will become effective upon successful completion of the EA. Debt restructuring negotiations with other official bilateral and London Club creditors are underway, with the authorities aiming for terms broadly similar to those in the Paris Club agreement.[11] In light of these efforts, the Fund could continue to provide resources under its lending into arrears policy.[12]

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[7] See background paper for a description of the tax reform.

[8] Henceforth, unless otherwise noted, references to paragraphs pertain to the MEFP of April 26, 2002.

[9] Excluding Fund disbursements of US$128 million and credits linked to clearance of debt arrears.

[10] The authorities have requested an extension of the March 20, 2002 deadline for the signing of bilateral agreements with Paris Club creditors; as of mid-April 2002, 5 out of 17 bilateral agreements had been concluded.

[11] The authorities have held several meetings with representatives of London Club creditors since early 2001. Recent meetings have focused on technical aspects of a possible restructuring agreement and on the reconciliation of debt figures. Contacts have also been initiated with non-Paris Club creditors (China and Libya) with a view to securing comparable treatment.

[12] After the clearance of arrears to four multilateral creditors in 2000-01 (IMF, Eurofima, EIB, and the World Bank), the sole remaining multilateral creditor to which the FRY

III. Policy discussions and the Proposed Program for 2002–05

12. **While progress to date has been satisfactory, economic conditions remain extremely difficult.** The discussions highlighted not only the progress in stabilizing the economy, in strengthening confidence in the currency, in building the legal and institutional framework to guide the transition, and in securing debt relief, but also the daunting tasks ahead faced by the authorities. Output was still at a historically very low level; the macroeconomic situation and external outlook were fragile; the enterprise sector was largely insolvent, decapitalized and overstaffed; the banking system could not meet the needs of a market economy; the government sector was large and inefficient; and the infrastructure was dilapidated, seriously impeding growth.

13. **The policy challenges are considerable if FRY is to make up for lost time.** The authorities and the mission agreed that strong, export-driven growth and external adjustment will require continued prudent macroeconomic policies and accelerated structural reform, which will now enter a more difficult stage. The restructuring of the enterprise sector commenced only recently and will involve difficult decisions affecting employment—against the backdrop of scarce fiscal recourses to mitigate the social impact. The creation of an efficient banking system will require improved governance through strengthened banking supervision and privatization. The streamlining of social benefits, transfers and state sector employment—essential to achieving fiscal sustainability—will be challenging. The fragility of the external outlook, reflecting weakness in the enterprise sector and the substantial debt servicing obligations despite debt relief, suggests that there is little room for policy missteps if FRY is to be placed firmly on the path of sustainable growth and external viability.

A. Medium-Term Objectives, Policies, and External Prospects

14. **The authorities' key economic objectives for 2002–05 include the achievement of low inflation with sustainable growth and external viability** (Text Table 1).

- **Inflation** in Serbia is targeted to decline rapidly, reflecting tight credit policy and the wearing off of administered price increases; the latter would also support disinflation in Montenegro (¶7).

- The **real GDP growth** objectives are somewhat higher than those experienced by successful transition economies in the 1990's but consistent with the potential for a "post-conflict" rebound and sizable amounts of foreign assistance (¶7).

- The **current account deficit** (before grants) is expected to widen in 2002, reflecting a resumption in external debt service as well as higher project-related imports (Tables 2–3). The deficit will be financed by expected inflows of grants (US$0.6

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government owes arrears is Eurofund, with claims of around US$28 million as of end-2001. Negotiations have recently taken place; the government is seeking to obtain new financing from Eurofund that would facilitate the repayment of outstanding obligations over a period of several years.

billion), loans from official creditors (US$0.8 billion) and foreign direct investment (US$0.4 billion). Over the medium term, the current account deficit is expected to narrow in relation to GDP on the basis of a recovery in exports to their real 1998 level. Despite rising FDI inflows, external financing requirements from donors and official creditors will remain significant.

Text Table 1: Key Macroeconomic Objectives and Policies, 2000-2005

	2000	2001		2002	2003	2004	2005
		Prog.	Prel.Est.	Proj.	Proj.	Proj.	Proj.
			(Percentage change)				
Real GDP Growth	5.0	5.0	5.5	4.0	5	5	5
Agriculture	-13.0	...	23.3	0.0	...	...	...
Non-agriculture	9.2	...	1.9	4.9	...	...	...
Inflation (end period)	113.5	35	39	20	12	8	7
Of which: Montenegro	...	6.5	24	12	6	5	4
			(In percent of GDP)				
Domestic investment	14.5	18.3	13.5	15.4	17.6	19.2	20.5
Domestic savings	-3.5	-3.5	-8.6	-6.4	-3.4	-0.2	2.6
National savings	10.3	7.0	8.0	7.2	8.1	10.4	13.6
Current account deficit (before grants)			(In billions of US$)				
US$ billion	0.6	1.5	1.2	1.6	1.7	1.6	1.4
In percent of GDP	7.6	14.6	10.9	12.8	12.4	10.7	8.8
Excluding net interest payments (percent of GDP)	7.0	12.6	10.2	9.8	9.0	7.3	5.7
Gross official reserves	0.5	0.7	1.2	1.6	2.0	2.5	2.9
In months of projected imports	1.2	1.5	2.4	3.0	3.5	3.9	4.2
			(In percent of GDP)				
Fiscal Deficit	0.9	6.1	1.3	5.7	5.3	4.8	4.2
Government credit from the banking system	0.2	0.6	0.7	0.5	0.5	0.5	0.4
		In percent of year-beginning reserve money					
NFA growth	147.7	8.2	86.8	25.2	...	...	...
NDA growth	-56.6	18.0	2.3	12.2	...	...	...
Reserve money growth	91.1	26.1	89.0	37.4	...	...	...

Sources: Yugoslav authorities; and IMF staff estimates.

15. **Consistent with these objectives, the EA provides for increased capital and reform-related spending, credit and wage restraint, and maintenance of external competitiveness.** Given the large uncertainties involved, the policy targets will be reviewed regularly during the EA.

- The overall **fiscal deficit** in FRY is projected to reach 5.7 percent of GDP in 2002, while trending downwards in subsequent years, in line with progress toward fiscal sustainability and lower inflation. The initial increase in the deficit reflects increased external debt service requirements, capital spending to alleviate capacity constraints, and reform-related spending. The deficit will be financed mostly by foreign grants, concessional loans, and privatization receipts, while the government's recourse to domestic financing will be contained under 1 percent of GDP throughout the EA (¶11)

- **Monetary** policy will be geared to lowering inflation. The monetary program for 2002 envisages strict limits on NDA expansion and cautiously assumes only a modest further recovery of confidence in the dinar (¶20).

- **Exchange rate** policy will seek to strike a proper balance between the inflation and external objectives. While the current level of the exchange rate appears appropriate, developments in the foreign exchange market as well as trends in exports, imports and wages will be monitored closely. Exchange rate policy will be assessed during program reviews.

- **Wage policy** in the government and state enterprises will continue to support monetary policy and protect external competitiveness.

16. **Structural reforms will be broad-ranging, to be implemented with technical assistance from the Fund, the World Bank, and bilateral donors.**

- In the *fiscal* sector, reforms would envisage further institutional improvements (strengthening of tax administration and public expenditure management) and streamlining of expenditure (reduction of overstaffing and improved targeting of social benefits) where little progress has been made so far.

- In the *financial* sector, the cleaning up of the banking sector has set the stage for important reforms: redesign of monetary policy instruments, further liberalization of the foreign exchange market, development of a market-friendly payments system, and strengthening of banking supervision.

- In the *enterprise* sector, with the establishment of an appropriate legal and institutional framework, the stage has been set for the difficult task of restructuring and privatizing the bulk of socially-owned enterprises.

17. **With sustained policy implementation, good progress toward a viable external position and sustainable growth could be achieved during the EA.** According to projections prepared in cooperation with the authorities, the envisaged policies are consistent with a substantial increase in domestic savings that would offset lower foreign savings and permit an increase in the investment/GDP ratio by about 5 percentage points during 2002–05 (Table 8). External debt indicators, while remaining relatively high, are expected to improve both during and after the EA, reflecting export-based growth and external adjustment, concessional external financing, and the phased debt reduction (Box 2 and Table 10). External debt as a share of GDP is expected to fall from 109 percent in 2001 to 59 percent in 2005 (to 85 percent excluding debt relief).[13] External debt service will be limited to an

[13] Debt reduction comparable to the recent Paris Club agreement is assumed to be offered by other official bilateral and commercial creditors, consistent with the commitments of the Yugoslav authorities under the Paris Club Agreed Minute.

average of 12 percent of exports of goods and services in 2002–04, owing to temporary debt service relief from bilateral creditors but would rise to an average of 21 percent in the latter half of the decade. This underscores the case for building a sufficiently comfortable international reserves position in the next few years so as to allow for a temporary draw down of funds in cases of unexpected and temporary shocks. Moreover, a period of sustained adverse developments in the latter half of the decade would also require corrective policies in order to safeguard the external position.

Box 2. External Debt Sustainability

The baseline macroeconomic scenario used to assess debt sustainability assumes a continued strong record of policy implementation and a recovery of export activity from its depressed levels. Export growth is projected to average 14 percent per year in U.S. dollar terms in the period to 2005 (largely reflecting a return of exports to historical levels), and moderating thereafter to around 10 percent per year (similar to the average growth rate witnessed in transition countries during the late 1990s, Tables 8-10). Nominal GDP in U.S. dollar terms is projected to rise by an average annual rate of 12 percent in 2002–05 (partly on account of the real appreciation in the early years) followed by an average of 8 percent in the second half of the decade. The balance of payments framework is further guided by the following key assumptions: strong import growth in the early part of the decade on account of reconstruction related needs and more modest growth later on given the high starting levels; a leveling off in private remittances after 2002; a rising level of foreign direct investment in line with improving economic conditions and the privatization program; and official financing inflows consistent with indications provided at the June 2001 Donors conference of around US$4.5 billion in external assistance for 2001–05.

In this scenario, trends in the stock of debt do not present a threat to debt sustainability, but liquidity problems in meeting debt service obligations could arise in the latter half of the decade. Even after assumed new borrowing, solvency indicators show a steady improvement over time, with ratios of debt-to-GDP, debt-to-exports, and debt-to-revenue all declining over the course of the decade. This outcome largely reflects the fact that a two-thirds debt reduction is being applied to roughly two-thirds of total external debt, after assuming comparable treatment from bilateral and commercial creditors. Indicators of potential liquidity pressures show a less sanguine trend. Reflecting grace periods on restructured debt and on new borrowing, the debt service to exports ratio is contained at around 14 percent in the 2002–05 period, but rises to an average of 22 percent during 2006–10. Also, government debt service as a share of revenues rises from an average of 9 percent in the 2002–05 period to 15 percent in the latter half of the decade, placing considerable strain on budgetary resources.

Further vulnerabilities could potentially arise if there are shortfalls in critical external inflows. In this regard, two adverse scenarios are considered: (i) export growth that is around 40 percent lower than assumed in the baseline (i.e., average growth of 7 percent per year over the 2002-10 period), and (ii) foreign direct investment inflows amounting to only half of the baseline projections (with additional gap-filling borrowing assumed to cover the incipient financing gap). For 2002-05, the sensitivity analysis indicates that debt service ratios, although higher by 4 percentage points, could still be manageable at around 18 percent. For the latter half of the decade, however, either one of the two downside scenarios—if unmatched by overperformance in other external inflows—would result in debt service ratios near 30 percent.

B. Fiscal Policy

18. **The envisaged fiscal policy for 2002 supports reconstruction and reform, consistent with progress toward stabilization and fiscal sustainability over the medium term** (Text Table 2, Tables 7A–D). The authorities stressed that—against the background of

Text Table 2. Federal Republic of Yugoslavia: Consolidated General Government Fiscal Operations in 2000-2005 1/
(In percent of GDP) 2/

	2000 5/	2001 5/		2002	2003	2004	2005
	Est.	Orig. Prog.	Prel. Est.	Prog.	Proj.	Proj.	Proj.
Total revenue	39.2	39.8	41.5	43.0	42.5	41.9	41.4
Tax revenue	35.3	36.5	37.8	39.4	39.0	38.5	38.0
Nontax revenue	3.8	3.1	3.7	3.5	3.4	3.3	3.3
Capital revenue	0.0	0.2	0.0	0.1	0.1	0.1	0.1
Total expenditure and net lending	40.1	45.9	42.8	48.7	47.8	46.7	45.6
Purchases of goods and services	18.5	19.4	18.6	18.3	17.9	17.5	17.0
Of which: Wages and salaries	10.1	10.3	10.1	10.1	9.9	9.7	9.4
Interest payment	0.6	1.0	0.8	1.8	1.9	1.9	2.3
Subsidies	2.3	3.3	3.6	4.3	3.9	3.4	3.0
Transfers to households	15.2	17.8	17.5	20.1	19.3	18.5	17.9
Capital expenditure	3.3	3.6	1.4	3.1	3.7	4.3	4.7
Other	0.2	0.9	1.1	1.1	1.0	1.0	0.7
Overall balance	-0.9	-6.1	-1.3	-5.7	-5.3	-4.8	-4.2
Financing	1.0	6.1	1.4	5.7	5.3	4.8	4.2
Domestic financing	0.2	0.6	0.7	0.5	0.5	0.5	0.4
Foreign grants	0.8	1.2	0.7	1.0	1.1	0.9	0.6
Foreign debt financing	0.0	2.9	0.0	3.0	2.4	2.2	2.1
Project financing	0.0	0.0	0.2	1.2	1.3	1.3	1.2
Budgetary support	0.0	2.9	-0.2	1.7	1.2	0.9	0.9
Privatization receipts	0.0	1.4	0.0	1.3	1.3	1.2	1.1
Accumulation of expenditure arrears	2.1	0.0	0.0	0.0	0.0	0.0	0.0
Overall commitment balance	-3.0	-6.1	-1.3	-5.7	-5.3	-4.8	-4.2
Memorandum items:							
Reform related spending 3/		0.2	0.4	1.5	1.5	...	...
Social spending 4/	20.5	21.1	21.8	24.1	23.3	22.5	21.9
Overall cash balance of:							
Serbian general government	-0.2	-5.6	-0.9	-5.3	...	...	...
Montenegrin general government	-0.7	-0.4	-0.4	-0.4	...	...	...
Overall cash balance of general government in Montenegro (in percent of Montenegro GDP)	-10.4	-6.1	-6.1	-6.3	...	...	...

Sources: Ministries of Finance of the Federal Republic of Yugoslavia, Republic of Serbia, and Republic of Montenegro; and IMF staff staff estimates.

1/ Consolidated general government includes the federal, republican and local governments, the social security funds and the extrabudgetary programs. Local governments in Montenegro are excluded.

2/ Expressed in terms of GDP of the FRY excluding Kosovo.

3/ Includes severance package for laid-off workers due to enterprise reform and bank restructuring.

4/ Includes pension, health care and other social welfare spending.

5/ Program targets for 2000 and 2001 were slightly changed due to the GDP revisions.

ten years of political and economic upheaval—fiscal policy for 2002 was designed to support as much reconstruction and reform spending as could be financed by foreign assistance, while containing inflationary pressures by limiting domestic borrowing to only ½ percent of GDP. The increase in the FRY overall fiscal deficit by over 4 percentage points of GDP is almost entirely accounted for by projected rises in (a) interest payments on external debt (1.6 percent of GDP), (b) bank and enterprise restructuring costs (1.2 percent of GDP), and (c) foreign-financed project spending (1.2 percent of GDP) (see ¶13,14, and 16 for a description of fiscal policy plans for 2002 at the federal and republican levels).[14] Net of such higher spending, the fiscal deficit would remain broadly constant in 2002, with other spending (including wages), which was compressed in 2001, rising broadly in line with GDP.

19. **Over the medium term, the fiscal deficit will be lowered while revenue and expenditure will be streamlined.** The authorities noted that the relatively high expenditure/GDP ratio projected for 2002 (48½ percent) reflects not only the immediate need for increased investment and reform-related spending but also the fact that expenditure-saving reforms take time to implement and yield results. However, the expenditure/GDP ratio will be targeted to decline by 3 percentage points by 2005, while allowing for increased debt servicing and capital spending (see below). On the revenue side, the policy effort will focus on improving tax administration so as to widen the tax base and, after the revenue-enhancing measures have become effective, lower tax rates to the extent permitted by the fiscal situation. The deficits will continue to be financed mostly by grants, concessional loans and privatization proceeds. On this basis, and after taking into account the external debt write-offs, the medium-term fiscal analysis points to progress toward fiscal sustainability, with the public debt/GDP ratio declining from around 127 percent at end-2001 to 79 percent at end-2002 and 64 percent at end-2005 (Table 9 and Figure 4).[15]

20. **Reorientation of expenditure policy will be an integral part of the medium-term strategy.** Noninterest current spending—projected to rise to 43½ percent in 2002—is high in relation to many other countries in the region, in part due to overstaffing of the government sector, while the quality of the government services is poor owing to improper incentives and inadequate targeting of social benefits. To ensure fiscal sustainability while addressing critical social needs, the government intends to embark on a major overhaul of expenditure—including subsidies, the civil service, healthcare, pensions, and other social benefits—with technical assistance from the World Bank, with a view to lowering noninterest current spending by about 5 percentage points to 38½ percent of GDP by 2005. The pension reform

[14] Bank and enterprise restructuring costs account for the full increase in subsidies (0.7 percent of GDP) and part of the increase in transfers to households (0.4 percent of GDP); the remainder of the increase in transfers in households is explained by higher pension and health-care spending (2 percent of GDP).

[15] Roughly two-thirds of public debt is owed to foreign creditors, a majority of whom will be offering debt reduction in 2002 and 2005; domestic debt obligations will be declining steadily over the decade as frozen foreign currency deposits (over 30 percent of GDP at end-2001) are repaid and owing to strict limits on new domestic borrowing.

measures adopted in Serbia late last year—including an increase in the retirement age by 3 years and a change in the indexation method—are tentatively expected to generate savings of about 1½ percent of GDP by 2005 (see background paper).[16]

21. **The EA envisages further structural reforms in tax policy, tax administration, and public expenditure management.** In light of the tax policy reforms implemented in mid-2001, the introduction of a VAT is the key remaining tax policy reform in Serbia. The VAT will be introduced only after the issue of trade relations between Serbia and Montenegro has been resolved—but technical preparations would begin in the coming months. In the area of tax administration, a lot remains to be done, including the reorganization of the Public Revenue Agency in preparation for the move to a modern payments system (¶15). On public expenditure management, a key measure is the establishment of a Treasury with basic functions by end-September 2002. (See ¶17 for fiscal reform plans in Montenegro.)

C. Wage and Pricing Policies

22. **The authorities noted that strict wage policy in the public sector continued to be key to lowering inflation and enhancing economic efficiency.** Wage policy will remain unchanged in 2002, with the wage bill of the *government* being kept constant in relation to GDP and that of *state-owned enterprises* (mainly public utilities, where wages tend to be above the public sector average) being kept constant in real terms. As of next year, employment in the public sector (the civil service, the education and health sectors, and the public utilities) will be reduced in both republics with a view to enhancing productivity and allowing greater wage dispersion to improve incentives.

23. **Administered prices for electricity will be adjusted to cost-recovery levels.** Energy prices, together with some agricultural producer prices, are still administered. Following an increase in electricity price in Serbia by 120 percent in 2001, a major further increase is scheduled for 2002 (to be monitored through a structural performance criterion), with a view to reaching a cost-recovery level by mid-2004 (¶19).[17] Sizable increases are envisaged also in Montenegro. The further liberalization and future privatization of the energy sector will benefit from the establishment of an independent regulator of electricity and other energy prices (¶19). Support prices for agricultural commodities will be reviewed under the program, taking into account fiscal costs and developments on international markets.

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[16] See Annex C to Appendix IV for a list of structural fiscal measures during the EA. Annex C has been included at the authorities' request to facilitate planning and coordination and does not represent formal Fund conditionality. Only structural measures in Annex B-2 are conditions for the Fund program.

[17] Budget support to the Serbian electricity company has been limited to 0.4 percent of GDP in 2002. In the absence of the envisaged price increase by mid-year, budget support would need to increase by the equivalent of 1 percent of annual GDP.

D. Monetary and Exchange Rate Policy

24. **Credit policy will remain tight in 2002 to consolidate the recent stabilization gains, against the backdrop of an important reform of policy instruments.** With persisting uncertainty about money demand and a projected increase in net foreign exchange inflows, NDA growth will continue to be strictly limited (Text Table 3, Tables 5 and 6). Reserve money is projected to rise by 37 percent, implying a smaller decline in velocity than in 2001 (¶20).[18] The NBY will also continue with its policy of sterilizing higher-than-projected NFA by keeping the NDA of the NBY below the program ceiling if the NFA overperformance does not appear to reflect increased money demand. Meanwhile, the reserve requirement system has been simplified considerably, while the NBY credit windows were reformed to facilitate the development of the interbank money market and improve the efficiency of monetary policy (¶23).

Text Table 3. Federal Republic of Yugoslavia: Monetary Indicators, 2000-02

	2000	2001					2002			
	Dec.	June	Sep.	December			Mar.	June	Sep.	Dec.
		Actual	Actual	Orig. Prog.	Second Review	Actual	Prel.	Target		
	(Cumulative change as percent of reserve money at year-beginning)									
NFA 1/	147.7	44.1	67.1	8.2	65.5	86.8	17.3	12.8	18.9	25.2
NDA 1/	-56.6	-18.0	-10.2	18.0	10.1	2.3	-4.8	5.9	9.1	12.2
Reserve money 1/	91.1	26.1	56.9	26.1	75.6	89.1	12.5	18.7	28.0	37.4
	(Cumulative percentage change from year-beginning)									
Currency in circulation 1/	64.1	31.0	61.4	36.0	90.0	95.4	17.2	22.5	33.8	45.0
	(Cumulative change in millions of U.S. dollars from year-beginning; end-Dec.-previous year exchange rates)									
NFA 2/	...	138.5	210.7	25.2	205.8	306.6	158.2	78.0	115.0	153.0
Gross official reserves 3/	...	386.4	514.6	216.3	509.7	684.5	308.7	271.0	373.0	476.0
	(End period cumulative percentage change from year-beginning)									
Memorandum item										
Retail prices	113.5	23.1	31.2	35.0	40.0	39.0	2.5	9.1	15.7	20.0

Sources: National Bank of Yugoslavia; and IMF staff estimates and calculations.

1/ Actual figures are based on monthly average from Dec. 2001 onwards. Change in 2002 are against adjusted reserve money and NDA figures at end-2001 for the bank closure and the new reserve requirement.

2/ Excludes US$161.5 million of BIS gold and foreign exchange deposits allocated to FRY in June 2001.

3/ Includes US$161.5 million of BIS gold and foreign exchange deposits allocated to FRY in June 2001.

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18 Reserve money velocity is projected to decline by 7 percent during 2002 against a decline of 32 percent last year.

25. **Exchange rate policy will be kept under close review, owing to the need to safeguard competitiveness.** Even though the NBY has maintained a stable exchange rate against the euro over the past year in the face of significant increases in prices and wages, developments in the foreign exchange market remain favorable, as indicated by broad balance in the interbank market (i.e., excluding foreign exchange inflows related to foreign assistance and privatization proceeds). Various real exchange rate indicators suggest that the value of the dinar remains within a historical range (Box 3). Moreover, euro wages are still relatively low, albeit rising fast. The authorities therefore believed that, in the current circumstances, raising the profitability of the traded goods sector should involve removing impediments to productivity growth rather than exchange rate depreciation, which would generate wage and price inflation pressures. Nevertheless, the persisting real appreciation of the dinar, in conjunction with the tendency of trade flows to respond to an erosion of competitiveness with a lag, could eventually lead to sudden downward pressures on the dinar, suggesting the need for caution. Accordingly, the monetary authorities intended to monitor closely developments in the foreign exchange market and to keep exchange rate policy under close review in light of export and wage developments.

Box 3. Assessing External Competitiveness

While various indicators of Yugoslavia's external competitiveness have recently worsened, they either have not yet reached worrisome levels (as in the case of the REER and U.S. dollar wages), or are based on too short a period of time to allow for definitive conclusions (such as export, import and current account trends).

- The recent rise of the **REER** (by 30 percent on the basis of price-based indices and by around 50 percent on the basis of wage-based indices) represents a return to the level prevailing in 1997–98, a period during which Yugoslavia temporarily benefited from normal (sanctions-free) trading relations and when exports were at their peak levels. Accordingly, the real appreciation could be viewed as a return of the REER back to its "equilibrium" value.
- **Wages** in Yugoslavia are low when compared to other transition countries. At end-2001, gross monthly wages were around US$170 for Yugoslavia compared to an average of US$350 for the region.
- The **current account balance** has deteriorated for the past three years, reflecting a failure of exports to recover from their sharp fall in 1999 (due to the Kosovo war) and the rising imports of goods and services financed by foreign assistance. Export growth was modest last year, especially considering that part of this increase is due to an improvement in recording following the removal of the multiple exchange rate regime (see footnote 2 above). However, some lag in the recovery of exports would be expected as it is only in late 2000 and early 2001 that normal economic activity was restored, with international sanctions removed and the trade system liberalized.

26. **The foreign exchange market will be further liberalized, in light of the authorities' intention to accept the obligations of Article VIII, Sections 2, 3 and 4 of the Fund's Articles of Agreement.** In spite of the above-mentioned unification of the multiple exchange rate system, the foreign exchange system remained unduly complex, imposing excessive restrictions and reporting requirements on banks. The recent cleaning up of the

banking system has permitted further exchange system liberalization. Under proposed legislation, all restrictions on payments and transfers for current international transactions will be eliminated, to pave the way for the acceptance of the obligations under Article VIII, Sections 2, 3, 4; and capital account transactions will be liberalized with the exception of capital outflows and short-term capital movements. Importantly, documentation requirements on banks will be sharply reduced (¶22). The staff is in the process of reviewing FRY's exchange system in light of these developments. If any exchange measures subject to Fund jurisdiction remain in existence, they will be identified for the Board before the Board meeting on the Article IV consultation.

E. Foreign Trade System

27. **Most of the remaining trade barriers will be removed during the EA period.** Following key steps in 2001, the program envisages the elimination of the remaining QRs on exports and imports—other than those maintained for health, environmental and security reasons—by end-2003 and end-2004, respectively. After implementing these measures, the ranking of Yugoslavia's trade regime on the Fund's index of restrictiveness would improve from "5" to "2."

F. Bank Restructuring

28. **Serbia's deeply insolvent banking system has been largely cleaned up.** On the basis of a comprehensive evaluation of the financial position of the commercial banks in Serbia—and with technical assistance from the Fund, the World Bank and bilateral donors—the NBY adopted a bank restructuring strategy in May 2001 and immediately began its implementation. An important step was taken in January 2002 with the closure of four large insolvent banks (¶4).[19] In total, some 28 banks, accounting for almost two-thirds of the

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[19] The (incremental) liquidation cost of the four banks—in the form of NBY liquidity support before the closure, payouts to depositors and severance payments to workers—reached about US$83 million (0.7 percent of GDP), in line with the budget estimate; of this amount, US$19 million represented severance payments (about US$2,200 per employee). The closure of the four banks did not have significant repercussions on the financial and real sectors.

book value of the total assets have been categorized as insolvent and, for the most part, put into bankruptcy (Box 4). The remaining 43 "healthy" banks include a growing number of foreign-owned banks (5 as of end-March 2002).

Box 4. Progress in Cleaning Up the Banking System

As of end-February 2002, out of 71 banks on the territory of Serbia, some 43 banks accounting for about 36 percent of the book value of total banking assets had been categorized either as healthy (category A, Text Table 4) or as solvent but undercapitalized and placed under enhanced NBY supervision (category B). The remaining 28 banks, accounting for 64 percent of the book value of banking assets, had been categorized as insolvent and had been either placed under the control of the Bank Rehabilitation Agency (BRA), pending their rehabilitation or liquidation (category C), or put in liquidation (category D).

Text Table 4. Republic of Serbia: Status of Commercial Banks as of end-March 2002
(In percent and in U.S. dollars)

	No. of Banks	Share in Book Value of Total Assets 1/ (In percent)	Share in Total Deposits Excl. Bank Deposits (In percent)
A (healthy)	33	19	58
of which: with foreign capital	5	2	13
B (solvent but undercapitalized)	10	17	25
Sub-total: A+B	**43**	**36**	**83**
C (insolvent; under BRA control)	5	3	1
D (insolvent; under liquidation)	23	61	16
Sub-total: C+D	**28**	**64**	**17**
Total	**71**	**100**	**100**
Total (in millions of U.S. dollars)		**11,052**	**1,554**

Source: Yugoslav authorities; and IMF staff estimates.
Notes: Based on balance sheet data as of end-Dec. 2001; for banks in category D, latest available data (mostly end-Sep. 2001)
1/ Total book value of bank assets is on aggregated basis and includes intra-bank credits.

29. **Efforts will now focus on the resolution/privatization of remaining problem banks and the strengthening of banking supervision.** The authorities will decide by end-June 2002 the feasibility of privatization plans for the 10 undercapitalized banks under enhanced supervision (group B) and on the rehabilitation or liquidation of 5 banks under the control of the Bank Rehabilitation Agency (group C); progress in this area will be monitored through a structural benchmark (¶25). In addition, the authorities intend to strengthen bank supervision and enforcement of prudential rules and regulations, with legislation expected to be adopted by end-June 2002 (monitored as a structural benchmark). Moreover, privatization of public banks will be accelerated.

G. Enterprise Restructuring and Privatization

30. **The authorities have embarked on a strategy to enhance the efficiency of the enterprise sector and allow the unfettered development of the private sector.** The FRY economy is dominated by state and socially-owned enterprises that are inefficiently organized, loss-making, undercapitalized and highly indebted. The private sector, has been

much more dynamic and profitable but remains small and constrained by excessive regulation and a severe lack of access to financial resources.[20] Against this background, the authorities have adopted a strategy, with World Bank assistance, that envisages (a) addressing the problems of socially and state-owned enterprises, through privatization, restructuring, and liquidation leading to sales of assets (¶27 and 28); and (b) improving the business environment by removing obstacles to the entry and growth of new private firms (¶29).

IV. Access, Phasing, and Conditionality

31. **Access under the proposed EA would amount to SDR 650 million or 139 percent of quota, to be disbursed in 13 equal purchases.** This would provide Yugoslavia with adequate balance of payments support throughout the period of reforms envisaged under the program. The first purchase will be available upon approval of the arrangement and subsequent purchases will be available on a quarterly basis contingent upon observance of quarterly performance criteria and in conjunction with completion of semiannual program reviews as needed (Table 15 and ¶31). Moreover, each purchase under the arrangement will be subject to a review of the financing of the program. Performance criteria for 2003 will be set in the context of the first semiannual review, which is expected to be completed in December 2002.

32. **Performance criteria and benchmarks have been proposed for the period through end-2002.** Annex A.2 to Appendix IV contains the list of quantitative performance criteria and indicative targets, while Annex B.2 to Appendix IV contains the list of prior actions, structural performance criteria and benchmarks. Structural conditionality issues are addressed in Box 5.

[20] Total dependent employment in Serbia is 2.1 million. Of this, about 20 percent is accounted for by the government, 7 percent by state-owned enterprises, 53 percent by socially owned enterprises, and 20 percent by the private sector.

Box 5. Structural Conditionality

Status of structural conditionality from the SBA
Most structural reforms monitored during the three program reviews have been completed; however, owing to capacity constraints, several measures have either been implemented with a delay or are in the process of being addressed (see Annex B.1). Notable milestones under the SBA's structural reform program included: a major streamlining of the tax system; the submission of key laws related to fiscal policy; the completion of an external audit in Montenegro; the implementation of an extensive program of banking system reform; and the raising of electricity prices. Related to private sector development, the legal and institutional framework for privatization was established and started to be implemented; and a new labor law was adopted.

Coverage of structural conditionality in the proposed EA
Structural conditionality under the EA will focus on the fiscal and financial sectors, in areas that are of macroeconomic importance and fall within the Fund's expertise. In the *fiscal sector*, conditionality will cover actions that improve budget coverage and reporting, raise the efficiency of the tax system (by introducing VAT and reducing financial transactions taxes), modernize tax administration, strengthen public expenditure management, and further reform the pension system. In the *financial sector*, structural reforms will aim to establish a modern, market-based financial system, including by liberalizing the foreign exchange market, developing monetary policy instruments, deepening money markets, and overhauling the existing payments system. Additional conditionality will apply to *electricity pricing policy* given the need to safeguard fiscal resources.

Structural areas covered by World Bank lending and conditionality
The World Bank is actively assisting Yugoslavia's structural reform program. In the fiscal sector, while the Fund is the key agency on tax policy and tax administration, the World Bank is taking the lead in public expenditure reform (including through work on a Public Expenditure and Investment Review) as well as in the reform of the pension, health, and social assistance systems. A recently approved Structural Adjustment Credit (SAC) is geared towards strengthening public expenditure management, energy sector reform, and social sector reform. A forthcoming SAC is expected to agree on conditionality related to reforms in the enterprise and banking system. Additional programs of bank lending and assistance are expected to focus on social sector issues.

Other relevant structural conditions not included in current program
The new program no longer covers measures in private sector development through explicit performance criteria or benchmarks, as the Bank has now commenced lending operations and has included relevant policy measures in its conditionality.

V. Staff Appraisal

33. **Despite the impressive achievements since late 2000, when FRY succeeded to membership in the Fund, the challenges facing the authorities remain daunting.** Steadfast policy implementation will be required if the economy is to remain on a path toward sustainable growth and external viability. The staff is impressed by the authorities' willingness and capacity to address difficult challenges demonstrated to date. This augurs well for the period ahead.

34. **The economic accomplishments to date have been considerable.** Inflation has been lowered sharply, confidence in the currency has strengthened, foreign reserves have almost

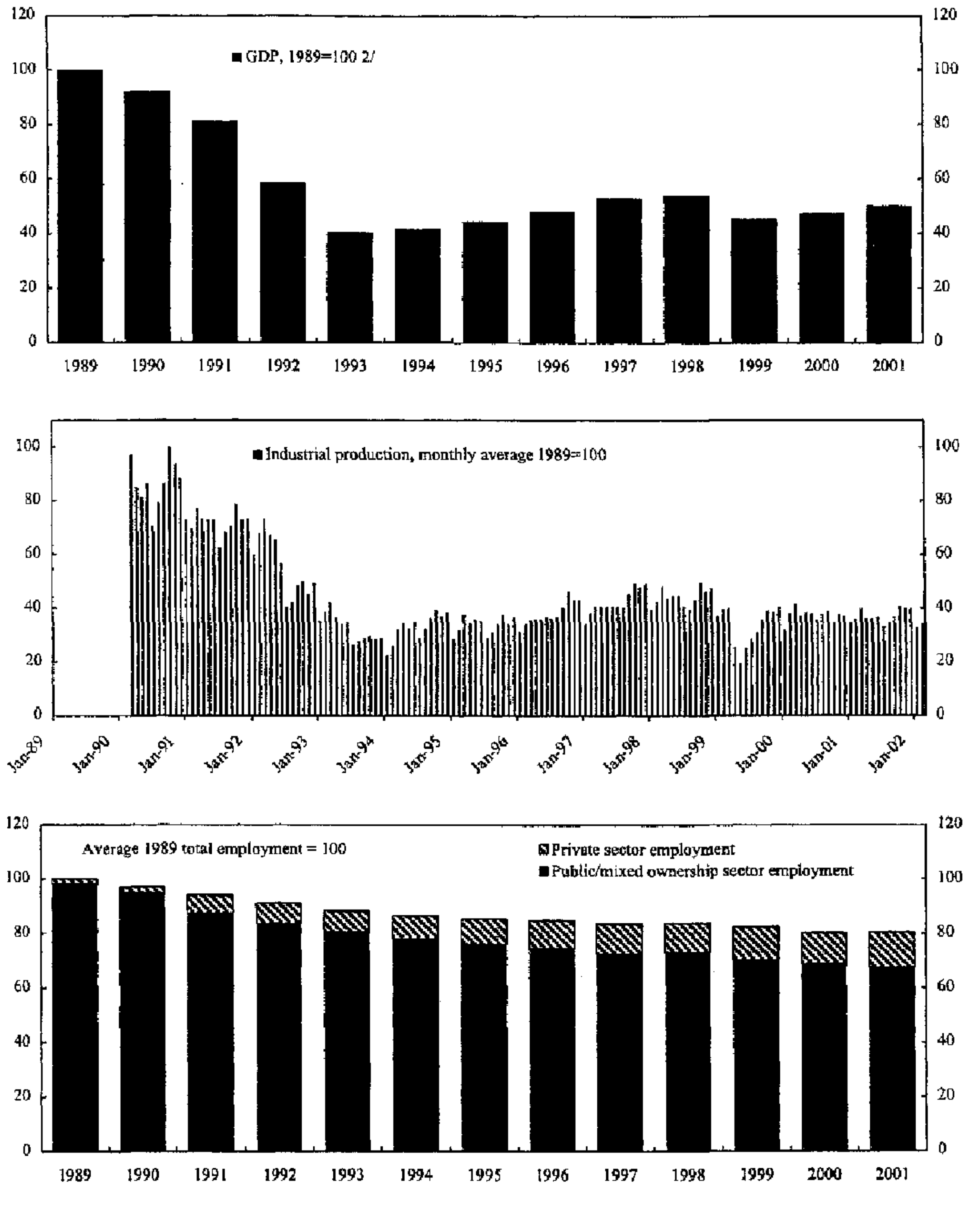
tripled, and output has started to recover. On the structural policy front, the price, exchange, trade, and tax regimes have been streamlined to allow economic market signals to affect economic behavior. In addition, new legal and institutional frameworks have been put in place to guide the restructuring of the economy, thereby paving the way for the successful privatization of some large companies and the closure of four large insolvent banks. The recent agreement on a plan for a new constitutional framework—by recognizing the status quo and normalizing relations between the two republics—should provide a good basis for streamlining government spending and strengthening the custom and tax systems. In recognition of the authorities' policy efforts as well as the needs of the country, the international community has extended considerable foreign assistance and debt relief.

35. **Looking ahead, there are risks and serious policy challenges owing to uncertainty about macroeconomic prospects over the EA period, and the room for maneuver is limited.** The authorities should be prepared to adapt policies to changes in the environment with a view to safeguarding the key macroeconomic objectives; in the immediate period ahead, the authorities should monitor closely the effects of the higher fiscal deficit and of the continuing real appreciation. Progress toward fiscal sustainability will critically require improvements in tax administration in preparation for a market-friendly payments system and the introduction of a VAT; and a streamlining of expenditure, involving a containment of noninterest current spending through improved efficiency in the delivery of services and better targeting of benefits. A continuation of reforms in the banking sector, including a strengthening of banking supervision, the restructuring of the decapitalized and overstaffed enterprise sector, and improvements in the business environment will be critical to ensure private sector-led growth.

36. **The FRY authorities' medium-term program of stabilization and reform sets a good basis for achieving sustainable growth and a viable external position, and deserves the continued support of the Fund through completion of the third review under the current stand-by arrangement and approval of the proposed extended arrangement.** The proposed access appears appropriate, taking into account the balance of payments need, the strength of the adjustment effort, and the country's projected debt servicing capacity. Considering the initial conditions, the medium-term economic outlook will inevitably remain challenging. It is important therefore that the authorities implement the program on a sustained basis and that the international community remains supportive through the intensive restructuring effort envisaged over the medium term.

37. It is recommended that the next Article IV consultation with FRY be conducted on the standard 12-month cycle.

Figure 1. Federal Republic of Yugoslavia: Selected Economic Activity Indicators, 1989-2002 1/



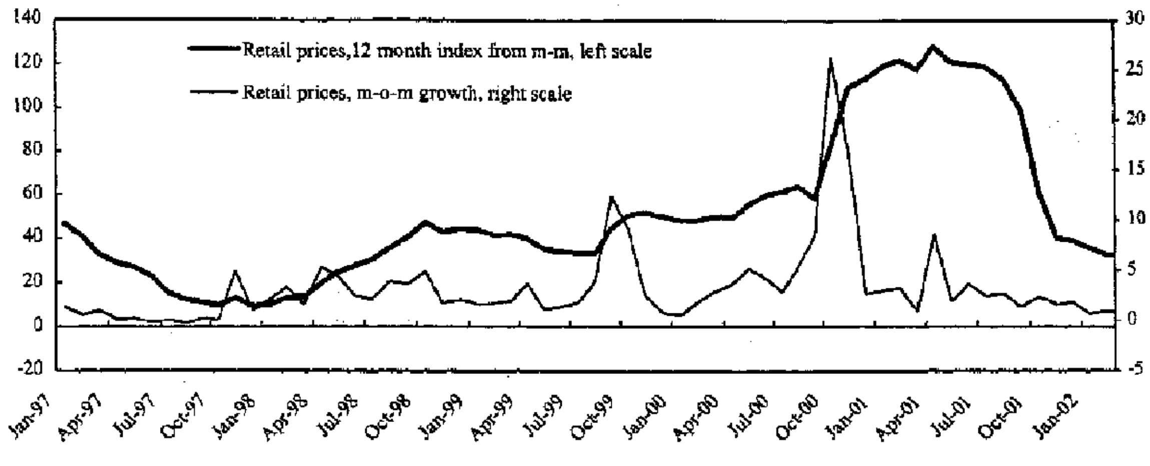
Source: Federal Institute of Statistics and National Bank of Yugoslavia.

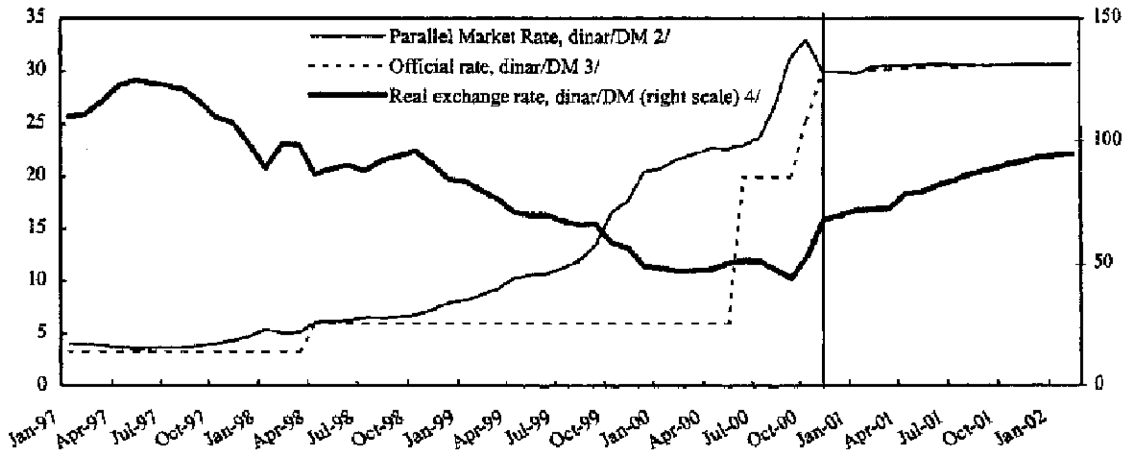
1/ Data before 1991 refer to the territory of the Republics of Serbia and Montenegro; after February 1999 indicators refer to the territory excluding Kosovo.

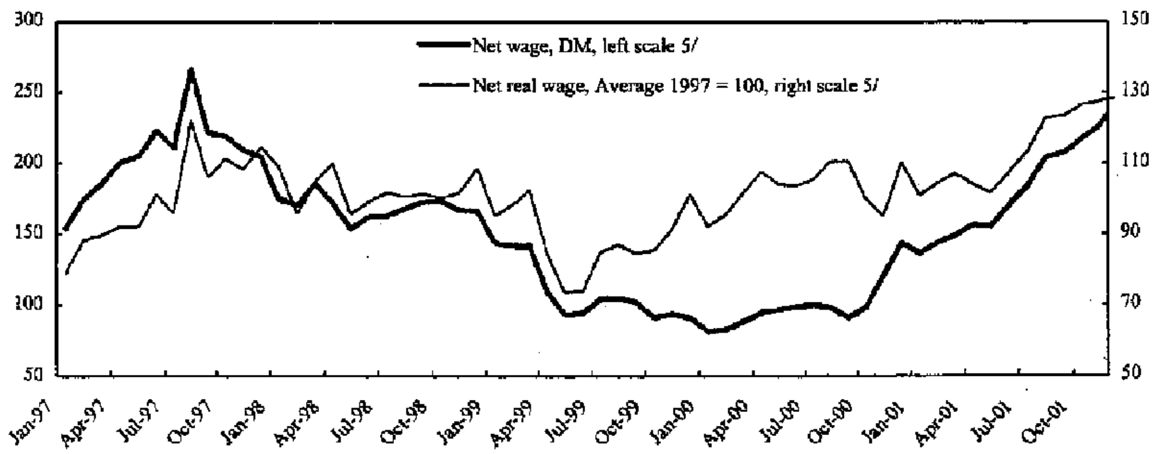
2/ Growth rates for 1990-94 refer to Gross Social Product (GSP), which is about 15-20 percent smaller than GDP as it excludes public and other services.

3/ In 1997 the official statistics begun to track employment in small enterprises excluded from other surveys.

Figure 2. Federal Republic of Yugoslavia: Prices, Exchange Rates, and Wages
January 1997-February 2002 1/







Sources: Federal Institute of Statistics; National Bank of Yugoslavia; and Fund staff calculations.

1/ Data after February 1999 exclude Kosovo.

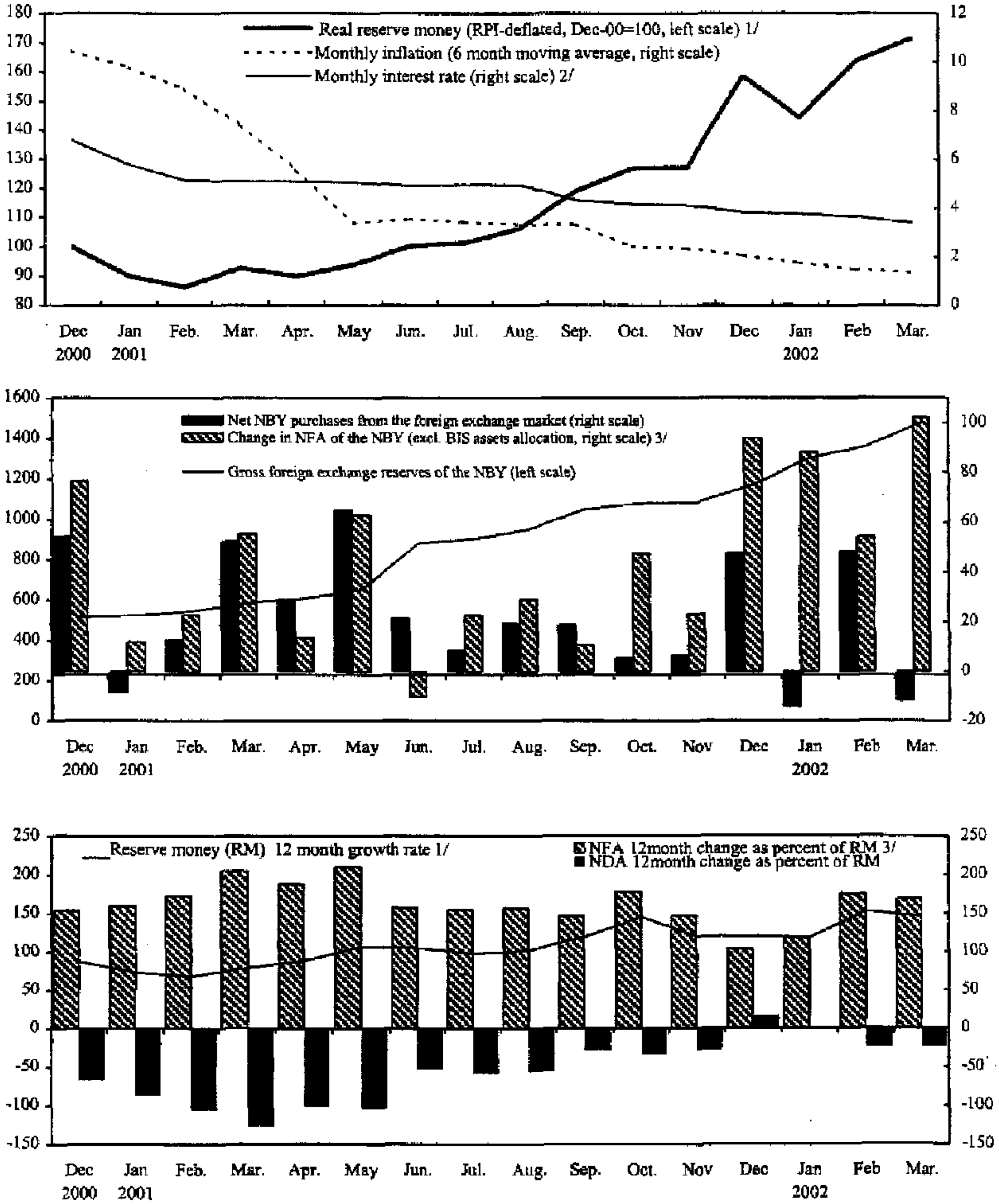
2/ Difference between official and parallel market rates are negligible in December 2000.

3/ The official exchange rate includes a premium which was applied in most but not all official transactions between May-November 2000. The exchange rate was unified on December 5, 2000.

4/ Real index obtained by applying the FRY retail price index and the German CPI to the average parallel market rate, and since December 2000 the official exchange rate. Increase denotes appreciation.

5/ Owing to a change in the definition of wages to include fringe benefits, the level of wages may be overestimated from June 2001.

Figure 3. Federal Republic of Yugoslavia: Real Reserve Money, Foreign Reserves, and Reserve Money Growth, December 2000-March 2002



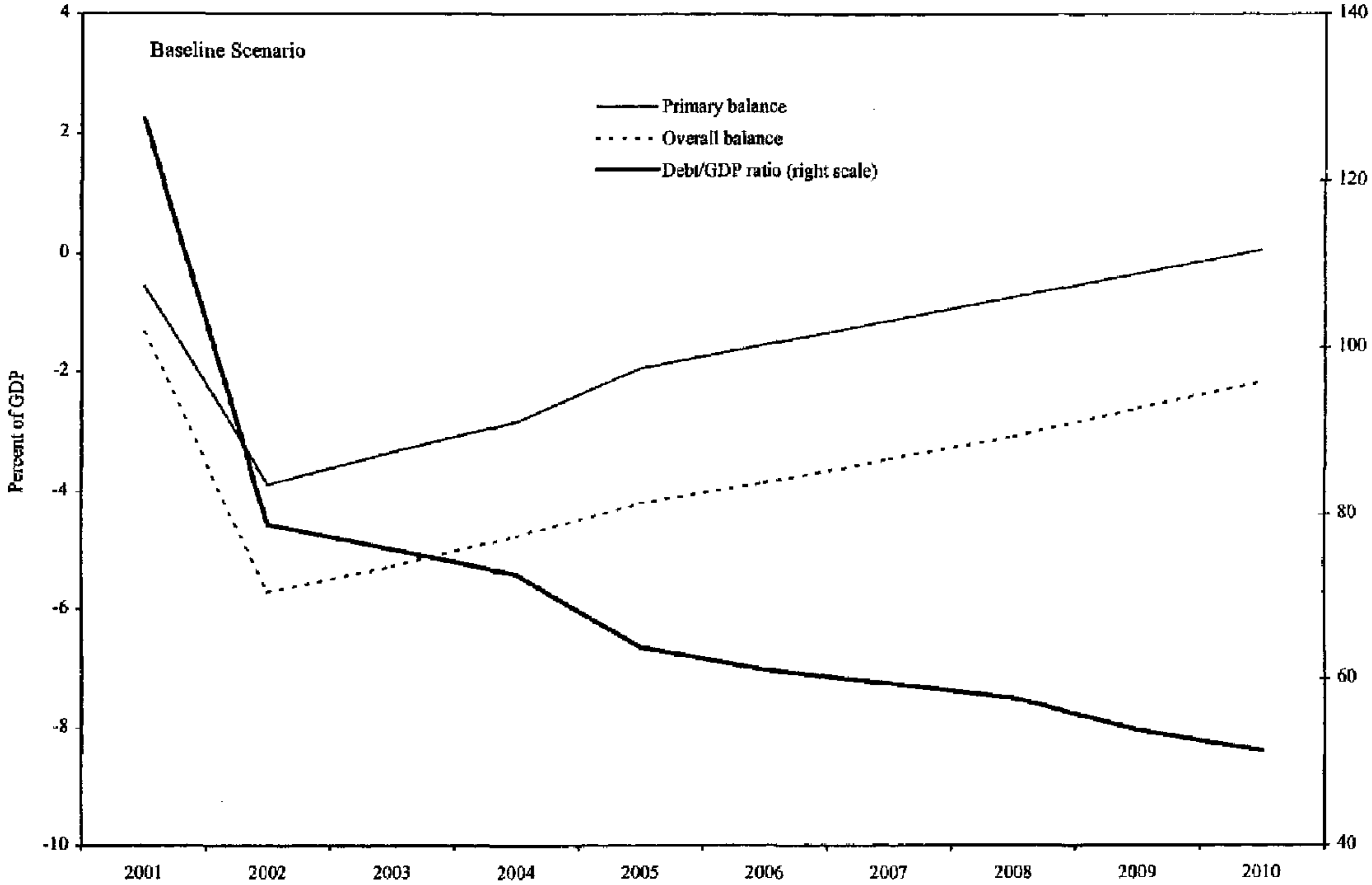
Sources: National Bank of Yugoslavia; and IMF staff estimates and calculations.

1/ Reserve money is adjusted to be comparable with the newly announced 20 reserve ratio and widening of reserve base.

2/ Weighted average of monthly interest rates of Commercial Paper, Bank Bills, and Certificates of Deposit.

3/ NFA is at Dec. 01 exchange rates and excludes BIS assets allocation.

Figure 4. Federal Republic of Yugoslavia: Public Debt, 2001-2010



Sources: Data provided by the Yugoslav authorities; and IMF staff estimates and projections.

Table 1. Federal Republic of Yugoslavia (Serbia/Montenegro): Selected Economic and Financial Indicators, 1998-2002 1/

	1998	1999	2000	2001	2002 Proj.
Real economy					
GDP, in billions of YUD	146.3	192.9	358.1	724.1	978.9
GDP, in millions of U.S. dollars	13,889	10,214	8,071	10,861	12,841
Average net real wage, 1997 =100	102	88	103	115	...
Average net wage in Euro	86	56	51	93	...
			(Percent change)		
Real GDP	2.5	-18.0	5.0	5.5	4.0
Industrial production	4.4	-24.4	11.1	0.0	3.0
Retail prices (annual average)	29.5	42.1	69.9	91.1	26.3
Retail prices (end of period)	44.5	49.9	113.5	39.0	20.0
Unemployment rate (in percent) 2/	25.1	26.5	27.3	27.8	...
			(Percent of GDP)		
General government finances 3/					
Revenue	...	...	39.2	41.6	43.0
Expenditure	...	...	40.1	43.0	48.7
Cash balance	...	...	-0.9	-1.3	-5.7
Foreign grants	...	...	0.8	0.7	1.0
Foreign loans	...	...	0.0	0.0	3.0
Privatization receipts	...	...	0.0	0.0	1.3
Domestic financing	...	...	0.2	0.7	0.5
Commitment balance 4/	...	...	-3.0	-1.3	-5.7
			(Percent change)		
Money supply (end-of-period) 5/					
M1	...	47.3	85.1	109.7	53.0
M2	...	67.6	61.4	86.3	45.3
Balance of payments			(In billions of U.S. dollars)		
Merchandise exports	3.0	1.7	1.9	2.0	2.2
Merchandise imports	-4.8	-3.3	-3.7	-4.8	-5.6
Trade balance	-1.8	-1.6	-1.8	-2.8	-3.3
Current account balance, after grants	-0.7	-0.8	-0.3	-0.6	-1.1
(In percent of GDP)	-4.8	-7.5	-4.2	-5.5	-8.2
Current account balance, before grants	-0.7	-0.8	-0.6	-1.2	-1.6
(In percent of GDP)	-4.8	-7.5	-7.6	-10.9	-12.8
Foreign debt (year-end) 6/	10.5	10.7	11.4	11.9	8.6
Gross official reserves	0.3	0.3	0.5	1.2	1.6
(In months of imports of goods and services)	1.1	0.9	1.2	2.4	3.0

Sources: Federal Statistical Office; National Bank of Yugoslavia; Federal and Republican Ministries of Finance; and IMF staff estimates.

1/ With the exception of foreign debt, data for 1999-2002 exclude Kosovo. GDP excludes Kosovo throughout.

2/ Excludes workers on "forced holiday".

3/ Fiscal operations of all levels of government, except for Montenegro where it excludes local governments.

4/ Excludes arrears of local governments and most interest payments on foreign debt due but not paid.

5/ From 1999 onwards excludes Montenegro.

6/ For 2002, figures reflect the first phase of the Paris Club debt reduction, and comparable treatment from other official bilateral and commercial creditors

Table 2. Federal Republic of Yugoslavia: Balance of Payments, 1997-2005

(In millions of U.S. dollars)

	1997	1998	1999	2000 Revised	2001 Original Program	2001 Prel. Estimate	2002 Proj.	2003 Proj.	2004 Proj.	2005 Proj.
Trade balance	**-2,070**	**-1,816**	**-1,619**	**-1,788**	**-2,441**	**-2,834**	-3,318	-3,500	-3,579	-3,655
Exports f.o.b.	2,756	3,033	1,676	1,923	2,064	2,003	2,250	2,618	3,048	3,505
(percent growth)		10.1	-44.7	14.7	7.3	4.2	12.3	16.4	16.4	15.0
Recorded	2,677	2,858	1,497	1,723	1,964	1,903	2,250	2,618	3,048	3,505
Unrecorded	79	175	179	200	100	100	0	0	0	0
Imports f.o.b.	-4,826	-4,849	-3,295	-3,711	-4,506	-4,837	-5,567	-6,119	-6,626	-7,160
(percent growth)		0.5	-32.1	12.6	21.4	30.4	15.1	9.9	8.3	8.1
Services, net	**456**	**493**	**228**	**331**	**210**	**436**	**522**	**585**	**644**	**701**
Receipts	818	914	471	624	775	759	904	1,000	1,095	1,191
Expenditure	-362	-421	-243	-293	-565	-323	-382	-414	-451	-491
Net factor income	**25**	**8**	-41	-1	**-152**	**-26**	**-300**	**-357**	-388	-370
Of which: Net interest	25	8	-41	11	-152	-26	-300	-357	-388	-370
Earnings	59	57	43	53	52	48	82	108	119	134
Payments 1/	-34	-49	-84	-42	-204	-74	-383	-465	-508	-504
Private remittances, net	**310**	**655**	**668**	**848**	**890**	**1,237**	**1,450**	**1,550**	**1,700**	**1,875**
Inflows	662	1,033	948	1,132	1,190	1,698	1,925	1,983	2,102	2,206
Recorded	465	688	501	632	980	1,578				
Unrecorded	197	345	447	500	210	120				
Outflows	-352	-378	-280	-284	-300	-461	-475	-433	-402	-331
Current account balance, before grants	**-1,279**	**-660**	**-764**	**-610**	**-1,493**	**-1,187**	**-1,646**	**-1,722**	**-1,623**	**-1,449**
(In percent of GDP)	-7.7	-4.8	-7.5	-7.6	-14.6	-10.9	-12.8	-12.4	-10.7	-8.8
Official grants 2/	0	0	0	271	650	591	351			
Foreign direct investment	740	113	112	25	160	165	400	500	500	600
Foreign loans, net	283	-10	-25	180	588	374	577	129	178	172
Medium and long term, net	54	25	12	213	588	299	508	53	100	75
Disbursements	128	50	29	227	599	332	560	154	255	275
Of which: Official creditors 2/					529	205	420			
Amortization 1/	-74	-25	-17	-14	-11	-33	-52	-101	-155	-200
Short term, net	229	-35	-37	-33	0	75	70	76	78	97
Other capital inflows 7/	139	78	30	49	50	629	50	50	50	50
Commercial banks, net					0	-274	-250	-100	-50	-50
Capital account balance	**1,162**	**181**	**117**	**255**	**798**	**894**	**777**	**579**	**678**	**772**
Errors and omissions	-103	278	410	267	290	307	290	290	290	290
Overall balance	**-220**	-201	**-237**	183	**245**	**605**	**-228**	**-853**	**-655**	**-387**
Financing	**220**	201	**237**	-183	**-9,614**	**-5,981**	**-4,181**	**-189**	**-328**	**-482**
Net foreign assets (increase, -)	18	115	111	-246	-25	-395	-164	-189	-328	-482
Central Bank, net					-25	-395	-164	-189	-328	-482
Gross foreign reserves (increase, -) 3/	18	115	111	-227	-217	-523	-476	-416	-401	-430
Of which: IMF purchases				152	128	128	312	250	252	126
Gross foreign liabilities	0	0	0	-19	192	128	312	227	73	-52
Arrears (reduction, -) 4/	202	86	126	63	-9,589	-5,587	-4,018	0	0	0
Financing expected							300	920	860	760
Official grants							245	400	300	300
Official borrowing (excluding IMF)							55	520	560	460
Residual gap					9,369	5,377	4,109	122	122	110
Arrears settlement with creditors (for 2001) 4/					9,369	5,377	4,018	0	0	0
Debt relief from creditors 5/					0	0	92	122	122	31
Memorandum items:										
Current account balance, after grants	-1,279	-660	-764	-339	-843	-596	-1,050	-1,322	-1,323	-1,149
(In percent of GDP)	-7.7	-4.8	-7.5	-4.2	-8.2	-5.5	-8.2	-9.5	-8.7	-7.0
Gross international reserves, USD mn (end period) 6/			289	516	733	1,169	1,645	2,061	2,462	2,892
in months of prospective imports of goods & services			0.9	1.2	1.5	2.4	3.0	3.5	3.9	4.2
Debt service, cash	108	74	101	56	215	107	343	467	719	852
(In percent of GDP)	0.7	0.5	1.0	0.7	2.1	1.0	2.7	3.3	4.7	5.2
Principal	74	25	17	14	11	33	52	124	334	378
Interest	34	49	84	42	204	74	291	342	385	474

Sources: National Bank of Yugoslavia, Ministry of International Economic Relations, and IMF staff estimates.

1/ Up to 2001, figures indicate debt service actually paid. For 2002, debt service recorded above-the-line is *after* the 51% debt reduction granted by bilateral & commercial creditors, but before the capitalization of moratorium interest (the effect of the latter is recorded as debt relief).

2/ Official grants and loans recorded above-the-line are amounts based on already secured commitments; amounts expected from new pledges are shown below-the-line.

3/ Reserve accumulation at fixed (Dec 2000) exchange rates and excluding US $161.5 mn on account of the distribution of BIS-related inflows.

4/ Of the approximately $9.6 bn in arrears at end-2000, $5.6 bn were cleared in 2001: $5.4 bn through restructuring agreements and $0.2 bn of EIB arrears through full payment. Negotiations are on-going to clear all remaining external arrears in 2002 (to the IFC, the London Club, other commercial creditors, and on short-term debt).

5/ Represents a 60 percent capitalization of moratorium interest due to bilateral and commercial creditors, as per November 2001 Paris Club agreement.

6/ Actual end-of-period reserves at current exchange rates. Includes $161.5 mn in the distribution of BIS gold and foreign exchange.

7/ For 2001, includes an estimated $632 mn in sales of foreign exchange notes by the public (amount above the level implied by trend growth) reflecting currency substitution.

Table 3. Federal Republic of Yugoslavia: External Financing Requirements and Sources, 1998-2005
(In millions of U.S. dollars)

	1998	1999	2000	2001 Est.	2002 Proj.	2003 Proj.	2004 Proj.	2005 Proj.
1. Gross financing requirements	**-720**	**-818**	**-1,074**	**-7,329**	**-6,191**	**-2,262**	**-2,357**	**-2,257**
External current account deficit (excluding official transfers)	-660	-764	-671	-1,187	-1,646	-1,722	-1,623	-1,449
Debt amortization	-60	-54	-47	-33	-52	-101	-155	-200
Medium- and long-term debt	-25	-17	-14	-33	-52	-101	-155	-200
Public sector	...	...	...	-11	0	0	0	0
Multilateral 1/	...	...	...	-11	0	0	0	0
Bonds and notes	...	...	...	0	0	0	0	0
Other	...	...	...	0	0	0	0	0
Commercial banks and corporate private sector	...	...	...	0	0	0	0	0
Short-term debt 2/	-35	-37	-33	0	0	0	0	0
Repayment of arrears	0	0	0	-5,587	-4,018	0	0	0
Gross reserve accumulation	0	0	-227	-523	-476	-416	-401	-430
IMF repurchases and repayments	0	0	-129	0	0	-23	-178	-178
2. Available financing	**720**	**818**	**1,074**	**1,620**	**1,295**	**1,370**	**1,423**	**1,562**
Official grants	0	0	271	591	596	400	300	300
Foreign direct investment (net)	113	112	25	165	400	500	500	600
Debt financing from private creditors	78	30	49	202	210	230	333	372
Medium and long-term financing	78	30	49	127	140	154	255	275
To public sector	0	0	0					
Of which : Balance of payments financing 3/	0	0	0					
To commercial banks	26	19	8					
To corporate private sector	52	11	41					
Short-term financing and other capital inflows	0	0	0	75	70	76	78	97
Official creditors (recorded under financing after 2000)	50	29	227	0	0	0	0	0
Multilateral 1/	...	...	...	...	...	...	...	...
Of which : Balance of payments financing	...	...	...	...	...	...	...	...
Bilateral	...	...	...	...	...	...	...	...
To public sector	...	...	...	...	...	...	...	...
Of which : Balance of payments financing	...	...	...	...	...	...	...	...
To private sector	...	...	...	...	...	...	...	...
IMF (after 2000, presented as part of exceptional financing)	0	0	150					
Accumulation of arrears (exceptional)	86	126	62	0	0	0	0	0
Other flows 4/	393	521	290	662	90	240	290	290
3. Financing	**0**	**0**	**0**	**5,709**	**4,896**	**893**	**934**	**695**
Program and project assistance	0	0	0	333	787	770	812	586
World Bank	0	0	0	0	220	170	160	160
IMF	0	0	0	128	312	250	252	126
EBRD	0	0	0	2	90	150	150	150
EIB	0	0	0	0	40	40	80	80
EU	0	0	0	203	55	0	0	0
Others (mostly official bilateral creditors)	0	0	0	0	70	160	170	70
Debt relief	0	0	0	5,377	4,109	122	122	31
4. Residual Financing Gap				**0**	**0**	**0**	**0**	**79**

Sources: National Bank of Yugoslavia; and Fund staff estimates.

1/ Including IMF for 2001.

2/ Original maturity of less than 1 year. Stock at end of the previous period.

3/ Includes those transactions that are undertaken for the purpose of financing a balance of payments deficit or an increase in reserves.

4/ Includes other capital inflows, errors & ommissions, and change in net foreign assets of commercial banks.

Table 4. Federal Republic of Yugoslavia: Net Foreign Assets--Actual and Program Floors, December 1999-December 2002

(In millions of U.S. dollars at end-2000 exchange rates)

	1999 Dec.	2000 Dec.	2001 March	2001 June Original Program	2001 June Actual	2001 September Original Program	2001 September Actual	2001 December Original Program	2001 December Second Review	2001 December Actual	2001 December Actual Dec.1 Exch. Rate 4/ (prel.)	2002 4/ Jan. Prel.	2002 4/ Feb. Prel	2002 4/ Mar. Prel	2002 4/ June Prog.	2002 4/ Sep. Prog.	2002 4/ Dec. Prog.
Net foreign assets of the NBY 1/	163	364	457	389	525	369	589	389	584	759	897	985	1,039	1,142	975	1,012	1,050
Net foreign assets of the NBY for program purposes 2/	-552	-309	-231	-283	-170	-303	-98	-283	-103	-2	582	621	786	856	660	697	735
Gross foreign assets	293	516	608	605	741	649	869	733	864	1,039	1,169	1,321	1,375	1,478	1,440	1,542	1,645
Gold	139	125	126	...	127	...	128	...	...	...	...			...	...	...	...
Foreign currencies	100	240	178	...	236	...	247	...	...	...	...			...	...	...	...
Foreign exchange accounts abroad	55	151	404	...	378	...	494	...	...	...	...			...	...	...	...
Reserve-related liabilities (-)	130	152	152	216	216	280	280	344	280	280	272	336	336	336	465	530	595
Gross reserve liabilities for program purposes (-)	844	825	840	888	911	952	967	1,016	967	1,041	586	701	589	622	779	844	909
IMF	130	152	152	216	216	280	280	344	280	280	272	336	336	336	465	530	595
Other	0	0	0	0	0	0	0	0	0	0	0	0		0			0
Adjustments for program purposes	714	672	688	672	695	672	687	672	687	761	314	365	253	286	314	314	314
Foreign currency liabilities to domestic banks	714	672	688	...	695	...	687	...	...	761	314	365	253	286	314	314	314
Loan from China deposited by Yugoslav bank	...	100	100	...	100	...	100	...	...	100	100	100	100	100	100	100	100
Forex deposits from commercial banks	...	61	66	...	57	...	54	...	...	59	116	116	2	2	116	116	116
Unpaid interest	...	70	70	...	70	...	70	...	...	70	4	3	3	3	4	4	4
Short-term loan from commercial banks	...	11	12	...	10	...	0	...	...	0	0	0	0	0	0	0	0
Required reserve and payments related deposits	...	105	115	...	133	...	138	...	...	207	94	146	148	181	94	94	94
Old obligations commercial banks	...	325	325	...	325	...	325	...	...	325	0	0	0	0	0	0	0
Foreign currency liabilities to nonbank non-government residents	0	0	0	...	0	...	0	...	...	0	0	0	0	0	0	0	0
Net foreign assets of commercial banks of Serbia 3/	26	16	7	24	29	1	102	24	188	298	569	600	890	820	829	859	889
Gross reserves	366	366	351	366	371	366	467	366	530	640	640	671	960	890	900	930	960
Reserve liabilities	340	349	344	342	342	365	365	342	342	342	71	71	71	71	71	71	71

Sources: National Bank of Yugoslavia; and IMF staff estimates and calculations.

1/ Exclude frozen assets and liabilities of FRY; undivided assets of SFRY; and, in 2001, BIS gold and foreign currency deposits allocated to FRY in June 2001.

2/ Program figures are floors.

3/ In current exchange rate.

4/ At end-Dec. 2001 exchange rates; includes BIS gold and foreign currency deposits allocated to FRY in June 2001; reclassified liabilities to domestic banks; excludes liabilities to and of closed banks and undivided liabilities belong to SFRY.

Table 5. Federal Republic of Yugoslavia: Balance Sheet of the National Bank of Yugoslavia, December 1999-December 2002 1/

(In millions of dinars; end of period)

	1999 Dec.	2000 Dec.	2001 March	2001 June Original Program	2001 June Actual	2001 September First Review	2001 September Actual EoP	2001 September Actual Average	2001 December Original Program	2001 December Second Review	2001 December Actual EoP	2001 December Actual Average	2001 December Actual Dec. 01 ER Eop 9/	2002 9/ January Preliminary EoP	2002 9/ January Preliminary Average	2002 9/ February Preliminary EoP	2002 9/ February Preliminary Average	2002 9/ March Preliminary EoP	2002 9/ March Preliminary Average	2002 9/ June Prog.	2002 9/ Sep. Prog.	2002 9/ Dec. Prog.
Net foreign assets 2/	-22,549	-19,501	-14,618	-17,879	-10,751	-16,127	-6,190	-6,228	-17,879	-6,503	-133	-2,290	39,412	41,991	38,580	53,185	47,091	57,895	54,316	44,690	47,194	49,765 2/
Net foreign assets in Euro million	-549	-332	-249	-305	-183	-275	-106	-106	-305	-111	-2	-39	660	703	646	891	789	971	911	749	790	834
Gross foreign assets 3/	11,975	32,587	38,430	38,197	46,793	45,459	54,891	51,758	46,282	54,579	65,623	61,707	79,100	89,406	85,995	93,074	90,743	99,989	96,410	97,438	104,341	111,311
Gross reserve liabilities (-) 4/	-34,524	-52,088	-53,048	-56,076	-57,544	61,587	-61,081	-57,986	-64,161	61,081	-65,756	-63,987	-39,688	-47,415	-47,415	-39,888	-43,652	-42,094	-42,094	-52,748	-57,147	-61,545
Net domestic assets 5/	32,016	39,347	34,289	39,064	35,770	43,185	37,329	35,508	42,909	41,350	43,861	39,804	1,734	-2,099	1,742	-7,575	-5,358	-9,711	-8,014	4,144	5,484	6,756 5/
Domestic credit	107,968	153,611	147,955	...	147,616	...	149,664	...	...	...	156,788	...	9,922	...	...	...	...	...	...	...	...	...
Net claims on government	5,096	5,480	1,644	...	2,628	...	6,072	...	...	...	9,096	...	5,564	...	...	...	...	...	...	...	...	...
Claims	6,713	11,424	11,433	...	11,433	...	14,715	...	...	...	19,189	...	13,066	...	...	...	...	...	...	...	...	...
Dinar credits	1,652	3,071	3,187	...	3,103	...	6,299	...	...	...	10,681	...	13,066	...	...	...	...	...	...	...	...	...
Foreign currency credits	5,060	8,353	8,246	...	8,330	...	8,416	...	...	...	8,508	...	0	...	...	...	...	...	...	...	...	...
Liabilities (-)	-1,617	-5,944	-9,789	...	-8,805	...	-8,643	...	...	...	-10,093	...	-7,502	...	...	...	...	...	...	...	...	...
Dinar liabilities	-547	-1,462	-3,608	...	-3,591	...	-2,528	...	...	...	-3,113	...	-3,719	...	...	...	...	...	...	...	...	...
Foreign currency liabilities	-1,070	-4,482	-6,181	...	-5,214	...	-6,115	...	...	...	-6,980	...	-3,783	...	...	...	...	...	...	...	...	...
Net claims on banks	100,214	144,932	143,171	...	142,085	...	140,887	...	...	...	145,646	...	4,076	...	...	...	...	...	...	...	...	...
Claims	100,677	145,603	144,423	...	144,293	...	143,985	...	...	...	146,423	...	4,853	...	...	...	...	...	...	...	...	...
Recourse to required reserves	866	1,174	882	...	1,017	...	847	...	...	...	2,286	...	777	...	...	...	...	...	...	...	...	...
Other dinar credits	4,120	3,364	3,401	...	3,346	...	3,144	...	...	...	1,820	...	1,740	...	...	...	...	...	...	...	...	...
Foreign currency credits	95,690	141,065	140,140	...	139,930	...	139,994	...	...	...	142,317	...	2,336	...	...	...	...	...	...	...	...	...
Foreign currency credits in Euro million	111	2,404	2,388	...	2,385	...	2,386	...	...	...	2,426	...	39	...	...	...	...	...	...	...	...	...
Liabilities (-)	-463	-671	-1,252	...	-2,208	...	-3,098	...	...	...	-777	...	-777	...	...	...	...	...	...	...	...	...
of which: stock of NBY bills	0	-86	-343	...	-1,372	...	-2,700	-2,761	...	...	-715	-2,026	-715	-2,887	-2,472	-4,010	-3,517	-4,881	-4,360	...	...	...
Net claims on the rest of the economy	2,658	3,199	3,140	...	2,903	...	2,705	...	...	...	2,046	...	281	...	...	...	...	...	...	...	...	...
Claims	2,785	3,660	3,559	...	3,702	...	3,493	...	...	...	3,655	...	1,284	...	...	...	...	...	...	...	...	...
Dinar credits	2,663	3,457	3,358	...	3,503	...	3,291	...	...	...	3,453	...	1,068	...	...	...	...	...	...	...	...	...
Foreign currency credits	123	203	201	...	199	...	202	...	...	...	202	...	216	...	...	...	...	...	...	...	...	...
Liabilities (-)	-127	-461	-419	...	-799	...	-788	...	...	...	-1,609	...	-1,003	...	...	...	...	...	...	...	...	...
Dinar deposits	-127	-461	-419	...	-799	...	-788	...	...	...	-1,609	...	-1,003	...	...	...	...	...	...	...	...	...
Other assets, net	-75,951	-114,264	-113,666	...	-111,846	...	-112,335	...	...	...	-112,927	...	-7,195	...	...	...	...	...	...	...	...	...
Reserve money (in dinar)	9,467	19,845	19,907	21,186	25,019	27,057	31,139	29,279	25,030	34,848	43,728	37,524	41,146	39,891	40,322	45,610	41,734	48,184	46,302	48,834	52,678	56,522
Currency in circulation	6,688	10,933	11,258	12,100	14,318	15,853	17,563	16,258	14,869	20,773	25,273	21,367	25,324	26,093	24,574	30,928	26,496	30,052	29,607	31,022	33,871	36,720
Reserve deposits	2,779	8,912	8,649	9,086	10,701	11,204	13,576	13,022	10,160	14,075	18,455	16,158	15,822	13,798	15,748	14,682	15,238	18,132	16,695	17,812	18,807	19,802
Required reserves held 6/	1,217	3,650	4,730	5,886	6,041	7,727	7,988	7,566	6,560	12,261	8,022	8,022	7,030	8,445	8,325	9,209	8,631	10,247	9,645	10,975	11,959	12,459
Shortfall in required reserves 6/	866	1,174	882	0	1,017	0	847	811	0	0	2,286	2,255	777	93	826	119	119	45	120	0	0	0
Excess reserves 7/	696	4,088	3,037	3,200	3,643	3,477	4,741	4,645	3,600	1,814	8,147	5,880	8,015	5,260	6,597	5,354	6,488	7,840	6,930	6,837	6,848	7,348
Memorandum items: (12-months growth rates, unless otherwise indicated)																						
Reserve money, nominal 8/	26.0	109.6	79.0	95.6	104.6	90.7	119.5	77.5	26.1	75.6	120.4	123.8	...	118.4	133.8	152.7	123.5	145.6	115.0	106.6	76.2	37.4
Reserve money, real 8/	-15.9	-1.8	-19.0	-11.6	-42.6	-2.1	10.2	-10.9	-4.8	25.4	58.5	61.0	...	60.7	72.1	90.0	68.0	84.9	61.8	67.7	43.9	14.5
Currency in circulation, nominal	32.3	63.5	81.5	69.0	100.0	75.6	94.0	89.3	36.0	90.0	131.2	133.5	...	163.4	144.7	196.8	167.3	166.9	176.1	116.7	92.9	45.0
Currency in circulation, real	-11.8	-23.4	-17.9	-23.5	-9.0	-8.2	-2.6	-5.0	7.0	35.7	66.3	68.0	...	93.8	80.1	123.2	101.0	98.7	107.8	75.8	51.2	20.8
Currency in circulation, monthly average, nominal	...	41.5	76.6	...	99.8	...	89.3	...	... ...		133.5	...	...	144.7	...	167.3	...	176.1	...	...	...	...
Currency in circulation, monthly average, real	...	-33.7	-18.8	...	-33.2	...	-5.0	...	... ...		68.0	...	...	89.1	...	101.0	...	107.8	...	...	...	...
Required reserves, including shortfall, nominal 8/	2.7	131.6	47.7	69.7	103.5	88.9	116.0	...	36.0	140.4	109.2	...	...	64.3	...	76.8	...	83.4	...	80.8	57.4	59.5
Required reserves, including shortfall, real 8/	-31.5	8.5	-33.2	-3.0	-20.4	-2.7	8.5	...	6.1	71.7	50.5	...	...	20.9	...	32.9	...	38.0	...	46.7	28.5	33.0
Velocity (based on annualized monthly GDP)	...	29.4	31.0	34.1	28.9	29.1	25.3	26.9	34.0	24.4	20.2	22.7	20.7	21.6	23.3	19.2	20.9	18.4	19.2	19.6	19.5	19.2
Excess reserves, nominal	62.4	487.4	146.6	237.5	284.2	214.5	352.2	...	-11.9	-39.4	99.3	...	...	53.8	...	99.5	...	158.1	...	87.7	44.4	-8.3
Excess reserves, real	8.4	175.1	31.6	53.8	74.8	61.9	127.0	...	-31.3	-56.7	43.4	...	...	13.2	...	50.0	...	94.3	...	52.3	13.2	-23.6
Excess reserves as a share of quarterly GDP (percent)	1.2	3.0	2.0	1.9	2.2	2.0	3.0	...	1.9	1.3	4.5	...	...	2.8	...	2.3	...	4.0	...	3.2	3.0	3.0
Cash in circulation as share of quarterly GDP (percent)	11.4	8.1	7.4	7.0	8.6	8.9	11.1	...	7.8	10.8	14.0	...	...	14.0	...	13.2	...	15.3	...	14.6	14.8	15.0
Stock of NBY bills as share of reserve money (percent)	0.0	0.4	1.7	...	5.5	...	8.7	9.4	...	...	1.6	5.4	...	7.2	6.1	8.8	8.4	10.1	9.4	...	...	...

Sources: National Bank of Yugoslavia; and IMF staff estimates and calculations.

1/ Foreign exchange denominated items converted at parallel market exchange rates up to June 2000, at YUD 30 = DM for September and at end-2000 (program) exchange rates thereafter.

2/ Program figures are floors.

3/ Excludes frozen assets of FRY; undivided assets of SFRY; and BIS gold and foreign currency deposits allocated to FRY in June 2001.

4/ Exclude long-term liabilities and undivided liabilities of the SFRY. Including foreign-currency denominated liabilities to resident banks and non-government residents.

5/ Program figures are ceilings. It will be monitored as a monthly average as defined in the Technical Memorandum of Understanding from September 2001 onwards.

6/ Reserves that banks are required to hold in NBY account 201 to satisfy the dinar reserve requirement.

7/ Comprise balances in Giro accounts and cash in commercial bank vaults.

8/ The growth rates of reserve money (in dinar) in 2001 and 2002 are adjusted for changes in dinar reserve requirements including exemptions in early 2000.

9/ At end-Dec. 2001 exchange rates; includes BIS gold and foreign currency deposits allocated to FRY in June 2001; adjusted for the closure of Beobanka, Beogradska Banka, Jugobanka, and Investbanka as well as other small banks in liquidation; and excludes undivided assets and liabilities of SFRY.
The dinar required reserve is adjusted to be consistent with the new reserve requirement implemented on April 11, 2002.

Table 6. Monetary Survey of Serbia, December 1999 - December 2002

(In millions of dinars; end of period)

	1999	2000	2001									2002 4/			
	Dec.	Dec.	March	June		September		December				March	June	Sep.	Dec.
				Original Program	Actual	Original Program	Actual	Original Program	Second Review	Actual	Actual Dec.1 Exch. Rate 4/	Est.	Prog.	Prog.	Prog.
Net Foreign Assets 1/	18,363	23,999	29,300	26,065	34,962	23,382	43,673	26,094	48,790	66,783	99,543	117,137	122,415	126,949	131,551
(NFA in Euro m.)	526	402	491	437	586	392	731	437	817	1,119	1,667	1,962	2,050	2,126	2,203
Assets	26,922	55,681	60,601	61,303	70,215	64,083	84,390	69,388	88,057	106,049	122,409	144,334	158,342	167,274	176,274
NBY	11,975	32,587	38,430	38,197	46,793	40,977	54,891	46,282	54,579	65,623	79,100	86,137	97,438	104,341	111,311
Commercial banks	14,947	23,093	22,171	23,106	23,422	23,106	29,498	23,106	33,478	40,426	43,309	58,196	60,903	62,933	64,963
Liabilities (-) 2/	-8,559	-31,682	-31,301	-35,238	-35,254	-40,701	-40,717	-43,294	-39,266	-39,266	-22,866	-27,197	-35,926	-40,325	-44,723
NBY	5,325	-9,623	-9,586	-13,628	-13,644	-17,671	-17,686	-21,714	-17,686	-17,686	-18,406	-22,737	-31,467	-35,865	-40,264
Commercial banks	-13,884	-22,059	-21,715	-21,610	-21,610	-23,030	-23,030	-21,580	-21,580	-21,580	-4,460	-4,460	-4,460	-4,460	-4,460
Net Domestic Assets 3/	22,224	19,464	38,238	46,214	40,122	51,255	46,000	52,807	58,822	50,531	18,895	33,335	39,266	41,415	40,515
Domestic credit	32,913	218,642	215,619	...	216,785	...	223,633	...	...	233,366	110,609	...			...
Net credit to government 3/	6,869	5,917	1,582	7,917	1,382	9,917	3,410	9,917	11,336	4,567	225	-3,246	-2,717	2,312	5,741
Credit	10,521	15,367	14,709	...	15,056	...	18,260	...	...	22,984	15,064	...			...
Dinar credit	4,573	5,521	5,052	...	4,750	...	8,225	...	...	12,859	14,789	...			...
NBY	1,652	3,071	3,187	...	3,103	...	6,299	...	...	10,681	13,066	...			...
Commercial banks	2,921	2,450	1,865	...	1,647	...	1,926	...	...	2,178	1,723	...			...
Foreign currency credits	5,948	9,846	9,657	...	10,306	...	10,035	...	...	10,125	275	...			...
NBY	5,060	8,353	8,246	...	8,330	...	8,416	...	...	8,508	0	...			...
Commercial banks	887	1,493	1,411	...	1,976	...	1,619	...	...	1,617	275	...			...
Deposits	-3,652	-9,450	-13,127	...	-13,674	...	-14,850	...	...	-18,417	-14,839	...			...
Dinar credit	-2,448	-4,745	-6,771	...	-8,271	...	-8,422	...	...	-11,010	-10,718	...			...
NBY	-547	-1,462	-3,608	...	-3,591	...	-2,528	...	...	-3,113	-3,719	...			...
Commercial banks	-1,901	-3,282	-3,163	...	-4,680	...	-5,894	...	...	-7,897	-6,999	...			...
Foreign currency deposits	-1,204	-4,705	-6,356	...	-5,403	...	-6,428	...	...	-7,407	-4,121	...			...
NBY	-1,070	-4,482	-6,181	...	-5,214	...	-6,115	...	...	-6,980	-3,783	...			...
Commercial banks	-134	-223	-175	...	-189	...	-313	...	...	-427	-338	...			...
Credit to the non-government sector	126,148	212,725	214,037	...	215,403	...	220,224	...	...	228,799	110,384	...			...
Households	1,663	2,684	2,344	...	3,494	...	4,581	...	...	5,121	4,390	...			...
Non-profit and other sectors	3,662	24,409	24,828	...	26,280	...	27,267	...	...	29,896	4,165	...			...
Enterprises in dinar	20,719	31,189	34,468	...	37,593	...	39,405	...	...	46,557	41,155	...			...
Enterprises in foreign currency	100,104	154,444	152,397	...	148,036	...	148,972	...	...	147,225	60,674	...			...
Enterprises in foreign currency (Euro million)	2,437	2,632	2,597	...	2,523	...	2,539	...	...	2,509	1,016	...			...
Other items, net.	-10,688	-199,178	-177,381	...	-176,663	...	-177,635	...	...	-182,835	-91,714	...			...
Broad Money (M2)	40,587	65,522	67,538	72,279	75,084	74,637	89,672	78,901	107,612	117,314	118,438	150,472	161,681	168,365	172,065
Dinar-denominated M2	18,229	32,588	35,244	38,521	43,543	40,591	54,485	44,319	65,503	67,213	64,296	72,050	85,883	93,649	98,974
M1	14,552	26,954	28,875	31,648	36,591	33,440	45,995	36,658	55,106	57,752	54,826	61,858	72,569	79,142	83,866
Currency outside banks	6,688	10,932	11,257	12,100	14,318	13,100	17,563	14,869	20,773	25,273	25,273	30,052	31,022	33,871	36,720
Demand deposit	7,864	16,022	17,618	19,548	22,273	20,340	28,432	21,789	34,333	32,479	29,553	31,806	41,548	45,271	47,146
Time and savings deposits	3,677	5,633	6,369	6,873	6,952	7,152	8,490	7,661	10,397	9,461	9,470	10,192	13,314	14,507	15,108
Foreign currency deposit (non-frozen)	22,358	32,933	32,294	33,758	31,541	34,046	35,187	34,581	42,109	50,101	54,142	78,422	75,798	74,716	73,091
Foreign currency deposit (not-frozen), (Euro million)	378	561	550	575	538	580	600	589	718	854	907	1,313	1,270	1,251	1,224
Memorandum items:															
12-months growth rates (in percent)															
Broad Money (M2)	68	61.4	57.9	55.3	61.4	24.5	49.5	20.4	64.2	79.0	...	122.8	115.3	87.8	45.3
Dinar-denominated M2	35	78.8	82.8	83.0	106.8	57.6	111.6	36.0	101.0	106.3	...	104.4	97.2	71.9	53.9
M1	47	85.2	86.6	83.9	112.6	58.7	118.2	36.0	104.4	114.3	...	114.2	98.3	72.1	53.0
Currency outside banks	32	63.5	81.5	69.0	100.0	45.1	94.6	36.0	90.0	131.2	...	167.0	116.7	92.9	45.3
Velocity (M1)	13.3	13.3	15.6	17.1	14.8	18.9	13.8	19.8	13.1	12.5	...	12.7	11.7	11.6	11.7
Multiplier (Dinar M2/Reserve money)	1.9	1.6	1.8	1.8	1.7	1.5	1.7	1.8	1.9	1.5	1.6	1.5	1.8	1.8	1.751
Currency/Dinar deposits (in percent)	58.0	50.5	46.9	45.8	49.0	47.7	47.6	50.5	46.4	60.3	64.8	71.6	56.5	56.7	59.0
Required reserve ratio (effective, in percent)	18.0	22.3	23.4	22.3	24.2	28.1	23.9	22.3	27.5	24.6	10.0	24.5	20.0	20.0	20.0
Excess reserves/Dinar deposits (in percent)	6.0	18.9	12.7	12.1	12.5	12.6	12.8	12.2	4.1	19.4	20.5	18.7	12.5	11.5	11.8
Foreign exchange deposit/Time deposit	6.1	5.8	5.1	4.9	4.5	4.8	4.1	4.5	4.1	5.3	5.7	7.7	5.7	5.2	4.8
Dinar-denominated M2/ annualized monthly GDP	...	5.8	5.7	5.3	6.0	5.2	6.9	5.2	7.7	7.9	7.6				
Frozen foreign currency deposit (dinar million)	143,956	211,431	...	...	...	...	...	...	...	199,336	...	...	...	...	...
Frozen foreign currency deposit (Euro million))	3,505	3,541	...	...	...	...	...	...	...	3,339	...	...	...	...	...

Sources: National Bank of Yugoslavia; and IMF staff estimates and calculations.

1/ Foreign-exchange denominated items converted at parallel market exchange rates up to September 2000, at YUD 30 = DM for September and at end-2000 (program) exchange rates thereafter.

2/ Excluding undivided liabilities of the SFRY and, from 2002 onwards, liabilities to banks in liquidation.

3/ Program figures are ceilings.

4/ At end-Dec. 2001 exchange rates; includes BIS gold and foreign currency deposits allocated to FRY in June 2001; adjusted for the closure of Beobanka, Beogradska Banka, Jugobanka, and Investbanka as well as other small banks in liquidation; excludes undivided assets and liabilities of SFRY.

Table 7A. Federal Republic of Yugoslavia: Consolidated General Government Fiscal Operations in 2000-2002 1/

	Consolidated General Government Excluding Montenegro								Consolidated General Government Including Montenegro							
	2000	2001		2002	2000	2001		2002	2000	2001		2002	2000	2001		2002
		Prog.	Prel	Budget		Prog.	Prel.	Budget		Prog.	Prel.	Budget		Prog.	Prel	Budget
	(Billion dinars)				(Percent of GDP) 2/				(Billion dinars)				(Percent of GDP) 2/			
Total revenue	128.8	250.6	277.2	392.1	36.0	36.4	38.3	40.1	140.2	273.8	300.5	421.0	39.2	39.8	41.5	43.0
Current revenue	128.8	250.1	277.2	390.9	36.0	36.4	38.3	39.9	140.2	272.7	300.5	419.8	39.2	39.7	41.5	42.9
Tax revenue	115.7	229.7	253.7	360.5	32.3	33.4	35.0	36.8	126.4	251.1	273.8	385.3	35.3	36.5	37.8	39.4
Personal income tax	12.4	25.5	32.9	48.6	3.5	3.7	4.5	5.0	12.7	26.2	36.2	52.8	3.5	3.8	5.0	5.4
Social security contributions	39.7	73.2	76.9	101.7	11.1	10.6	10.6	10.4	44.8	83.8	85.5	112.9	12.5	12.2	11.8	11.5
Corporate income tax	1.1	2.1	3.4	4.6	0.3	0.3	0.5	0.5	1.1	2.1	3.4	4.6	0.3	0.3	0.5	0.5
Retail sales tax	22.8	57.5	72.1	106.4	6.4	8.4	10.0	10.9	26.3	63.8	75.8	110.5	7.3	9.3	10.5	11.3
Excises	10.7	26.7	26.2	48.1	3.0	3.9	3.6	4.9	10.7	26.7	28.4	50.3	3.0	3.9	3.9	5.1
Taxes on international trade and operations	8.5	14.1	14.3	21.7	2.4	2.1	2.0	2.2	10.3	17.8	16.0	23.9	2.9	2.6	2.2	2.4
Other taxes	13.8	30.6	27.9	29.5	3.8	4.4	3.9	3.0	13.9	30.8	28.6	30.4	3.9	4.5	3.9	3.1
Extrabudgetary taxes	6.6	0.0	0.0	0.0	1.8	0.0	0.0	0.0	6.6	0.0	0.0	0.0	1.8	0.0	0.0	0.0
Nontax revenue	13.1	20.4	23.5	30.4	3.7	3.0	3.2	3.1	13.8	21.6	26.6	34.6	3.8	3.1	3.7	3.5
Capital revenue	0.0	0.5	0.0	1.2	0.0	0.1	0.0	0.1	0.0	1.1	0.0	1.2	0.0	0.2	0.0	0.1
Total expenditure and net lending	129.6	289.3	283.9	444.2	36.2	42.1	39.2	45.4	143.6	315.4	310.2	477.0	40.1	45.9	42.8	48.7
Current expenditure	118.6	261.5	268.8	405.8	33.1	38.0	37.1	41.5	131.2	284.7	292.6	435.9	36.6	41.4	40.4	44.5
Expenditure on goods and services	61.6	123.8	123.4	165.3	17.2	18.0	17.0	16.9	66.4	133.2	134.5	178.9	18.5	19.4	18.6	18.3
Wages and salaries	33.4	64.5	65.4	89.1	9.3	9.4	9.0	9.1	36.0	71.0	73.0	98.6	10.1	10.3	10.1	10.1
Other purchases of goods and services	28.2	59.3	58.0	76.2	7.9	8.6	8.0	7.8	30.4	62.2	61.6	80.3	8.5	9.0	8.5	8.2
Interest payment	2.2	6.7	5.6	16.5	0.6	1.0	0.8	1.7	2.2	6.7	5.7	18.0	0.6	1.0	0.8	1.8
Subsidies and other current transfers	54.8	131.1	139.8	224.1	15.3	19.1	19.3	22.9	62.5	144.8	152.4	239.0	17.5	21.1	21.0	24.4
Subsidies	7.1	21.7	25.2	40.4	2.0	3.2	3.5	4.1	8.1	22.5	25.9	41.9	2.3	3.3	3.6	4.3
Transfers to households	47.7	109.3	114.6	183.7	13.3	15.9	15.8	18.8	54.5	122.3	126.5	197.0	15.2	17.8	17.5	20.1
Capital expenditure	11.0	23.5	8.8	29.3	3.1	3.4	1.2	3.0	11.8	24.7	10.0	30.5	3.3	3.6	1.4	3.1
General reserves	0.0	2.9	0.0	9.1	0.0	0.4	0.0	0.9	0.3	4.1	0.4	9.8	0.1	0.6	0.1	1.0
Lending minus repayment	0.0	1.4	6.3	0.0	0.0	0.2	0.9	0.0	0.3	1.9	7.2	0.8	0.1	0.3	1.0	0.1
Net transfer to other levels of government	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.2	0.0	0.1	0.0	0.0	0.0	0.0
Overall balance	-0.8	-38.7	-6.7	-52.2	-0.2	-5.6	-0.9	-5.3	-3.4	-41.7	-9.7	-56.1	-0.9	-6.1	-1.3	-5.7
Foreign grants	0.1	5.2	3.4	7.8	0.0	0.7	0.5	0.8	2.8	8.0	5.4	9.8	0.8	1.2	0.7	1.0
Overall balance including grants	-0.7	-33.6	-3.3	-44.4	-0.2	-4.9	-0.5	-4.5	-0.6	-33.7	-4.3	-46.3	-0.2	-4.9	-0.6	-4.7
Statistical discrepancy	0.0	0.0	0.6	0.1	0.0	0.0	0.1	0.0	0.0	0.0	0.6	0.0	0.0	0.0	0.1	0.0
Financing	0.7	33.6	3.9	44.5	0.2	4.9	0.5	4.5	0.6	33.7	5.0	46.4	0.2	4.9	0.7	4.7
Domestic financing	0.7	4.2	3.9	5.6	0.2	0.6	0.5	0.6	0.6	4.4	5.0	4.4	0.2	0.6	0.7	0.5
Bank financing	0.3	4.2	5.1	7.5	0.1	0.6	0.7	0.8	0.3	4.4	5.7	6.3	0.1	0.6	0.8	0.6
NBY	0.8	4.0	6.4	6.6	0.2	0.6	0.9	0.7	0.8	4.0	7.0	5.5	0.2	0.0	1.0	0.6
Commercial banks	-0.5	0.2	-1.2	0.9	-0.1	0.0	-0.2	0.1	-0.5	0.4	-1.3	0.9	-0.1	0.1	-0.2	0.1
Non-bank financing	0.4	0.0	-1.2	-1.9	0.1	0.0	-0.2	-0.2	0.4	0.0	-0.7	-1.9	0.1	0.0	-0.1	-0.2
Foreign Financing	0.0	19.6	0.0	27.5	0.0	2.9	0.0	2.8	0.0	19.6	0.0	29.0	0.0	2.9	0.0	3.0
Privatization receipts	0.0	9.7	0.0	11.4	0.0	1.4	0.0	1.2	0.0	9.7	0.0	12.9	0.0	1.4	0.0	1.3

Sources: Ministry of Finance of FRY, Republic of Serbia and Republic of Montenegro; and IMF staff estimates.

1/ Consolidated general government includes the federal, the republican and local governments, the social security funds and the extrabudgetary programs.

2/ Expressed in terms of GDP of the FRY excluding Kosovo.

Table 7B. Federal Republic of Yugoslavia: Federal Government Fiscal Operations, 1997-2002
(In percent of GDP) 1/

	1997	1998	1999	2000	2001 Prog.	2001 Prel. Jan.-Sep.	2001 Prel. Jan. - Dec.	2002 Budget
A Total revenue and grants (1+2)	6.6	6.4	6.8	5.2	7.6	3.9	6.8	6.7
1 Total revenue (1.1+1.2)	6.6	6.4	6.8	5.2	7.6	3.9	6.8	6.7
1.1 Current revenue (1.1.1+1.1.2)	6.6	6.4	6.8	5.2	7.6	3.9	6.8	6.7
1.1.1 Tax revenue (1.1.1.1+1.1.1.2+1.1.1.3)	5.3	5.4	5.6	4.7	6.3	3.3	5.9	5.8
1.1.1.1 Turnover (retail sales) tax	2.1	2.6	2.4	1.6	3.7	2.2	3.7	2.6
1.1.1.2 Taxes on international trade and operations	2.7	2.4	2.3	1.7	2.4	1.0	2.0	2.2
1.1.1.3 Other taxes	0.5	0.4	0.3	0.1	0.3	0.1	0.2	1.0
1.1.1.4 Extrabudgetary taxes	0.0	0.0	0.6	1.3	0.0	0.0	0.0	0.0
1.1.2 Nontax revenue	1.4	1.0	1.2	0.4	1.3	0.6	0.9	0.9
1.2 Capital revenue	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
2 Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
B Total expenditure and net lending (1+2)	6.6	6.4	6.8	5.2	7.6	3.9	6.6	6.6
1 Total expenditure (1.1+1.2)	6.6	6.4	6.8	5.2	7.4	3.8	6.6	6.6
1.1 Current expenditure (1.1.1+1.1.2)	6.6	6.4	6.8	5.2	7.3	3.8	6.5	6.4
1.1.1 Interest	0.0	0.0	0.0	0.1	0.1	0.0	0.2	0.0
1.1.2 Non-interest (1.1.2.1+1.1.2.2+1.1.2.3+1.1.2.4)	6.6	6.4	6.8	5.1	7.2	3.8	6.2	6.4
1.1.2.1 General Government Services	0.8	1.0	0.8	0.6	1.2	0.4	1.0	0.2
1.1.2.2 Defense	4.8	4.5	5.1	3.9	4.7	1.8	3.7	3.6
1.1.2.3 Social Insurance and Social Security Transfers	0.6	0.6	0.5	0.4	1.1	0.7	1.5	1.4
1.1.2.5 Other non-interest expenditure	0.4	0.4	0.4	0.2	0.1	0.8	0.0	1.0
1.2 Capital expenditure	0.0	0.0	0.0	0.0	0.1	0.0	0.1	0.2
2 Net lending	0.0	0.0	0.0	0.0	0.2	0.1	0.0	0.0
Overall budget balance (cash) (A-B)	0.0	0.0	0.0	0.0	0.0	0.0	0.3	0.1
Financing	0.0	0.0	0.0	0.0	0.0	0.0	-0.3	-0.1
1 Domestic financing (net) (1.1+1.2)	0.0	0.0	0.0	0.0	0.0	0.0	-0.3	-0.1
1.1 Banking system (1.1.1+1.1.2)	0.0	0.0	0.0	0.0	0.0	0.0	-0.3	0.0
1.1.1 National Bank of Yugoslavia	0.0	0.0	0.0	0.0	0.0	0.0	-0.3	0.0
1.1.2 Commercial banks	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
1.2 Nonbank	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.1
Memorandum items:								
Nominal GDP (billion Dinars)	112.4	146.3	192.9	358.1	604.0	724.1	724.1	978.9
Modified overall balance including newly accumulated arrears	...	...	...	0.0	...	0.0	0.3	0.1

Sources: Ministry of Finance of the FRY; and IMF staff estimates.

1/ Expressed in terms of GDP of the FRY excluding Kosovo.

Table 7C. Serbia: Republican Government Fiscal Operations, 1997-2002
(In percent of GDP) 1/

	1997	1998	1999	2000	2001				2002
				Actual	Budget	Program	Prel. Jan.-Sep.	Prel. Jan.-Dec.	Budget
A Total revenue and grants (1+2)	12.3	11.5	9.1	13.8	16.2	15.8	11.1	17.3	19.2
1 Total revenue (1.1+1.2)	12.3	11.5	9.1	13.8	15.7	15.2	11.0	16.8	18.5
1.1 Current revenue (1.1.1+1.1.2)	12.3	11.5	9.1	13.8	15.7	15.2	11.0	16.8	18.5
1.1.1 Tax revenue (1.1.1.1+...+1.1.1.6)	12.3	11.5	9.1	12.4	15.5	14.4	10.4	15.7	17.5
1.1.1.1 Personal income tax	6.4	5.0	3.6	3.5	3.7	3.6	2.8	4.3	4.6
1.1.1.2 Corporate income tax	0.3	0.4	0.5	0.3	0.3	0.3	0.3	0.5	0.5
1.1.1.3 Turnover (retail sales) tax	3.6	3.3	3.1	3.4	4.3	4.0	3.5	5.2	6.9
1.1.1.4 Excises	1.0	0.8	0.5	2.2	3.7	3.6	2.2	3.4	3.9
1.1.1.5 Property taxes	0.3	0.4	0.4	0.2	0.0	0.0	1.0	1.4	0.8
1.1.1.6 Other taxes	0.7	1.6	1.1	2.7	3.5	2.9	0.6	1.0	0.7
1.1.2 Nontax revenue	0.0	0.0	0.0	1.4	0.2	0.8	0.7	1.0	1.0
1.2 Capital revenue	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
2 Grants	0.0	0.0	0.0	0.0	0.5	0.5	0.1	0.5	0.8
Of which: Grants for the budget for recovery and restructuring	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
B. Total expenditure and net lending (1+5)	12.3	11.5	9.1	14.1	18.9	20.6	11.2	18.1	23.8
1. Total expenditure (2+3+4)	12.3	11.5	9.1	14.1	18.9	20.6	10.5	17.2	23.8
2 Current expenditure (2.1+2.2+2.3)	12.0	11.4	8.7	12.3	17.0	17.3	10.1	16.7	21.3
2.1. Expenditure on goods and services (2.1.1+...+2.1.4)	9.8	9.6	7.8	6.8	7.6	7.8	4.4	7.1	7.7
2.1.1 Wages and salaries	4.5	3.8	3.7	3.7	4.0	4.0	2.5	4.1	4.2
2.1.2 Employer contribution	1.4	1.2	1.2	0.9	0.9	0.9	0.6	0.8	1.1
2.1.2.1 Contribution	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.8
2.1.2.2 Tax	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.3
2.1.3 Severance payments	0.0	0.0	0.0	0.0	0.2	0.2	0.0	0.0	0.0
2.1.4 Other purchases of goods and services	3.9	4.6	2.9	2.2	2.6	2.7	1.3	2.3	2.4
2.2. Interest payment	0.1	0.3	0.2	0.1	0.8	0.7	0.1	0.1	1.6
2.3. Subsidies and other current transfers	0.0	0.0	0.0	0.0	8.6	8.9	5.7	9.5	12.0
2.3.1 Subsidies	0.0	0.0	0.0	0.0	2.4	2.3	1.8	3.0	3.1
2.3.2 Transfers to households	2.1	1.5	0.8	5.3	3.2	3.1	1.8	2.9	3.2
Of which: Repayment for frozen foreign currey deposit	0.0	0.0	0.0	2.0	0.8	0.7	0.4	0.5	0.7
2.3.3 Current transfers to other levels of government	0.0	0.0	0.0	0.0	3.0	3.4	2.0	3.6	5.7
Federal budget	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Republican budget	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Local Budgets	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.1
Pension Funds	0.0	0.0	0.0	0.0	2.4	2.5	1.6	2.9	4.5
Health Fund	0.0	0.0	0.0	0.0	0.3	0.3	0.2	0.3	0.5
Labor Market Fund	0.0	0.0	0.0	0.0	0.2	0.4	0.0	0.1	0.3
3. Capital expenditure	2.0	1.4	0.7	1.4	0.7	2.9	0.4	0.5	1.9
Of which: Budget for recovery and reconstruction	0.0	0.0	0.0	0.0	0.0	2.2	0.0	0.0	1.2
4. General reserves	0.0	0.0	0.0	0.0	1.2	0.4	0.0	0.0	0.6
5. Lending minus repayment	0.0	0.0	0.0	0.0	0.0	0.0	0.8	0.9	0.0
Overall budget balance (cash) (A-B)	0.0	0.0	0.0	-0.3	-2.6	-4.8	-0.1	-0.9	-4.5
Core balance 2/	0.0	0.0	0.0	-0.3	-2.6	-2.6	-0.1	-0.9	-4.5
Balance of the budget for recovery and reconstruction 3/	0.0	0.0	0.0	0.0	0.0	-2.2	0.0	0.0	0.0
Statistical Discrepancy	0.0	0.5	0.2	0.0	0.0	0.0	0.1	0.1	0.0
Financing (1+2+3+4)	0.0	0.5	0.2	0.3	4.9	4.8	0.2	1.0	4.5
1 Domestic financing (net) (1.1+1.2)	0.0	0.5	0.2	0.3	0.6	0.6	0.2	1.0	0.6
1.1 Banking system (1.1.1+1.1.2)	0.0	0.5	0.2	0.2	0.6	0.6	0.4	1.1	0.7
1.1.1 Central Bank of Serbia	0.0	0.1	0.2	0.2	0.6	0.6	0.4	1.1	0.7
1.1.2 Commercial banks	0.0	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0
1.2 Nonbank	0.0	0.0	0.0	0.1	0.0	0.0	-0.2	-0.2	-0.1
2 Foreign financing (net) (2.1-2.2)	0.0	0.0	0.0	0.0	2.9	2.9	0.0	0.0	2.8
2.1 Program	0.0	0.0	0.0	0.0	2.9	2.9	0.0	0.0	1.6
2.2 Project	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	1.2
3 Privatization receipts	0.0	0.0	0.0	0.0	1.4	1.4	0.0	0.0	1.2
Memorandum items:									
Nominal GDP (billion dinars)	112.4	146.3	192.9	358.1	685.0	687.5	724.1	724.1	978.9

Sources: Ministry of Finance of Serbia; and IMF staff estimates.

1/ Expressed in terms of GDP of the FRY excluding Kosovo.
2/ Core balance excludes grants for and expenditure in the budget for recovery and reconstruction.
3/ Includes grants for and expenditure in the budget for recovery and reconstruction.

Table 7D. Montenegro: Republican Government Fiscal Operations, 2000-2002
(In percent of GDP)

	2000	2001						2002
		Budget	Jan.-Dec. Rev.Prog.	Jan.-Dec. Prel.	Jan.-Mar. Prelim	Jan.-June Prel.	Jan-Sep Prelim	Budget
A Total revenue and grants (1+2)	**37.2**	**27.3**	**30.9**	**30.2**	**6.2**	**12.1**	**20.8**	**32.1**
1 Total revenue (1.1+1.2)	28.8	23.5	27.6	28.3	5.7	11.0	19.7	29.0
1.1 Current revenue (1.1.1+1.1.2)	28.8	23.5	27.6	28.3	5.7	11.0	19.7	29.0
1.1.1 Tax revenue (1.1.1.1+1.1.1.2+1.1.1.3+1.1.1.4)	23.4	21.3	24.3	23.4	4.6	9.4	17.2	22.4
1.1.1.1 Personal income	6.8	6.9	7.0	7.1	1.5	3.1	5.0	7.3
1.1.1.2 Turnover (retail sales) tax	4.8	6.9	7.6	7.3	1.2	2.7	5.1	6.7
1.1.1.3 Excises	7.4	4.2	4.1	4.4	0.7	1.7	3.0	3.6
1.1.1.4 Other taxes	4.4	2.2	5.5	3.4	1.2	1.9	4.2	3.5
1.1.2 Nontax revenue	5.4	2.2	3.3	4.9	1.1	1.6	2.5	6.6
1.2 Capital revenue	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
2 Grants	8.3	3.8	3.3	1.8	0.4	1.1	1.1	3.1
B Total expenditure and net lending (1+2)	**37.0**	**28.6**	**32.7**	**32.3**	**7.6**	**14.7**	**23.2**	**35.3**
1 Total expenditure (1.1+1.2)	37.0	28.2	32.2	31.5	7.7	14.5	22.7	34.1
1.1 Current expenditure (1.1.1+1.1.2)	32.4	26.0	29.8	29.1	7.0	13.3	21.0	32.3
1.1.1 Interest	0.2	0.1	0.1	0.1	0.0	0.0	0.0	2.5
1.1.2 Non-interest (1.1.2.1+1.1.2.2+1.1.2.3+1.1.2.4)	32.2	25.9	29.8	29.0	7.0	13.2	20.9	29.7
1.1.2.1 Wages and salaries	15.6	14.7	14.5	13.5	2.6	5.2	9.2	14.5
1.1.2.2 Goods and services	0.0	4.9	6.9	6.9	1.7	3.1	5.0	5.8
1.1.2.3 Social Insurance and Social Security Transfers	3.9	3.9	5.8	5.6	1.8	3.2	4.5	4.8
1.1.2.4 Subsidies to enterprises	0.0	1.4	6.8	1.5	0.5	0.8	1.2	2.8
1.1.2.5 Other non-interest expenditure	12.8	1.0	1.2	1.4	0.3	0.8	1.1	0.5
1.2 Capital expenditure	4.6	2.3	2.3	2.4	0.7	1.2	1.7	1.8
2 Net lending	0.0	0.3	0.6	0.8	-0.1	0.3	0.5	1.2
C Net transfer to other levels of government (1+3-2-4)	**0.1**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
1 Transfers to lower levels of government	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
2 Transfers from lower levels of government	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
3 Transfers to extra-budgetary social security funds	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
4 Transfers from extra-budgetary funds	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall budget balance excluding grants (cash) (A-B-C-2)	**-8.3**	**-5.1**	**-5.1**	**-4.0**	**-1.9**	**-3.8**	**-3.5**	**-6.3**
Overall budget balance (cash) (A-B-C)	0.0	-1.2	-1.8	-2.1	-1.4	-2.7	-2.4	-3.2
Financing (1+2+3)	0.0	1.2	1.8	2.1	1.4	2.7	2.4	3.2
1 Domestic financing (net) (1.1+1.2)	0.0	0.0	1.8	2.1	1.4	2.7	2.4	-1.8
1.1 Banking system (1.1.1+1.1.2)	0.0	0.0	1.8	1.1	1.4	2.7	2.4	-1.8
1.1.1 Central Bank of Montenegro	0.0	0.0	1.5	1.3	1.9	1.6	1.5	-1.8
1.1.2 Commercial banks	0.0	0.0	0.4	-0.2	-0.4	1.2	1.0	0.0
1.2 Nonbank	0.0	0.0	0.0	1.1	0.0	0.0	0.0	0.0
2 Foreign financing (net) (2.1-2.2)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	2.4
2.1 Disbursements	0.0	0.0	0.0	0.0	0.0	0.0	0.0	2.4
2.2 Amortization	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
3 Privatization receipts	0.0	1.2	0.0	0.0	0.0	0.0	0.0	2.6
Memorandum items:								
Nominal GDP (million DM)	1300.0	1570.0	1570.0	1570.0	1570.0	1570.0	1570.0	1817.7

Sources: Ministry of Finance of Montenegro; and IMF staff estimates.

Table 8. Federal Republic of Yugoslavia: Macroeconomic Framework, 2000-2005

	2000	2001 Prel.	2002 Proj.	2003 Proj.	2004 Proj.	2005 Proj.
GDP (YUD billion)	358	724	979	1,190	1,370	1,546
GDP (US$ million)	8,071	10,861	12,841	13,938	15,177	16,505
	(Percent change)					
End-period inflation (RPI)	113.5	39.0	20.0	12.0	8.0	7.0
	(Percent change in real terms)					
GDP	5.0	5.5	4.0	5.0	5.0	5.0
	(In percent of nominal GDP)					
Gross domestic savings	-3.5	-8.6	-6.4	-3.4	-0.2	2.6
Non-government	-5.3	-8.9	-5.2	-3.2	-1.4	0.1
Government	1.8	0.3	-1.2	-0.1	1.2	2.5
Net factor receipts and transfers from abroad	13.9	16.6	13.6	11.4	10.6	10.9
Non-government	13.1	15.8	14.1	12.0	11.4	12.4
Government	0.8	0.7	-0.5	-0.6	-0.8	-1.4
Gross national savings	10.3	8.0	7.2	8.1	10.4	13.6
Non-government	7.8	6.9	8.8	8.8	10.0	12.5
Government	2.5	1.1	-1.6	-0.7	0.4	1.1
Gross domestic investment 1/	14.5	13.5	15.4	17.6	19.2	20.5
Non-government	12.3	11.8	12.0	13.6	14.6	15.6
Government	3.3	1.4	3.1	3.7	4.3	4.7
Savings-investment balance 1/	-4.2	-5.5	-8.2	-9.5	-8.7	-7.0
Non-government	-4.5	-4.9	-3.1	-4.8	-4.6	-3.2
Government	-0.8	-0.3	-4.8	-4.4	-3.9	-3.6
Foreign savings	4.2	5.5	8.2	9.5	8.7	7.0
Foreign savings including official grants	7.6	10.9	12.8	12.4	10.7	8.8
Net exports of goods and services	-18.0	-22.1	-21.8	-20.9	-19.3	-17.9

Sources: Data provided by the Yugoslava Federal Bureau of Statistics; Ministry of Finance; and IMF staff projections.

1/ Components do not add up to the total as a result of inventory changes.

Table 9. Federal Republic of Yugoslavia: Fiscal Sustainability (Baseline), 2001-2010 1/

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
					(Percent of GDP)					
Primary revenue	41.5	42.9	42.4	41.8	41.3	41.2	41.1	41.0	40.9	40.8
Primary expenditure 2/	42.1	46.9	45.9	44.8	43.4	42.9	42.4	41.9	41.4	40.9
Of which: Repayment of frozen foreign currency deposits	0.8	0.9	1.2	1.3	0.9	0.9	0.9	0.9	0.9	0.9
Capital expenditure	1.4	3.1	3.7	4.3	4.7	5.0	5.3	5.6	5.9	6.2
Other primary expenditure	39.9	42.9	41.0	39.2	37.7	36.9	36.1	35.3	34.5	33.7
Primary balance	-0.6	-3.9	-3.4	-2.9	-2.0	-1.6	-1.2	-0.8	-0.4	0.0
Adjusted Primary balance 3/	0.2	-3.0	-2.2	-1.6	-1.1	-0.7	-0.3	0.1	0.5	0.9
Interest costs 2/	0.8	1.8	1.9	1.9	2.3	2.3	2.3	2.3	2.3	2.2
Overall balance	-1.3	-5.7	-5.3	-4.8	-4.2	-3.9	-3.5	-3.1	-2.6	-2.2
Financing	1.4	5.7	5.3	4.8	4.2	3.9	3.5	3.1	2.6	2.2
Foreign grants	0.7	1.0	1.1	0.9	0.6	0.4	0.4	0.4	0.3	0.3
Of which: grants committed	0.7	1.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
grants expected at the donor conference			1.1	0.9	0.6	0.4	0.4	0.4	0.3	0.3
Foreign borrowing	0.0	3.0	2.4	2.2	2.1	1.4	0.8	0.3	0.2	0.1
Borrowing		3.0	2.4	2.3	2.1	1.6	1.4	1.3	1.3	1.3
Of which: committed borrowing		3.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
borrowing expected at the donor conference			2.4	2.3	2.1	1.6	1.4	1.3	1.3	1.3
Repayment		0.0	0.0	0.0	0.0	0.1	0.6	1.0	1.1	1.2
Domestic borrowing	0.7	0.5	0.5	0.5	0.4	0.4	2.2	2.4	2.1	1.8
Privatization receipts	0.0	1.3	1.3	1.2	1.1	1.6	0.0	0.0	0.0	0.0
Public debt (end of year stock) 4/	127.4	78.7	75.7	72.6	63.9	61.1	59.5	57.7	53.9	51.4
Public debt (NPV) 4/	107.7	62.9	60.1	57.1	48.6	46.0	44.9	43.4	41.2	38.4
Public sector gross borrowing requirement	0.6	3.4	2.9	2.7	2.5	2.0	3.6	3.7	3.4	3.0
Gross borrowing requirement as percent of primary own revenue	1.4	8.0	6.9	6.5	6.1	4.8	8.9	9.0	8.3	7.5
Interest expenditure as percent of primary own revenue	1.9	4.3	4.6	4.6	5.5	5.6	5.6	5.7	5.6	5.5
Assumptions										
Real growth (ppa)	5.5	4.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0
GDP (in million U.S. dollars)	10,861.2	12,840.6	13,937.7	15,177.0	16,504.9	17,830.6	19,251.6	20,630.7	22,117.1	23,710.6

Sources: Data provided by the Yugoslav authorities; and IMF staff estimates and projections.

1/ Consolidated general government, excluding the social security funds and local governments in Montenegro.

2/ Excludes payments on called guarantees.

3/ Adjusted, for the purpose of better assessing debt sustainability, by excluding the repayment of frozen foreign currency deposits, which is treated as primary spending in the fiscal accounts but also results in an equivalent decline in domestic indebtedness.

4/ Excludes foreign debt held by the National Bank but includes the liabilities of commercial banks related to frozen foreign currency deposits.

Table 10. Federal Republic of Yugoslavia: Medium-Term External Sustainability, 2000-2010

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	Average 2002-05	Average 2006-10
							(In millions of U.S. dollars, unless indicated otherwise)						
Export growth (US$ terms, in percent) 1/	15.1	10.4	12.3	16.4	16.4	15.0	13.0	11.0	10.3	10.3	9.5	15.0	10.8
Import growth (US$ terms, in percent)	12.6	30.4	15.1	9.9	8.3	8.1	7.0	6.4	6.3	6.3	6.3	10.3	6.4
Current account balance, before grants	-610	-1,187	-1,646	-1,722	-1,623	-1,449	-1,363	-1,282	-1,176	-1,039	-914	...	...
percent of GDP	-7.6	-10.9	-12.8	-12.4	-10.7	-8.8	-7.6	-6.7	-5.7	-4.7	-3.9	-11.2	-5.7
Current account balance, after grants	-339	-596	-1,050	-1,322	-1,323	-1,149	-1,113	-1,082	-976	-839	-714	...	...
percent of GDP	-4.2	-5.5	-8.2	-9.5	-8.7	-7.0	-6.2	-5.6	-4.7	-3.8	-3.0	-8.3	-4.7
Gross official reserves	516	1,169	1,645	2,061	2,462	2,892	3,042	3,167	3,311	3,474	3,769	...	...
in months of imports of goods and services	1.2	2.4	3.0	3.5	3.9	4.2	4.2	4.1	4.0	4.0		3.7	4.1
External debt 2/	11,403	11,948	8,598	9,397	10,130	9,706	9,840	9,780	9,472	9,036	8,908	...	...
As percent of exports of goods and services	453	429	273	260	245	207	188	169	149	130	118	246	151
As percent of GDP	143	109	67	67	67	59	55	51	46	41	38	65	46
As percent of government revenue	368	263	156	159	159	142	134	123	112	100	92	154	112
External debt service 3/	56	107	343	467	719	852	1,107	1,315	1,512	1,630	1,308	...	...
As percent of exports of goods and services	2.2	3.9	10.9	12.9	17.4	18.1	21.1	22.7	23.9	23.5	17.3	14.8	21.7
As percent of GDP	0.7	1.0	2.7	3.3	4.7	5.2	6.2	6.8	7.3	7.4	5.5	4.0	6.7
As percent of government revenue	1.8	2.4	6.2	7.9	11.3	12.5	15.0	16.6	17.8	18.0	13.5	9.5	16.2
Sensitivity Analysis													
Lower export growth scenario 4/													
Debt service to exports of g&s		...	11.4	14.3	20.3	22.2	27.0	30.2	32.9	33.5	25.5	17.1	29.8
Debt to exports of g&s		...	287	288	286	253	240	225	206	186	174	279	206
Debt to GDP		...	67	67	67	59	55	51	46	41	38	65	46
Lower foreign direct investment scenario 5/													
Debt service to exports of g&s		...	11.4	15.8	22.2	24.4	27.4	28.8	29.9	29.3	22.9	18.5	27.6
Debt to exports of g&s		...	279	270	256	218	199	180	160	140	127	256	161
Debt to GDP		...	70	72	74	67	64	60	56	51	48	71	56

Sources: National Bank of Yugoslavia; and IMF staff projections.

1/ Recorded exports only.

2/ Incorporates the phased 66 percent debt reduction offered by the Paris Club, with comparable action provided by other official bilateral and commercial creditors.

3/ Besides the phased 66 percent debt reduction offered by the Paris Club, assumes a 60 percent capitalization of moratorium interest for the 2002-2005 period (as per the Paris Club agreement). Debt service projections for other official bilateral and commercial creditors are based on the assumption of comparable treatment.

4/ Growth in exports of goods and services is assumed to be only 60 percent of that under the baseline scenario. GDP growth unchanged from the baseline.

5/ Foreign direct investment is assumed to be only half of of that under the baseline scenario (on account of a worsened global environment), and gap-filling borrowing is utilized to cover the emerging financing gaps.

Table 11. Federal Republic of Yugoslavia: Indicators of Capacity to Repay the Fund, 2000-2012

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
		Projections 1/											
Fund repurchases and charges 2/													
In millions of SDRs	...	7.9	10.9	35.8	161.7	163.3	48.3	86.6	149.9	203.4	156.6	86.4	16.9
In millions of U.S. dollars	...	10.2	13.6	44.8	203.4	205.4	60.8	108.9	188.6	255.9	197.0	108.7	21.3
In percent of exports of goods and NFS	...	0.4	0.4	1.2	4.9	4.4	1.2	1.9	3.0	3.7	2.6	1.3	0.2
In percent of debt service	...	9.6	4.0	9.6	28.3	24.1	5.5	8.3	12.5	15.7	15.1	8.8	2.0
In percent of quota	...	1.7	2.3	7.7	34.6	34.9	10.3	18.5	32.1	43.5	33.5	18.5	3.6
In percent of gross official reserves	...	0.9	0.8	2.2	8.3	7.1	2.0	3.4	5.7	7.4	5.2	2.7	0.5
Fund credit outstanding													
In millions of SDRs	116.9	216.9	466.9	648.2	708.5	668.8	641.7	575.0	441.7	250.0	100.0	16.7	0.0
In millions of U.S. dollars	154.2	280.2	583.2	810.9	891.3	841.4	807.3	723.4	555.7	314.5	125.8	21.0	0.0
In percent of quota	25.0	46.4	99.8	138.6	151.5	143.0	137.2	122.9	94.4	53.5	21.4	3.6	0.0
In percent of GDP	1.9	2.6	4.5	5.8	5.9	5.1	4.5	3.8	2.7	1.4	0.5	0.1	0.0
In percent of gross official reserves	29.9	24.0	35.4	39.3	36.2	29.1	26.5	22.8	16.8	9.1	3.3	0.5	0.0
Memorandum items:													
Exports of goods and NFS (millions of US$)	2,547	2,762	3,154	3,618	4,143	4,696	5,248	5,786	6,338	6,944	7,567	8,235	8,931
Debt service, after debt relief (millions of US$)	56	107	343	467	719	852	1,107	1,315	1,512	1,630	1,308	1,236	1,041
Quota (millions of SDRs)	468	468	468	468	468	468	468	468	468	468	468	468	468
Quota (millions of US$)	617	604	584	585	588	588	588	588	588	588	588	588	588
Gross official reserves (millions of US$)	516	1,169	1,645	2,061	2,462	2,892	3,042	3,167	3,311	3,474	3,769	3,956	4,154
GDP (millions of US$)	8,071	10,861	12,841	13,938	15,177	16,505	17,831	19,252	20,631	22,117	23,711	25,419	27,250
U.S. dollar per SDR	1.32	1.29	1.25	1.25	1.26	1.26	1.26	1.26	1.26	1.26	1.26	1.26	1.26

Sources: Yugoslav authorities; and IMF staff estimates.

1/ As of end-March, 2002.

2/ Arrears to the Fund of SDR 101 million were cleared on December 20, 2000.

Table 12. Federal Republic of Yugoslavia: Stock of External Debt at December 31, 2001
(In millions of U.S. dollars)

Creditor	Total Debt	*Of which:* Arrears Principal	Interest	Late Interest	Total Arrears
Total stock of external debt	11,948	2,536	1,039	443	4,018
Multilateral creditors	2,706	97	66	51	214
IMF	272	-	-	-	-
IBRD	1,840	-	-	-	-
Eurofima	130	-	-	-	-
IFC 1/	175	70	58	47	175
EIB	49	-	-	-	-
Eurofund	199	22	7	-	28
MIB 1/ 2/	11	6	2	4	11
EBRD	28	-	-	-	-
European Community	2	-	-	-	-
Official bilateral creditors	4,818	-	-	-	-
Paris Club 3/	4,557	-	-	-	-
Other official bilateral creditors	261	-	-	-	-
Commercial creditors	3,398	1,412	972	392	2,777
London Club 4/	2,299	842	838	133	1,813
Other commercial creditors: convertible currencies	914	411	109	259	779
Other commercial creditors: non-convertible currencies	185	160	25	-	185
Short-term debt 1/	1,026	1,026	-	-	1,026
Trade arrears related to oil and gas imports 5/	502	502	-	-	502
Other short-term debt	524	524	-	-	524

Source: National Bank of Yugoslavia, unless indicated otherwise.

1/ Debt is not owed by government and does not have government guarantees.
2/ In February 2002, debt owed to the MIB ($11 mn of non-government debt) was transferred to a commercial creditor.
3/ Debt figure reflects Paris Club estimate from the November 2001 Paris Club session.
4/ Excludes $500 million in debt held by Yugoslav "connected parties".
5/ Overdue obligations (trade credits) owed to oil and gas enterprises in Russia and China.

Table 13. Federal Republic of Yugoslavia: Indicators of External Vulnerability, 1998-2002 1/

(In percent of GDP, unless otherwise indicated)

	1998	1999	2000	2001	2002
Financial indicators					
Public sector debt	...	...	127.0	100.6	59.0
Broad money (percent change, 12-month basis)	69.4	67.6	61.4	80.6	39.0
Private sector credit (percent change, 12 month basis)	...	128.4	68.6	8.2	...
Weighted interest rates (percent per month, December) 2/	7.0	3.9	6.8	3.8	...
Retail prices (percent per annum, e.o.p.)	...	49.9	113.5	39.0	20.0
External Indicators					
Exports (recorded exports, percent change, 12-month basis in US$)	24.0	-44.7	14.7	10.4	12.3
Imports (percent change, 12-month basis in US$)	1.0	-32.0	14.4	30.4	15.1
Terms of Trade (percent change, 12 month basis)	-2.6	-4.4	0.0	...	...
Current account balance, before grants	-4.8	-7.5	-8.3	-10.9	-12.8
Current account balance after grants and FDI	-3.9	-6.4	-4.6	-4.0	-5.1
Errors and omissions	2.0	4.0	3.6	2.8	2.3
Gross official reserves (in US$ millions)	326	293	516	1,169	1,645
(in months of imports GS of the following year)	1.1	0.9	1.2	2.4	3.0
Central Bank short-term foreign liabilities (in US$ millions) 3/	0	0	0	0	0
Gross reserves of the banking system (in US$ millions)	774	659	882	1,516	2,605
(in months of imports GS of the following year)	2.6	1.9	2.1	3.1	4.8
Short term foreign liabilities of the commercial banks (in US$)	...	...	349	342	...
Foreign currency liabilities of the commercial banks (in US $)	...	...	2,953	3,216	...
Official reserves/Broad money (M2) (percent)	18	30	50	60	72
Official reserves/Narrow money (M0) (percent)	59	126	164	174	150
Total short term external debt by original maturity (in US$ millions) 4/	...	...	1,153	1,026	1,026
Total short term external debt by remaining maturity (in US$ millions) 4/	...	...	1,153	1,026	1,026
Total short term external debt to reserves by original maturity (in percent)	...	...	223.4	87.7	62.4
Total short term external debt to total debt by original maturity (in percent)	...	...	10.1	8.6	11.9
Total short term external debt to total debts by remaining maturity (in percent)	...	...	10.1	8.6	11.9
Total short term external debt to reserves by remaining maturity (in percent)	...	...	130.7	67.7	39.4
Total external debt (in US$ millions)	...	...	11,403	11,948	8,598
Of which: Public and Publicly guaranteed debt 5/	...	...	10,250	10,922	7,572
Total external debt (in percent of exports of G&S)	...	...	448	433	273
External interest payments, cash basis (in percent of exports of G&S)	...	...	1.6	2.7	9.2
External amortization payments, cash basis (in percent of exports of G&S)	...	...	0.0	1.2	1.7
Exchange rate, official (per DM, end of period)	6	6	30	31	...
Exchange rate, parallel (per DM, end of period)	8	21	30	31	...
REER (annual average, February-December 1994 = 100) 6/	91.7	66.9	51.4	82.0	91.5

Sources: Yugoslav authorities; and IMF staff estimates.

1/ All stocks are measured end-of-period.

2/ Weighted interest rates on commercial paper, bank bills, and certificates of deposit.

3/ Excluding IMF and liabilities to domestic residents.

4/ Includes overdue obligations on debt related to imports of oil and gas. Remaining maturity debt includes stock of arrears.

5/ Assuming all long- and medium-term external bank debt to official creditors is government guaranteed.

6/ Increase denotes appreciation.

Table 14. Federal Republic of Yugoslavia: Schedule of Purchases
Under the Stand-By Arrangement

	Amount of Purchase			
	In millions of SDRs	In percent of quota 1/	Conditions	Available on or after
1.	50.0	10.7	Board approval of SBA	(Disbursed)
2.	50.0	10.7	Observance of end-June 2001 performance criteria and completion of quarterly review.	(Disbursed)
3.	50.0	10.7	Observance of end-September 2001 performance criteria and completion of quarterly review.	(Disbursed)
4.	50.0	10.7	Observance of end-December 2001 performance criteria and completion of quarterly review.	February 15, 2002
Total	200.0	42.8		

1/ The quota is SDR 467.7 million.

Table 15. Federal Republic of Yugoslavia: Schedule of Purchases
Under the Extended Arrangement

Available on or after	Amount of Purchase In millions of SDRs	In percent of quota 1/	Conditions
1. April 15, 2002	50.0	10.7	Board approval of the Extended Arrangement.
2. August 15, 2002	50.0	10.7	Observance of end-June 2002 performance criteria.
3. November 15, 2002	50.0	10.7	Observance of end-September 2002 performance criteria and completion of semi-annual review.
4. February 15, 2003	50.0	10.7	Observance of end-December 2002 performance criteria.
5. May 15, 2003	50.0	10.7	Observance of end-March 2003 performance criteria and completion of semi-annual review.
6. August 15, 2003	50.0	10.7	Observance of end-June 2003 performance criteria.
7. November 15, 2003	50.0	10.7	Observance of end-September 2003 performance criteria and completion of semi-annual review.
8. February 15, 2004	50.0	10.7	Observance of end-December 2003 performance criteria.
9. May 15, 2004	50.0	10.7	Observance of end-March 2004 performance criteria and completion of semi-annual review.
10. August 15, 2004	50.0	10.7	Observance of end-June 2004 performance criteria.
11. November 15, 2004	50.0	10.7	Observance of end-September 2004 performance criteria and completion of semi-annual review.
12. February 15, 2005	50.0	10.7	Observance of end-December 2004 performance criteria.
13. May 15, 2005	50.0	10.7	Observance of end-March 2005 performance criteria and completion of semi-annual review.
Total	650.0	139.0	

1/ The quota is SDR 467.7 million.

Federal Republic of Yugoslavia: Fund Relations
As of February 28, 2002

I. **Membership Status:** Joined: 12/14/1992; Article XIV

II. **General Resources Account:**	SDR Million	%Quota
Quota	467.70	100.00
Fund Holdings of Currency	734.64	157.07

III. **SDR Department:**	SDR Million	%Allocation
Net cumulative allocation	56.66	100.00
Holdings	4.80	8.47

IV. **Outstanding Purchases and Loans:**	SDR Million	%Quota
Stand-by arrangement	266.93	57.07

V. **Financial Arrangements:**

Type	Approval Date	Expiration Date	Amount Approved	Amount Drawn
Emergency Post Conflict Assistance	12/20/00	...	SDR 116.9 million	SDR 116.9 million
Stand-by	6/11/01	3/31/02	SDR 200.0 million	SDR 150.0 million

VI. **Projected Obligations to Fund:**
Under the Repurchase Expectations Assumptions[1]

	Forthcoming				
	2002	2003	2004	2005	2006
Principal		18.80	127.20	114.70	6.30
Charges/Interest	6.40	8.60	7.10	3.50	1.30
Total	6.40	27.40	134.30	118.20	7.60

VII. **Safeguards Assessments:**

Under the Fund's safeguards assessment policy, the National Bank of Yugoslavia is subject to a full Stage One safeguards assessment with respect to the Stand-By Arrangement approved on June 11, 2001, which is scheduled to expire on March 31, 2002. An on-site assessment of the NBY, conducted during October 2001, identified vulnerabilities and proposed remedies that have been agreed to by the central bank and are being implemented..

[1] Disbursements made after November 28,2000—with the exception of disbursements of emergency assistance and loans from the Poverty Reduction and Growth Facility—are expected to be repaid on the expectations schedule. Countries may request the IMF Executive Board to make repayments according to the obligations schedule if their external payments position is not strong enough to meet the repayment expectations without undue hardship or risk. Please note: Repayment under the Supplemental Reserve Facility are scheduled to be repaid on the expectation schedule.

VIII. **Exchange Arrangement**

The currency of FRY is the Yugoslav Dinar (YUD). On January 1, 2001, FRY adopted a managed float system. During 1994-99, the dinar was officially pegged to the DM; for most of the period, multiple exchange rates were in effect.

IX. **Last Article IV Consultation**

No consultation discussions have yet been held with FRY.
The authorities have requested a multi-sector GDDS.

X. **Technical Assistance**

Department	Timing	Purpose
FAD	February 2001	Tax policy and administration
FAD	March 2001	Public expenditure management
FAD	April 2001	Tax administration
FAD	November 2001	Install a new resident advisor on tax administration
MAE	November 2000	Diagnostic mission
MAE	December 2000	Diagnostic mission: Monetary policy instruments Bank supervision Payments system Foreign exchange operations and reserves management Development of money and securities markets
MAE	February 2001	Banking supervision and restructuring
MAE	April 2001	Diagnostic mission: Bank restructuring Monetary and foreign exchange dev.
MAE	July 2001	Banking supervision and restructuring.
MAE	October 2001	Diagnostic mission: Monetary policy instruments Bank restructuring Payments system Foreign exchange operations and reserves Management Development of money and securities markets
MAE	February 2002	Payments system reform.
MAE	March 2002	Reform in foreign exchange regulations and monetary policy instruments; development of capital market
STA	February 2001	Money and banking statistics

XI. **Resident Representative**

Mr. Joshua Charap took up his position as Resident Representative in March 2001.

Federal Republic of Yugoslavia: Relations with the World Bank Group

1. Based on a decision by the World Bank's Board of Directors, the Former Socialist Federal Republic of Yugoslavia (SFRY) ceased to be a member of the World Bank Group in February 1993. On May 8, 2001, the World Bank's Board approved the succession of the Federal Republic of Yugoslavia (FRY) to SFRY's membership in the IBRD. FRY membership in IDA was confirmed on June 11, 2001.

2. The conditions for FRY's membership were that it would: (i) become a member of the IMF; (ii) accept the Bank's Articles of Agreement and the terms and conditions of subscription to the shares of Bank capital to which it succeeds; (iii) make local currency payments as necessary with respect to shares to which it succeeds; (iv) enter into final agreement with the Bank on the loans of the SFRY it assumes; and (v) eliminate or agree with the Bank on a plan to eliminate the arrears in the servicing of the Bank loans it has assumed.

3. As of December 31, 2000, the stock of arrears of the FRY to the IBRD amounted to around US$1.7 billion. The arrears clearance plan approved by IBRD's Board of Executive Directors provided for the exceptional consolidation of FRY's arrears and principal not yet due into a new package of IBRD loans. This package of consolidation loans was approved by the Board on December 13, 2001, and became effective in early-January 2001, thereby clearing FRY's arrears to IBRD. As part of the membership package, the Bank's Board of Directors approved temporary exceptional IDA eligibility for FRY, allowing up to US$540 million in new IDA loans during FY02–04.

4. The Bank has in place a two-phase strategy that enabled it to be active even prior to arrears clearance. On March 13, 2001, the Board of Directors approved the establishment of a Trust Fund for FRY (TFFRY) and the transfer of US$30 million of IBRD surplus to be used to provide grant financing of selected priority activities. These resources have been fully committed through the finalization of Grant Agreements for five projects. The Bank has also been active in providing analytical and advisory support to FRY, in partnership with the European Commission, the IMF and others. This support initially focused on preparing an Economic Recovery and Transition Program, which was submitted to a donor pledging conference on June 29, 2001. A total of US$1.33 billion was pledged, on a commitments basis, towards the program in CY01 by donors.

5. In the context of the membership package the Bank's Board of Directors also endorsed a Transitional Support Strategy (TSS) that provides the framework for World Bank assistance to FRY in FY02. A total of up to US$200 million in IDA resources could be provided as credits to FRY in FY02, with up to US$160 million as quick-disbursing assistance in support of priority reforms in the areas of fiscal management, private sector development and banking reform. A first Structural Adjustment Credit of US$70 million for the Republic of Serbia was approved on January 29, 2002 and has been disbursed. A Private and Financial Sector Adjustment Credit of a similar magnitude (also for Serbia) is scheduled for negotiation in April, and a smaller Structural Adjustment Credit focused on reforms in the Republic of Montenegro, is also under preparation. In addition, up to US$40 million would also be provided in support of investment operations in FY02. Advisory activities already commenced under the TSS include a Public Expenditure and Institutional Review (PEIR), a Country Procurement Assessment Report (CPAR), a Country Financial Accountability Assessment (CFAA), household survey work preparatory to a Poverty Assessment (and to the government's planned Interim Poverty Reduction Strategy Paper), and a Private Sector Development Strategy (in conjunction with the IFC and EBRD).

Federal Republic of Yugoslavia: Statistical Issues

1. Yugoslavia has a well-developed statistical database. However, coverage slipped during the 1990s as transactions were increasingly conducted outside the formal economy. Kosovo has not reported data to the Federal authorities since March 1999. In 2000, Montenegro ceased to report monetary data, while real sector data have been reported only for inclusion in Federal aggregates, but not for separate publication. Further, definitions are not in line with international standards, as they were developed to accommodate national characteristics and because they were not updated during the recent decade when Yugoslavia was isolated from international developments. The authorities have, therefore, requested that the Fund send an ROSC mission to undertake a comprehensive data quality assessment, as a basis for further technical assistance. Yugoslavia does not have a presentation in *IFS*.

A. Real Sector

2. Real sector statistics are compiled and published by the Federal Statistics Bureau (FBS), the Statistics Institute of the Republic of Serbia, and the Statistics Institute of the Republic of Montenegro. A key basic source of economic information is the Accounts and Payments Bureau (ZOP), which compiles semi-annual and annual balance sheets and income statements from all economic agents. The compilation methods and statistical measurements are still largely those appropriate to a socially/state-owned economy and material definition of production. Information on production and labor is principally collected from compulsory enterprise reports although yearly surveys are conducted on household expenditures and employment in small establishments. As small, private, enterprises, whose compliance with statistics requirements tends to be low, have accounted for an increasing share of economic activity, the reliability and coverage of official statistics have deteriorated over the past years.

3. National accounts on a material basis are compiled annually with approximately a half-year delay. National accounts in accordance with the *SNA* methodology have been compiled regularly and with increasing elaboration since 1994, but with substantial delays; the latest available data refer to 1999. The *SNA* methodology appears to be adequately implemented at present, but the source data—enterprise income statements—suffer from serious deficiencies due to nonstandard accounting rules and misreporting. The three major sources of distortion in the estimates of production are incomplete coverage, use of official exchange rates for the recording of all transactions when in the past most transactions were carried out at gray market rates, and overstatement of stock accumulation due to valuation inaccuracies. Price statistics are compiled on a number of price baskets, notably the retail price index, cost of living index, industrial producers' price index and others. While frequency and methodology of observation appear adequate, weighting, data storage, and dissemination could be improved.

B. Balance of Payments

4. The balance of payments is compiled by the National Bank of Yugoslavia (NBY). Principal data sources are customs data on merchandise trade as processed by the FBS and information of foreign exchange transactions provided by banks and exchange bureaus. These are complemented by data from the Ministry of International Economic Relations on external grants and loans. The NBY keeps appropriately detailed records of external debt held by commercial banks, the government and itself. While the data compilation procedures

appear appropriate, some components of the balance of payments suffer from substantial underrecording owing to the large proportion of foreign exchange transactions carried outside official channels. During 2001, the NBY expended commendable efforts to improve its estimation of actual flows based on existing data.

C. Government Finance

5. Fiscal statistics for the federal government are compiled by the Federal Ministry of Finance, for the rest of Serbia by the Serbian Ministry of Finance. Principal data source are the budget execution reports of the spending Ministries and first-level budget units and ZOP reports. Revenue data are timely and reliable as they are reported by ZOP. Expenditure data are compiled with longer delays. During 2001, the government in Serbia made serious effort to bring the existing budget reporting system in line with GFS methodology, but full compliance will require a complete overhaul of the system of fiscal accounts which will be done this year with technical assistance from the Fund and other TA providers. Data on expenditure arrears are less reliable due to the lack of basic treasury functions in the existing system of expenditure management. Fiscal data for the central government of Montenegro is prepared by the Ministry of Finance, based on the new GFS classification and is available on a timely basis. Data for the social security funds are reported directly by the funds and are available only with major delays and are not based on GFS classification. No data are available for local governments. Yugoslavia does not report data for publication in *the GFSY.*

D. Monetary Accounts

6. Monetary statistics prepared by the NBY are based on accounting data that deviate from international standards. Considerable effort has been devoted by the Fund, during eight EU1 missions during 2000–02 and one STA mission in 2001, in preparing monetary statistics that approximate Fund standards. The STA mission reviewed procedures for collecting and compiling monetary statistics. The mission concluded that, while a good institutional base existed for monetary data collection and compilation, major enhancements were needed to ensure closer conformity with internationally accepted practices. The mission initiated preparatory work to facilitate implementation of the framework for monetary statistics recommended in the *Monetary and Financial Statistics Manual (MFSM)* and made specific recommendations in a number of areas, including the sectorization and classification of existing accounts. A follow up STA mission is scheduled for May 2002. The mission will review the implementation of a new chart of accounts (introduced in the beginning of 2002) for financial institutions in Serbia and assist the authorities in compiling monetary statistics in accordance with the *MFSM* recommended methodology, using data collected from the new chart of accounts. The mission will also assist the authorities in developing call report form for use by banks to report data to the NBY. The mission will visit Montenegro to review the status of the collection and compilation of the monetary and financial statistics, which will serve as basis for future technical assistance work to the area. Currently, Montenegro adopts euro as legal tender, no longer reports monetary data to the NBY, and is in the process of establishing its own monetary statistical database with technical assistance from USAID.

Federal Republic of Yugoslavia: Core Statistical Indicators
(As of December 12, 2001)

	Exchange rates	International Reserves	Central Bank Balance Sheet	Reserve Money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Government Balance	Gross Social Product	External Debt/ Debt Service
Date of Latest Observation	Mar. 28, 2002	Mar. 28, 2002	Dec. 31, 2002	Mar 28, 2001	Dec. 31, 2001	Feb. 28, 2002	March 31, 2001	Dec 31 2001	Dec. 31, 2001	Dec. 31, 2001	Dec. 31, 2000	Dec. 31, 2001
Date Received	Apr. 2, 2002	Apr. 2, 2002	Apr. 2, 2002	Apr. 3, 2002	Feb. 8, 2002	Mar. 20, 2002	April 5, 2002	Feb. 2002	Feb. 2002	Jan. 2002	Feb. 2002	Feb. 2002
Frequency of Data	Daily	Daily	Monthly	Daily	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Annually	Monthly
Frequency of Reporting	Weekly	Weekly	Monthly	Weekly	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Annually	Monthly
Source of Update	NBY	NBY	NBY	NBY	NBY	NBY	FBS	FBS	NBY	Ministries of Finance of the FRY, Serbia, and Montenegro	FBS	NBY
Mode of Reporting	Report to the Fund	Report to the Fund	Report to the Fund	Report to the Fund	Report to the Fund	Report to the Fund	Website	Website	Website	Report to the Fund	Website	NBY
Confidentiality	Public	Confi-Dential	Confi-dential	Confi-dential	Confi-dential	Public	Public	Public	Public	Public	Public	Confiden-tial
Frequency of Publication	Daily	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Annually	Annually	Monthly

April 26, 2002

Mr. Horst Köhler
Managing Director
International Monetary Fund
700 19th Street
Washington DC 20431

Dear Mr. Köhler:

Our firm implementation of the economic program supported by the Fund under the current stand-by arrangement has succeeded in restoring financial stability under extremely difficult conditions and in facilitating the adoption of important reform measures. This has set a good basis for continued reforms and progress toward sustainable growth and a viable external position. Over the past several months, in cooperation with Fund and World Bank staffs, we have formulated and begun implementing a medium-term stabilization and reform program. Our program for 2002-05 is described in detail in the attached Memorandum on Economic and Financial Policies. On this basis, we request (a) completion of the third review under the current stand-by arrangement and (b) approval of a three-year extended arrangement in the amount of SDR 650 million.

We believe that the policies and measures described in the attached memorandum are sufficient to achieve its objectives, but we stand ready to take additional measures and seek new understandings with the Fund, as necessary, to keep the program on track. We will remain in close consultation with the Fund in accordance with the Fund's policies on such consultations, and will provide the Fund with all information that it requests to assess the implementation of the program. The program will be reviewed by the Fund on a semiannual basis (by May 15 and November 15, respectively). The first, third and fifth reviews will focus in particular on the annual budgets and financial programs for 2003, 2004 and 2005, respectively. Moreover, we understand that each purchase under the arrangement will be subject to a review of the financing of the program.

Yours sincerely,

Miroljub Labus /s/
Deputy Prime Minister and Minister
of Foreign Economic Relations
Federal Republic of Yugoslavia

Mladjan Dinkic /s/
Governor
National Bank of Yugoslavia

Bozidar Djelic /s/
Minister of Finance
Republic of Serbia

Miroslav Ivanisevic /s/
Minister of Finance
Republic of Montenegro

FEDERAL REPUBLIC OF YUGOSLAVIA

MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES, 2002-05

I. INTRODUCTION

1. This memorandum updates the Memorandum of Economic and Financial Policies (MEFP) attached to the Letter of Intent of May 25, 2001, as subsequently revised by the MEFPs attached to the Letters of Intent of September 4, 2001, December 26, 2001, and January 4, 2002. The memorandum (a) reports on economic performance and policy implementation under the program for 2001 that was supported by the IMF under a 10-month stand-by arrangement approved on June 11, 2001; (b) outlines the key economic and policy objectives of a 2002-05 program of stabilization and reform that could be supported under a prospective Extended Arrangement (EA); and (c) describes the policy measures envisaged during 2002. Annex A to this memorandum contains information on the quantitative performance criteria and indicative limits under the current arrangement and those proposed for 2002 under the envisaged arrangement. Annex B contains information on the structural performance criteria and benchmarks under the current arrangement and those proposed for the envisaged arrangement, as well as the preconditions for consideration by the IMF Executive Board of the third review and the request for an Extended Arrangement. Annex C contains a detailed list of structural policy measures envisaged to be implemented during the EA. Annex D defines the performance criteria and indicative targets and describes the reporting arrangements.

2. **Economic performance has been impressive since late 2000, reflecting the firm implementation of macroeconomic and structural reform policies.** Inflation during 2001 declined by two-thirds to 39 percent by year-end; adjusting for increases in administered prices and indirect taxes, core inflation is estimated at 15 percent. Real GDP grew by an estimated 5½ percent in 2001. GDP growth is attributed to a rebound (by 25 percent) in agricultural output after the previous year's severe drought, and increasing activity in services. Industrial production was roughly unchanged in 2001 as a whole, reflecting capacity constraints after years of disinvestment and the ongoing economic restructuring, but has recently shown signs of a modest recovery. The external current account deficit (before grants), estimated at US$1.2 billion or 10.9 percent of GDP in 2001, was lower than originally projected owing mainly to buoyant inflows of remittances. The foreign exchange reserves of the NBY more than doubled to US$1.2 billion (2.6 months of projected imports of goods and services) by end-2001.

3. **Macroeconomic policy implementation has remained firmly on track.** Specifically, quantitative performance criteria at end-December 2001 were observed. The fiscal deficit in FRY was contained to an estimated 1.4 percent of GDP in 2001, against an original target of 6.1 percent of GDP, as a result of revenue overperformance as well as spending compression in response to delays in privatization proceeds and foreign financing. Revenue performance was enhanced by wide-ranging reforms and efforts to curtail tax evasion. Fiscal policy implementation in Montenegro improved in the second half of 2001,

while problems in fiscal transparency were being addressed through the establishment of a Treasury in the Ministry of Finance. The NDA and NFA targets were comfortably observed, while the indicative target for wage growth in large state enterprises was exceeded by less than ½ percent.

4. **Structural reform has generally proceeded at a fast pace, even though some structural benchmarks were not observed.** Following the liberalization of the price, foreign exchange, and trade regimes in early 2001, new institutional frameworks for bank and enterprise restructuring have been implemented with technical assistance from the Fund and the World Bank. The closure in early January of four large insolvent banks—accounting for almost 60 percent of the book value of the banking system assets but less than 20 percent of banking services—represented an important step toward building a healthy banking system. In addition, an excellent start on the privatization program took place in late December, with the sale of three cement companies to foreign investors for the total amount of US$140 million. In Montenegro, important progress was made in reforming the tax system, improving public expenditure management, and privatizing public properties through reliance on the voucher method of mass privatization. Nevertheless, six out of 17 structural benchmarks for the period between mid-December 2001 and end-March 2002 were not observed. In the fiscal area, staffing constraints at the PRA headquarters delayed the set-up of the Large Taxpayer Unit, which is now expected by end-June 2002. The benchmarks related to the central accounting unit and a new system of control will be met after the Treasury has been set up by April 2002. The appointment of privatization advisors by the Serbian Privatization Agency has also been delayed by several weeks, but the privatization program remains on track.

5. **Prospects for external sustainability were enhanced by the Paris Club decision to reduce the net present value (NPV) of debt to official bilateral creditors by 66 percent.** The first phase of the Paris Club debt reduction (51 percent) will enter into force with the approval of the prospective EA, while the second phase (the remaining 15 percent) will become effective upon successful completion of the EA. Discussions are continuing with other official bilateral and commercial creditors with a view to obtaining debt relief on terms similar to those granted by the Paris Club.

6. **Relations between Serbia and Montenegro will be reformed.** On March 14, 2002, the federal and republican authorities, under the auspices of the EU, reached agreement on a new constitutional framework. The agreement provides for the streamlining of common administrative institutions; acknowledges the existence of different monetary, exchange, customs, and tax regimes; and envisages harmonization of the economic systems of Serbia and Montenegro with that of the EU. A draft Constitutional Charter is to be submitted to the federal and republican parliaments by end-June 2002. By the same date, the Serbian and Montenegrin authorities will reach agreement on how to resolve the issue of inter-republic trade regarding customs, excises and VAT. Changes to policies and program conditionality, to reflect the evolving constitutional framework, will be discussed in the context of the program reviews.

II. ECONOMIC AND POLICY OBJECTIVES FOR 2002-05

7. **The economic objectives for 2002-05 envisage achievement of sustainable growth and improved living standards, low inflation, and a viable external position:**

- **Real GDP** is projected to grow by 4 percent in 2002, on the expectation that normal growth in agricultural output after last year's strong rebound will be accompanied by nonagricultural growth of 4 to 5 percent (as compared with an estimated 1½ percent in 2001), reflecting increased foreign assistance, inflows of FDI, and the response of the economy to improved incentives. Beyond this, the medium-term growth rates are expected to increase to about 5 percent as a result of the implementation of reforms and a projected rise in the level and efficiency of domestic investment.

- **Inflation** (retail prices) in Serbia is targeted to be halved to 20 percent by end-2002, which would correspond to a core inflation rate of about 10 percent after accounting for further large adjustments in administered prices; to 12 percent by end-2003; and to 8 percent by end-2004. In Montenegro, inflation is projected to be halved to 12 percent by end-2002 and to decelerate further in 2003-04. Over the medium term, inflation in FRY is projected to converge toward EU levels, with the margin explained by further increases in administered prices (notably for electricity).

- The external **current account deficit** in FRY is expected to widen to US$1.6 billion (12.9 percent of GDP) in 2002 reflecting a resumption in external debt service as well as higher project-related imports. Thereafter, the current account deficit as a share of GDP should show a steady improvement to 2005, mostly due to a recovery of exports to their historical levels. In 2002, the current account deficit will be financed largely by official grants and loans that have already been pledged; financing assurances are expected for the remainder. For 2003-05, consistent with indications provided at the June 2001 Donors conference, an average of US$840 million in additional financing is expected from bilateral donors as well as multilateral lending agencies, including the World Bank, EBRD and EIB. FDI inflows will play an increasing role as the privatization program and other economic reforms reach an advanced stage.

- **Official foreign reserves** will be targeted to rise to the equivalent of 4½ months of imports of goods and services by end-2005, with a view to ensuring a strong external position in anticipation of a peak in debt servicing obligations in the second half of the decade.

8. **The 2002-05 program envisages the continuation of prudent macroeconomic policies.** Moreover, given the uncertainty surrounding medium-term macroeconomic prospects, the fiscal and other policy targets will be kept under close review to achieve the key objectives of low inflation, sustainable growth, and a resilient external position.

- The **fiscal deficit** will remain sizable—in line with the experience of other transition and post-conflict countries—owing to the investment needs in the country's dilapidated infrastructure, external debt service requirements, and the higher costs of maintaining an adequate social safety net during the transition. The deficit will be financed mostly by foreign grants and concessional loans, which have been estimated on the basis of past and expected donor commitments, as well as projected privatization receipts. The government's recourse to domestic financing will be subject to a limit—to be treated as a performance criterion—of around ½–1 percent of GDP throughout the EA.

- **Monetary policy** will be geared to lowering inflation while supporting economic recovery. The monetary program for 2002 assumes a further recovery of confidence in the dinar in line with recent trends.. Even though the current level of the **exchange rate** appears to be appropriate, developments in the foreign exchange market will be monitored closely and exchange rate policy will be assessed regularly during the program reviews with a view to safeguarding competitiveness.

- **Wage policy in the state sector** (government and major state enterprises) will serve as an inflation anchor and as a means of encouraging a streamlining of employment to raise labor efficiency.

9. **Achievement of the economic objectives will also require implementation of an ambitious structural reform agenda aimed at fostering private sector-led growth, with the support of the World Bank and other donors.** The program will include (a) further fiscal reforms, mainly to improve tax administration, expenditure management, the targeting of social services and transfers, and the finances of the pension fund in addition to addressing the implications of fiscal decentralization; (b) legal and regulatory measures to strengthen further the financial position of commercial banks, following up on recent progress in closing insolvent banks; and (c) rapid progress in restructuring the enterprise sector, which is mostly decapitalized and overstaffed, and creating a business environment that supports the development of the private sector.

10. **Considerable progress toward fiscal and external sustainability should be achieved during the EA.** The program envisages a much-needed reduction in government indebtedness in relation to GDP, a streamlining of expenditures and revenues, and steadily declining deficits. Increases in government and nongovernment savings would permit a sizable rise in the investment/GDP ratio during 2001–2005, notwithstanding an envisaged decline in foreign assistance and increasing interest payments on external debt. Moreover, external debt indicators, while remaining relatively high, are expected to improve both during and after the EA, reflecting largely the phased debt reduction and the reliance on grants, concessional loans, and FDI inflows to finance the current account deficits. A prudent policy of external debt management will underpin progress towards external sustainability. The federal and republican authorities will aim to clear all remaining external arrears, observe the limits on non-concessional borrowing specified under the program, and avoid the accumulation of new external arrears.

A. Fiscal Policy

Overview

11. **The fiscal framework for 2002 supports investment in infrastructure and economic restructuring.** After substantial compression of expenditure in 2001 due to delays in foreign financing and privatization proceeds, the general government deficit is projected to reach 5.7 percent of GDP and will be financed mainly by foreign assistance and privatization proceeds. Domestic borrowing will be limited to the equivalent of ½ percent of GDP. Budgeted foreign assistance (mainly from the World Bank and the EU) appears to be firm, assuming that policy conditionality is met, while the target for privatization receipts in 2002 is likely to be comfortably met. In the event of a shortfall in revenue or in foreign assistance and privatization proceeds, possible expenditure cuts have been identified. Any excess privatization proceeds will be used, in the first instance, to reduce net government indebtedness and, in consultation with Fund and World Bank staffs in the context of program reviews, to facilitate enterprise privatization.

12. **Fiscal policy over the medium term will aim to support economic recovery and reform while ensuring progress toward further disinflation and fiscal sustainability.** The overall expenditure/GDP ratio—which is projected to reach 48½ percent in 2002—will be targeted to decline by about 3 percent of GDP over the EA period, while making room for increased debt servicing and capital spending. This would require noninterest current spending to be lowered in relation to GDP over the medium term, by containing real increases in such spending. To this end, all governments will embark on a major overhaul of subsidies, the civil service, healthcare, pensions, and other social benefits. On the revenue side, the policy effort will focus on improving tax administration to widen the tax base and, to the extent permitted by the fiscal situation, lower tax rates.

Federation

13. **The federal government will continue with a balanced budget in 2002 coupled with expenditure reform.** Expenditure and revenue will remain constant in relation to GDP. Capital spending will be slightly higher in relation to GDP, while the share of excises in total revenue will increase significantly, offset by a corresponding decline in sales tax revenue, as result of a new federal-Serbian revenue-sharing formula. Fiscal reporting will improve substantially following the adoption of GFS classification with the 2002 budget. The military has initiated restructuring to enhance its efficiency, in part though downsizing the officer corps and shortening the conscription period from 12 months to 9 months. This, combined with expected expenditure savings in the federal administration in light of the recent agreement on a new constitutional framework, should permit spending currently undertaken by the federation to decline in relation to GDP over the medium term.

Serbia

14. **The 2002 Serbian budget bears most of the new fiscal burdens of the FRY economy.** Expenditure will increase by about 5½ percentage points of GDP owing to higher

debt service, bank and enterprise restructuring costs, capital spending and higher transfers to social funds. Tax revenue will increase by about 2 percent of GDP on account of the carry-over effect of tax reform initiated mid-2001, the change of the revenue-sharing formula with the federal budget, and the increase in excises (jointly contributing about 3 percent of GDP), which will be partly offset by a reduction in the financial transactions tax and some reclassification of state agencies' own-revenue (a loss of revenue of about 1 percent of GDP). Since the 2002 budget was prepared with the new GFS classification, budget reporting and monitoring should improve during the year, thereby facilitating the conduct of fiscal policy. In the event of a shortfall in revenue and foreign financing, or other developments that may endanger achievement of the macroeconomic objectives, possible expenditure cuts of ½ percent of GDP have been identified in the areas of subsidies and capital spending.

15. **Further structural reforms in the fiscal area will involve tax policy, tax administration, public expenditure management and social spending.** In light of the wide-ranging tax reforms adopted last year, the introduction of the VAT is the key remaining tax policy reform in Serbia. Technical preparations have already begun for the introduction of the VAT in January 2004. In the area of tax administration, a Law on Tax Administration Organization and a Law on Identification, Control and Payment of Public revenue are expected to be adopted by parliament by end-June 2002 (to be monitored as a structural benchmark). The Ministry of Finance intends to reorganize the Public Revenue Agency (PRA), move to a modern computerized system and—to be monitored as structural benchmarks—establish a Large Taxpayer Unit (LTU) and create a unique taxpayer identification number.(see Annex C). In the area of public expenditure management, a Treasury with some basic functions will be set up by end-September 2002 (to be monitored as a structural benchmark). With World Bank support (including Public Expenditure and Institutional Review missions), policy reforms affecting pensions, healthcare, and social welfare programs will help streamline social spending, while the planning and policy analysis capacity of the Serbian Ministry of Finance (MoF) will be strengthened.

Montenegro

16. **The 2002 budget for Montenegro puts fiscal policy on a more sustainable basis by containing non-interest current expenditure in relation to GDP.** Spending across the board will either remain largely constant or decline as a share to GDP; an increase in the share of wages is entirely explained by the underpayment of social security contributions in 2001 because of a delay in the receipt of foreign budgetary grants. Total revenue will be higher by about 2 percent of GDP mainly on account of increased own-revenues of state agencies that have been reflected in the Treasury single account for the first time in 2002, while expenditure is higher mainly on account of external debt service and the aforementioned anomaly in the wage bill data. On the whole, foreign grants and concessional loans will be sufficient to finance Montenegro's consolidated government deficit of 6.3 percent of Montenegro's GDP as well as to repay funds borrowed from the Central Bank of Montenegro last year.

17. **Fiscal reforms will concentrate on the implementation of recently adopted tax legislation, pension and healthcare reform, and improvement in Treasury operations.**

The government adopted a set of six tax laws in December 2001, envisaging their phased implementation in 2002. The most visible changes will affect tax administration, which is now undergoing reorganization and preparing for the introduction of new excises in April, the personal income tax in July, and the VAT and the property tax in January 2003. At the same time, the government is preparing regulations that will change the current net wage system to a gross concept that is consistent with the new personal income tax law. The Treasury already controls about 55 percent of total transactions, with full coverage expected by mid-2003. Reforms in the pension system have been initiated with World Bank assistance and will involve a phased increase in the retirement age by 3 years as well as a shift in the pension indexation scheme from wage increases to an arithmetic average of wage and price increases (to be monitored as a structural benchmark).

B. Wage and Pricing Policies

18. **The growth of the wage bill in the state sector will be strictly controlled during 2002-05, with a view to containing wage pressures in the economy, lowering inflation, and encouraging labor shedding.** In 2002, the state sector wage bill in relation to GDP would be kept constant; thereafter, the share in GDP should be lowered gradually, while real average wages could rise as a result of streamlining the civil service, the education & health sectors, and the public utilities. Private and socially-owned companies will continue to face a hard budget constraint, while a recently adopted Serbian labor law that liberalizes employment contracts and wage determination—along with a similar Montenegrin law that is expected to be adopted soon—will raise labor market flexibility.

19. **Administered prices for electricity will be adjusted to cost-recovery levels.** Electricity prices in Serbia were raised by 120 percent during 2001 to US¢2.03 per kWh, while production costs were contained and the collection rate was increased. Electricity prices will be raised further by about 50 percent to a level that covers operational costs by mid-2002 (to be monitored as a performance criterion) and to "full-cost recovery" (estimated at US¢4.5 per kWh by World Bank staff on the basis of regional comparisons) by mid-2004. To facilitate further liberalization and future privatization, an independent regulator of electricity and other energy prices will be established with World Bank assistance by end-2003. In Montenegro, electricity prices will be raised by October 2002 to at least 4.6 € cents/kWh (US¢4.2 per kWh),excluding the aluminum plant, thereby reducing cross-subsidies.

C. Monetary and Exchange Rate Policy

20. **Monetary policy in 2002 will continue to be guided by the same principles as in 2001.** Reserve money growth will be driven by increases in NFA arising from foreign exchange inflows and a portfolio shift to the domestic currency by residents, while the NDA will continue to be strictly limited. Reserve money will be targeted to rise by about 37 percent, implying a further decline in velocity of about 7 percent, compared with a decline of about 32 percent during 2001. (The end-2001 base data have been adjusted for the effects on reserve money of the closure of four large banks as well as the envisaged change in the reserve requirement.) Growth in the NDA and in the NFA of the NBY is projected to

contribute 12 and 25 percentage points, respectively, to reserve money growth. In the event of higher-than-projected NFA, the NBY would consult with the Fund staff on the implications for credit policy and—if the NFA overperformance does not appear to reflect increased money demand—would maintain the NDA below the program ceiling. The NBY will conduct auctions of its securities in quantities sufficient to absorb the excess liquidity in the interbank market, consistent with the NDA target, and accept the resulting interest rates. The discount rate will be set to reflect market conditions.

21. **The managed float policy—which has served Serbia well, inter alia in lowering inflation and strengthening confidence—will be continued and implemented flexibly with the goal of striking the right balance between attaining the disinflation objectives of the program and avoiding an unsustainable appreciation of the real exchange rate.** The broad stability of the exchange rate of the dinar against the euro since the beginning of 2001 continues to be associated with favorable developments in the foreign exchange market, as indicated by broad balance of demand and supply in the interbank market (i.e., even excluding autonomous foreign exchange inflows, such as those related to foreign assistance and privatization proceeds) and continuing increases in the NFA of the NBY. Meanwhile, the dinar has appreciated substantially in real terms since late 2000, albeit from very low levels. Looking ahead, exchange rate policy will be kept under close review taking into account not only conditions in the interbank market but also developments in exports, imports, and wages.

22. **The foreign exchange market will be further liberalized.** A proposed new foreign exchange law, to be submitted to the federal parliament by end-April 2002, and implementing regulations under preparation will streamline the operation of the foreign exchange market and pave the way for FRY's acceptance of the obligations of Article VIII, Sections 2, 3 and 4 of the Fund's Articles of Agreement. In general, all restrictions on payments and transfers for current international transactions will be eliminated, and capital account transactions will be considerably liberalized with the exception of lending and investing abroad and short-term capital movements. Documentation requirements for permitted transactions will be sharply reduced. Transactions will be allowed at exchange rates other than those set in the daily fixing session of the interbank foreign exchange (as an interim measure, the banks have been recently allowed to trade within a range of +/- 2.5 percent). Banks will be allowed to purchase foreign exchange from the NBY on their own account for the purpose of covering open positions as well as for carrying out current and legitimate capital account transactions on behalf of their customers. The restrictions on purchases and sales of foreign banknotes by commercial banks will be repealed. The NBY will consult with the IMF's Legal Department with a view to identifying and removing any remaining exchange restrictions, thus paving the way for FRY to accept the obligations of Article VIII, Sections 2, 3 and 4, by mid-2002.

23. **Important progress in bank restructuring has set the stage for reform of monetary policy instruments, the development of the financial market, and reform of the payments system.** With Technical Assistance from the Monetary and Exchange Affairs Department (MAE) of the IMF, the reserve requirements system will be reformed by end-March 2002, through a widening of the deposit base to include all broad money deposits

(with the exception of individuals' "new"—i.e., made since July 1, 2001—foreign currency deposits that are subject to a 50 percent liquidity requirement), the adoption of a lower reserve requirement ratio, and the introduction of an averaging system. Measures in line with MAE recommendations are also being implemented to develop the nascent financial market. A draft Securities Law will be submitted to the federal parliament by end-June 2002 to enhance the protection of investors and the efficiency and transparency of transactions (to be monitored as a structural benchmark.) In the area of payments reform, following some delays, policy efforts have been intensified with a view to introducing a modern payments system. In particular, from January 1, 2003, commercial banks will be permitted to initiate and settle payments among themselves on behalf of enterprises and individuals without the mandatory intervention of the domestic payments service (ZOP) or any other agency (to be monitored as a performance criterion).

D. Foreign Trade System

24. **Most of the remaining trade barriers will be removed during the EA period.** At the federal level, the trade system was greatly simplified in the first half of 2001, when most quantitative or licensing restrictions were removed and the tariff system was reformed. The remaining restrictions on imports and exports—other than those maintained for health, environmental and security reasons—will be phased out by end-2003 and end-2004, respectively. In the areas of trade in services and foreign investment, Yugoslavia will maintain its liberal regime. Montenegro's export and import quotas will be phased out by end-2003 and end-2004, respectively.

E. Bank Restructuring

25. **The focus of the bank reform effort will now shift to ensuring proper governance of the remaining banks.** With the closure of the four large insolvent banks—which represents major progress toward cleaning up the banking system—the next steps in bank reform will involve the strengthening of bank supervision and strict enforcement of prudential rules and regulations with a view to improving bank management and further enhancing the financial position of the banking system. Out of 47 remaining banks, further action is needed in terms of resolving the remaining banks under the control of Bank Rehabilitation Agency (BRA) and under NBY administration or enhanced supervision (with a decision on these banks expected by end-June 2002, to be monitored as a structural benchmark), and following up on the banks that were required to increase their capital to comply with new stricter prudential regulations. Prudential regulations in line with international standards will be introduced following the expected adoption of the new Law on the National Bank and amendments to the Law on Banks in the coming months(to be monitored as a structural benchmark). IAS-based financial statements of the NBY will be published by end-June 2002, while the Accounting Law is expected to be amended by end-September 2002 to adopt IAS as the permanent accounting framework of all financial institutions (to be monitored as structural benchmarks). The government and the NBY are elaborating plans to accelerate the privatization of banks—including the recently established National Savings Bank—and the physical assets of the bank liquidation estates. In addition, to underpin the soundness of the banking system in the aftermath of the January bank

closures, the state and state-owned entities will no longer contribute capital to banks. In Montenegro, legislation will be adopted to empower Central Bank of Montenegro to supervise the existing offshore banks in line with the rules and regulations applicable to onshore banks (to be monitored as a structural benchmark). In addition, a decision on the resolution of Montenegro Banka, Jugobanka ad Podgorica, and Beranska Banka that is yet to be relicensed will be taken by end-May and will not involve direct or indirect fiscal resources except for appropriate social programs (to be monitored as a structural benchmark).

F. Enterprise Restructuring and Privatization

26. **In parallel with policies to enhance the efficiency of the state and socially-owned enterprise sector, appropriate legal and institutional structures will be put in place to allow the economy to grow.** The problems of socially and state-owned enterprises will be addressed through the privatization of entire companies, the reorganization of some companies prior to privatization, liquidations leading to sales of assets, and workouts to extract viable business lines from failing firms. In addition, the business environment will be improved by removing bureaucratic obstacles to the entry and growth of new private firms, developing supporting institutions, and improving access to capital.

27. **Building on the institutional framework that was established in 2001, privatization and restructuring of socially and state-owned enterprises in Serbia will gain momentum during the EA period.** Over the EA period, the Privatization Agency will offer for sale through international tenders some 100 large socially-owned enterprises that are considered to be viable, with technical assistance from the World Bank. Procedures are well advanced for some 27 of these enterprises, which are expected to be sold during 2002. As regards the bulk of the other socially-owned enterprises (over 4,000), these are envisaged, under the existing law, to initiate their own privatization under the supervision of the Privatization Agency and have been given incentives (in terms of cost-free allocation of shares to employees) to complete their privatization by mid-2005. Even so, a large number of these enterprises are nonviable, pointing to the need for strengthening bankruptcy procedures to facilitate restructuring. With World Bank technical assistance, the bankruptcy law will be amended by end-2002 to allow for privatization through bankruptcy of socially-owned enterprises and facilitate implementation of the amended law. Some 40 conglomerates will be restructured prior to privatization, starting with 6 conglomerates during 2002 and all conglomerates by 2004.

28. **Montenegro has relied on a Mass Voucher Privatization Plan (MVP) for minority stakes in selected enterprises as well as tenders and auctions for majority stakes in enterprises with a view to attracting strategic investors.** The MVP was completed in late 2001 when vouchers were distributed to all citizens and widespread share ownership was established. During 2002, sales of shares in selected companies to strategic investors are expected to raise at least some Euro 25 million in revenue.

29. **The business environment will be further improved.** Some progress has already been made through the adoption of a labor law that liberalizes employment contracts and wage determination, a simplification of the tax system, and a reduction of the rate of wage

taxation to encourage official rather than informal employment. The web of regulations hindering business activities is being addressed through a process of eliciting public comments on existing and new public policy initiatives that is coordinated by the Serbian Ministry of International Economic Relations. In addition, with World Bank support, envisaged legal and regulatory changes will provide better incentives for financial institutions to finance the private sector. These include a reform of collateral laws and the establishment of a collateral registry. Montenegro has liberal business registration procedures, and future efforts will focus on improving the overall business environment, including through the envisaged liberalization of the labor market.

III. Program Monitoring

30. Policy performance under the EA will be monitored on the basis of the quarterly quantitative performance criteria and indicative targets that have been employed under the current stand-by arrangement (Annex A). In addition, the performance criterion for domestic government borrowing at the FRY level will be supplemented by indicative targets for the consolidated governments of each of the two republics. Progress in structural reform will be monitored through structural performance criteria and benchmarks on some key policy measures (Annex B). For 2002, performance criteria and structural benchmarks are proposed for end-June, end-September and end-December.

31. There will be six reviews under the arrangement at approximately six-month intervals. All reviews will include a focus on progress in implementing structural reforms, especially in the bank and enterprise sectors, and on financing assurances. The first, third and fifth reviews will hinge upon reaching understandings on the annual budgets and financial programs for 2003, 2004 and 2005, respectively. A schedule of structural reforms will be included on an annual rolling basis.

Annex A.1. Federal Republic of Yugoslavia: Quantitative Performance Criteria and Indicative Limits for 2002 Under the 2001-2002 Stand-By Arrangement 1/

(In millions of dinars, unless otherwise noted)

	2000	2001									
	End-Dec.	End-Mar.	End-June		End-Sep. Target			End-Dec. Target			
	Actual		Target	Actual	Original	First Review	Actual	Original	First Review	Second Review	Actual
A. Quantitative performance criteria											
Floor on the net foreign assets of the NBY 2/	-309	-231	-283	-170	-303	-255	-98	-283	-244	-103	-2
Ceiling on net domestic assets of the NBY 3/	39,347	34,289	39,064	35,770	41,766	43,185	35,508	42,909	44,328	41,351	39,804
Ceiling on net credit of the banking system to the consolidated general government 4/ 5/	3,373	88	5,373	122	7,373	8,792	2,018	7,373	8,792	8,792	3,022
Ceiling on contracting or guaranteeing of new nonconcessional external debt with original maturity of more than one year by the public sector 2/ 6/	...	0.0	0.0	7.3	0.0	57.3	7.3	0.0	57.3	57.3	57.3
Ceiling on new external debt owed by the consolidated general government or guaranteed by the public sector with an original maturity of up to and including one year 2/ 7/	...	0	0	0	0	0	0	0	0	0	0
Ceiling on new guarantees and the assumption of enterprise debt to banks by the public sector 8/	...	0	0	0	0	0	6	0	0	6	6
Ceiling on outstanding external debt service arrears 2/ 9/	...	0	0	0	0	0	0	0	0	0	0
B. Indicative targets											
Ceiling on net domestic assets of the banking system 10/	19,464	38,238	46,214	40,122	51,255	52,228	46,000	52,807	54,398	58,822	50,531
Ceiling on change in the arrears of											
the federal government	...	-507	0	-1,082	0	0	-3,469	0	0	-3,469	-4,434
the consolidated general government in Serbia	...	1,095	0	786	0	0	294	0	0	294	-175
the consolidated general government in Montenegro	...	0	0	382	0	0	700	0	0	0	0
Ceiling on the wage bill of the 8 largest public enterprises, cumulative from beginning of year 11/	9,992	4,318	8,756	8,378 12/	13,207	13,355	13,030	17,658	18,251	18,251	18,310

1/ Quantitative performance criteria and indicative targets are defined in Annex C of the Revised Memorandum of Economic and Financial Policies of September 4, 2001. Appendix IV of EBS/01/154, 9/5/01). Contrary to the definition of debt contained on page 61 of that document, the term debt for the purposes of the end-December 2001 performance criterion on external debt will exclude debt contracted in the context of rescheduling agreements.

2/ In millions of U.S. dollars.

3/ The revised targets for September and December will be monitored based on monthly averages as defined in Annex C in the Appendix IV of EBS/01/154, 9/5/01.

4/ For program purposes, the ceilings on net credit of the banking system to the consolidated general government will be adjusted downward by the cumulative increase in the stock of government debt held by the nonbank public, starting from January 1, 2001, and upward for any decrease. The ceilings will also be adjusted fully to the revision of end-2000 net deposits of the Montenegro consolidated government in the banking system of YUD 2544.

5/ The consolidated general government comprises the federal, the Serbian republican and local governments, the Montenegrin republican. government, the Serbian and Montenegrin social security funds, and the Serbian special extrabudgetary programs.

6/ Excluding loans from the IMF, EBRD, EIB, IBRD, or IFC as well as debt contracted in the context of rescheduling agreements. The public sector comprises the consolidated general government and the National Bank of Yugoslavia. The increase of $50 million for end-Sept. and end Dec. ceilings represents anticipated borrowing by the Serbian governments under relatively favorable terms to rehabilitate the ailing energy sector.

7/ Excluding normal import-related credits.

8/ Excluded is indebtedness arising from the fulfillment of existing guarantees.

9/ Excludes debts subject to rescheduling/negotiations. The nonaccumulation of new external arrears is also a continuous performance criterion.

10/ Foreign currency denominated loans and deposits at program exchange rates. Excludes Montenegro.

11/ JP Elektroprivreda Srbije, JP Nafna Industrija Srbije, JP PTT Srbije, JP Jugoslovenski Aerotransport, JP Zelenicko Transportno Preduzece Srbije, JP Radio Televizija Srbije, JP Srbija Sume, and JP Srbija Vode. Wage bill ceilings are consistent with nominal wages being maintained throughout the year at their January 2001 level, in accordance with the *Decree on the Level of Wages and Other Earnings in Public Enterprises, Official Gazette, 110/01.*

12/ Includes wage payments for YAT of YUD 81.3 million that were deferred from June to July.

Annex A.2. Federal Republic of Yugoslavia: Quantitative Performance Criteria and Indicative Limits for 2002 Under the 2002-2005 Extended Arrangement 1/

(In millions of dinars, unless otherwise noted)

	2001	2002			
	Actual	March (Proj.)	June	Sep.	Dec.
A. Quantitative performance criteria					
Floor on the net foreign assets of the NBY 2/	582	622	660	697	735
Ceiling on net domestic assets of the NBY 3/	1,734	2,871	4,144	5,484	6,756
Ceiling on net credit of the banking system to the consolidated general government 4/ 5/	1,603	-1,715	-912	2,896	6,096
Ceiling on contracting or guaranteeing by the public sector of new nonconcessional external debt with original maturity of more than one year 2/ 6/	...	0	0	0	0
Ceiling on new external debt contracted or guaranteed by the public sector with an original maturity of up to and including one year 2/ 7/	...	0	0	0	0
Ceiling on new guarantees and the assumption of enterprise debt to banks by the public sector 8/	...	0	0	0	0
Ceiling on outstanding external debt service arrears 2/ 9/	...	0	0	0	0
B. Indicative targets					
Ceiling on net credit of the banking system to					
consolidated general government of Serbia 4/ 10/	225	-3,246	-2,717	2,312	5,741
consolidated general government of Montenegro 4/ 10/	1,378	1,530	1,805	584	355
Ceiling on net domestic assets of the banking system 11/	18,895	33,335	39,266	41,415	40,515
Ceiling on change in the arrears of					
the federal government	...	0	0	0	0
the consolidated general government in Serbia	...	0	0	0	0
the consolidated general government in Montenegro	...	0	0	0	0
Ceiling on the wage bill of the 8 largest public enterprises, cumulative from beginning of year 12/	18,310	5,492	11,163	17,021	23,070

1/ Quantitative performance criteria and indicative targets are defined in Annex D.

2/ In millions of U.S. dollars.

3/ Monitored on the basis of monthly averages as defined in Annex D.

4/ For program purposes, the ceilings on net credit of the banking system to the consolidated general government will be adjusted downward by the cumulative increase in the stock of government debt held by the nonbank domestic public, starting from January 1, 2002, and upward for any decrease. The ceilings will also be adjusted fully to the revision of end-2001 figures. In addition, in the event of a budgetary foreign financing shortfall (excess), which is not offset by higher (lower) than budgeted privatization revenue, of up to YUD 5 billion, the ceilings for Serbia will be adjusted upward (downward) by 50% of the amount of the shortfall (excess). For Montenegro, in the case of a budgetary foreign financing shortfall (excess), which is not offset by higher (lower) than budgeted privatization revenue, of up to US$10 million, the ceilings for Montenegro will be adjusted upward (downward) by 50% of the amount of the shortfall (excess).

5/ The consolidated general government comprises the federal, the Serbian republican and local governments, the Montenegrin republican government, the Serbian and Montenegrin social security funds, and the Serbian special extrabudgetary programs.

6/ Excluding loans from the IMF, EBRD, EIB, EU, IBRD, or IFC as well as debt contracted in the context of restructuring agreements. The public sector comprises the consolidated general government and the National Bank of Yugoslavia.

7/ Excluding normal import-related credits.

8/ Excluded is indebtedness arising from the fulfillment of existing guarantees.

9/ Excludes debts subject to restructuring/negotiations. The nonaccumulation of new external arrears is also a continuous performance criterion.

10/ Consolidated Montenegrin government includes all entities in Montenegro defined under footnote 5/, the rest of entities under footnote 5/ is included in the consolidated Serbian government.

11/ Foreign-currency denominated loans and deposits at program exchange rates. Excludes Montenegro.

12/ JP Elektroprivreda Srbije, JP Nafna Industrija Srbije, JP PTT Srbije, JP Jugoslovenski Aerotransport, JP Zelenicko Transportno Preduzece Srbije, JP Radio Televizija Srbije, JP Srbija Sume, and JP Srbija Vode.

Annex B-1: Federal Republic of Yugoslavia: Stand-By Arrangement, May 2001-March 2002 Remaining Structural Benchmarks

	Implementation Date Reported in EBS/01/216	Status/revised implementation date
A. Fiscal Sector		
1. (Serbia) Submission of the Organic Budget Law and the Public Procurement Law to parliament	end-December 2001	Implemented
2. (Montenegro) De-linking of the statutory minimum wage from public sector pay and social benefits levels through legislation.	end-December 2001	Implemented
3. (Serbia) Establishment of a Central Accounting Division in the Ministry of Finance and Economy.	end-December 2001	[...]
4. (Serbia) Establishment of a new system of commitment control based in the Treasury's Central Accounting Division.	end-December 2001	[...]
5. (Serbia) Set-up of a Large Taxpayer Office in Belgrade.	end-December 2001	end-June 2002
6. (Federation and Serbia) Adoption of pension reform legislation, providing for an immediate increase in retirement age by [3] years and indexation of pension to the arithmetic average of price and wage increases.	end-December 2001	Implemented
7. (Serbia) Submission of the Tobacco Law and the Lottery Law to parliament	end-January 2001	Implemented
8. (Serbia) Submission of a new law on tax assessment and collection to parliament.	mid-February 2002	end-June 2002
B. Financial Sector		
1. (Montenegro) The CBM will decide on the resolution (liquidation, rehabilitation, mergers, no action) of all banks.	mid-December 2002	Implemented
2. (Federation) The NBY will take a decision: (i) to address the accounting treatment of unresolved succession issues, (ii) for financial year 2001, to prepare financial statements on the basis of International Accounting Standards (IAS), and (iii) to adopt IAS as its permanent accounting framework, effective with the 2003 financial year.	end-December 2001	Implemented
3. (Federation) The Internal Audit Department of the NBY, as part of its regular audit cycle, will review the reconciliation of the accounting records and the NFA data submitted to the Fund for program purposes on a monthly basis, effective with the end-December 2001 data. In addition, the NBY will strengthen the functioning of the Internal Audit Department by: (i) defining its role with the development of a charter and ensuring an appropriate degree of independence and objectivity; (ii) continuing to recruit additional staff with skill levels necessary to successfully conduct financial and information systems risk-based audits; and (iii) commissioning an independent assessment of the Internal Audit Department.	mid-February 2002	Implemented

Annex B-1: Federal Republic of Yugoslavia: Stand-By Arrangement, May 2001-March 2002
Remaining Structural Benchmarks

	Implementation Date Reported in EBS/01/216	Status/revised implementation date
C. Private Sector Development		
1. (Serbia) Conclusion of at least four contracts for the privatization of pools of companies (of 3-5 enterprises each) with investment banks hired through competitive international tenders (out of a total of seven pools for which international advisors will be solicited this year).	end-December 2001	Implemented
2. (Federation and Serbia) Request for the opinion of the Supreme Court on a draft memorandum of understanding between the Privatization Agency and the Bank Restructuring Agency.	end-December 2001	Implemented (Referred to lower courts.)
3. (Serbia) Adoption of a new labor law to liberalize the labor market.	end-December 2001	Implemented
4. (Serbia) Appoint advisors for the privatization of 2 pools comprising a total of 12 companies.	January 15, 2002	Implemented February 2002
5. (Serbia) Offer of at least one pool of companies consisting of 3-5 enterprises for sale observing well defined, internationally accepted tender rules.	end-February 2002	[...]
6. (Serbia) Offer at least 2 pools of companies consisting of 3-5 enterprises for sale observing well defined, internationally accepted tender rules	End-March, 2002	[...]

Annex B.2. Federal Republic of Yugoslavia: Extended Arrangement, March 2002-March 2005
Prior Actions, Structural Performance Criteria, and Structural Benchmarks, March 2002-March 2003

	Proposed implementation date
I. Prior Action for Board Consideration	
Federation: Submission to federal Parliament of proposed new Foreign Exchange Law and completion of draft implementing regulations consistent with the key principles described in the MEFP of April 26, 2002	
II. Structural Performance Criteria	
Serbia: Increase electricity prices by 50 percent on average.	end-June 2002
Federation: Effective January 1, 2003, permit commercial banks to initiate and settle payments among themselves on behalf of enterprises and individuals without the mandatory intermediation of ZOP.	end-December 2002
III. Structural Benchmarks	
A. Fiscal Sector	
1. Serbia: Establish a Large Taxpayers Unit in the Belgrade office.	end-June 2002
2. Serbia: Adopt the Law on Tax Administration organization and the Law on Identification, Control and Payment of Public Revenue.	end-June 2002
3. Serbia: Establish a Treasury in the Ministry of Finance with basic core functions in cash and debt management.	end-September 2002
4. Serbia: Create a unified taxpayer identification number.	end-December 2002
5. Montenegro: Adopt a pension law that shifts pension indexation to the Swiss formula (arithmetic average of wage and price increases) and raises the minimum retirement age by 3 to 5 years in a phased manner.	end-December 2002
B. Financial Sector	
1. Montenegro: Adopt legislation to empower CBM to supervise the existing offshore banks in line with the rules and regulations applicable to onshore banks.	end-April 2002
2. Montenegro: Adopt final decision on the resolution of Montenegro Banka and Jugobanka ad Podgorica, as well as Beranska Banka that is yet to be re-licensed without direct or indirect fiscal resources except for appropriate social programs.	end-May 2002
3. Federation: Adopt a new Law on the National Bank of Yugoslavia to provide for a NBY Supervisory Board and amend the Law on Banks and Other Financial Institutions and establish a regulatory framework in line with international standards.	end- June 2002
4. Federation: Publish IAS-based financial statements of the NBY.	end-June 2002
5. Federation: Submit draft Law on Securities Market to Parliament.	end-June 2002
6. Federation: Decide on (a) privatization plans for banks under NBY enhanced supervision and administration and (b) resolution plans for banks under control of the BRA.	end-June 2002
7. Federation: Amend the Accounting Law to adopt IAS as the permanent accounting framework of all financial institutions, including the NBY.	end-September 2002

Federal Republic of Yugoslavia: Summary and Timetable for Potential Structural Measures Under the Extended Arrangement-Supported Program, 2002-2005[1]

Policy Area	Objectives and Targets	Selected Strategies and Measures	Implementation	Lead Agency Technical Assistance	National Agency Responsible
1. Fiscal Sector					
1.1 Fiscal transparency	(a) Broaden the coverage of government	(1) (F, S, M) Bring all extrabudgetary funds—notably the social security fund—into the annual budgetary preparation and approval process.	2003-04	IMF/World Bank (F, S) EAR, USAID (M)	Federal, Serbian, and Montenegrin MoF
	(b) Strengthen internal audit of budget	(1) (F, S, M) Set up an internal audit office and prepare a plan for annual audits.	2003	IMF/World Bank/ Bilateral Donors	Federal, Serbian and Montenegrin MoF
		(2) (F, S, M) Issue internal audit manuals and standards and complete internal audit.	2004		
	(c) Improve fiscal reporting	(1) (F, S) Reconcile monetary and fiscal data on budget financing.	2002 (April)	IMF/World Bank	Federal and Serbian MoF
		(2) (F, S, M) Establish a GFS-consistent fiscal reporting system from all levels of general government.	2002-2004		Federal, Serbian, and Montenegrin MoF
1.2 Tax policy	(a) Improve the efficiency of the tax system by broadening the tax base and, as appropriate, reducing tax rates	(1) (F, S, M) Decide on how to resolve the issue of inter-republic trade relations regarding customs, excises, and VAT.	2002 (June)	IMF	Federal, Serbian and Montenegrin MoF
		(2) (S) Further reduce substantially the financial transactions tax.	2003 (January)		Serbia and Montenegro MoF
		(3) (M) Eliminate most of the exemptions introduced in the six laws on direct and indirect taxes adopted in 2002.	2003-2005		Montenegro MoF
		(4) (S) Convert the schedular personal income tax to a global tax and reform corporate income tax	2005		Serbian MoF

[1] Please note that *italicized* measures are proposed to be designated as structural performance criteria or structural benchmarks under the envisaged Extended Arrangement

Federal Republic of Yugoslavia: Summary and Timetable for Potential Structural Measures Under the Extended Arrangement-Supported Program, 2002-2005[1]

Policy Area	Objectives and Targets	Selected Strategies and Measures	Implementation	Lead Agency Technical Assistance	National Agency Responsible
1.3 Tax administration	(a) Modernize tax administration to improve collection and compliance while reducing compliance costs	(1) (S) Secure financing for PRA modernization projects.	2002 (May)	IMF/bilateral donors	Serbian PRA
		(2) (S, M) Introduce new guidelines to simplify tax administration procedures, including those in assessment and payment, taxpayer services, and compliance control.	2002 (December)		Serbian and Montenegrin PRA
		(3) *(S) Adopt the law on tax administration organization and the law on tax administration procedures.*	2002 (end-June)		Serbian PRA and MoF
		(4) (S) Create a unified taxpayer identification number.	*2002 (December)*		Serbian PRA
		(5) (M) Prepare for the implementation of new laws on personal income tax, excises, property tax, and corporate income tax	2002		Montenegrin PRA
		(6) (S, M) Establish LTUs in Belgrade and regional offices. • *Belgrade office*	2002-2003 *2002 (June)*		Serbian and Montenegrin PRA
		(7) (S, M) Introduce a VAT.	Montenegro 2003 (January); Serbia 2004 (January)		Serbia and Montenegro PRA
1.4 Public expenditure	(a) Strengthen government financial management and capacity for budget planning, preparation and execution	*(1) (S) Establish a Treasury within MoF with cash and debt management functions.*	*2002 (September)*	World Bank/US Treasury and other bilateral donors	Serbian MoF
		(2) (S, M) Reorganize MoF and strengthen capacity along functional lines corresponding to its mandate and responsibilities .	2002-2004		Serbia and Montenegro MoF

Federal Republic of Yugoslavia: Summary and Timetable for Potential Structural Measures Under the Extended Arrangement-Supported Program, 2002-2005[1]

Policy Area	Objectives and Targets	Selected Strategies and Measures	Implementation	Lead Agency/ Technical Assistance	National Agency Responsible
		(3) (S, M) Develop fiscal and budget planning functions and build capacity for policy analysis.	2002 (late) - 2004 (early)		Serbia and Montenegro MoF
		(4) (S, M) Establish a Centralized Accounting Division; develop comprehensive accounting of budget operations.	2003 (March)		Serbia and Montenegro MoF
		(5) (M) Establish debt management capacity.	2003 (early)		Montenegro MoF
		(6) (S, M) Establish a system of commitment control, unify system of making payments, and strengthen control processes and procedures.	2003 (mid)		Serbia and Montenegro MoF
	(b) Civil service reform	(1) (F, S) Reduce overlap between federal and republic agencies and activities.	2002 (mid)-2004	World Bank	Federal and Republican Governments
		(2) (F, S, M) Downsize public sector employment and reform the public sector pay scale.	2003 - 2004		
	(c) Repay frozen foreign currency deposits in a fiscally sustainable manner	(F, S) Amend the law that guides the repayment of frozen forex deposits so as to ?? contain total repayments of such deposits—including debt service on bonds that will be issued to repay the foreign exchange deposits exceeding DM 10,000—to the equivalent of 0.9 percent of GDP in 2005-2010 and 1 percent thereafter.	2002 (June)	IMF	NBY, Federal and Serbian MoF
2. Social Security					
2.1 Social welfare	(a) Improve equity, targeting, and administration of social welfare provision	(1) (S) Means-test the third-child allowance, i.e., grant on the same basis as the allowance for the first two children.	2002 (June)	World Bank	Serbian Ministry of Social Affairs, and Ministry of Labor
		(2) (S) De-link child allowance from the average wage.	2002 (June)		

Federal Republic of Yugoslavia: Summary and Timetable for Potential Structural Measures Under the Extended Arrangement-Supported Program, 2002-2005[1]

Policy Area	Objectives and Targets	Selected Strategies and Measures	Implementation	Lead Agency Technical Assistance	National Agency Responsible
		(3) (S) Design a Serbia-wide comprehensive welfare provision framework with unified eligibility criteria and standardized approval procedures.	2004		
2.2 Pensions	(a) Reform the pension system to improve long-term financial viability and facilitate a lowering of payroll taxes	(1) (F, S, M) Modify the benefit formula to improve the link between contributions and benefits, and make redistribution more transparent and consistent with available resources. (Specifically, benefits will be based on lifetime wage history instead of the best 10 years.)	2002 (late)-2003 (early)	World Bank	Federal and Republican governments, and Ministry of Social Affairs in Serbia.
		(2) (F, S, M) Redesign and tighten eligibility requirements for disability pensions.	2003 (February)		Serbian and Montenegrin govts. & Ministry of Social Affairs
		(3) (F, S) Assess the need for further measures to strengthen the financial position of the pension fund.	2003-2004		Federal government and Serbian MOF
		(4) (M) Increase the minimum retirement age in a phased manner by 3 to 5 years.	*2003 (January)*		Montenegrin government
		(5) (M) Change the indexation formula to the arithmetic average of price and wage increases (the Swiss model).	2003 (January)		Montenegrin government
2.3 Health	(a) Rationalize and provide cost-effective public health services	(1) (S, M) Improve commitment and spending control by redefining the criteria for contracting medical services, redesigning the drug prescription form to reduce fraud, and adjust the positive drug list to minimize costs.	(S) 2002 (September) (M) 2003	World Bank	Serbian and Montenegrin Health Fund
		(2) (F, S, M) Draft new laws on health insurance, healthcare provision and on pharmaceuticals, to reduce overlap, clarify roles of the public health institutions, and to set a framework for more	(F,S) 2002 (December) (M) 2003		Ministry of Health, Health Fund in Serbia and Montenegro

Federal Republic of Yugoslavia: Summary and Timetable for Potential Structural Measures Under the Extended Arrangement-Supported Program, 2002-2005[1]

Policy Area	Objectives and Targets	Selected Strategies and Measures	Implementation	Lead Agency Technical Assistance	National Agency Responsible
		efficient public health system.			
		(3) (S) Eliminate excess capacity, duplication, and other structural problems with the delivery system.	2003-2004		Serbian Ministry of Health, and Health Fund
3. Financial Sector					
3.1 Monetary instruments	(a) Improve monetary policymaking	(1) (F) Reform the reserve requirement by extending the reserve base to foreign exchange deposits (other than individuals' foreign exchange deposits accumulated since July 1, 2001), while holding foreign exchange reserves against foreign exchange deposits, lowering the reserve ratio, and adopting monthly averaging.	2002 (March)	IMF	NBY
		(2) (F) Create a formal body within NBY (monetary policy committee) that sets the monetary policy.	2002 (June)	IMF	NBY
		(3) (F) Unify the reserve requirement by extending the reserve base to all foreign exchange deposits.	2003	IMF	NBY
3.2 Foreign exchange market	(a) Liberalize foreign exchange market	*(1) (F) Pass a new Foreign Exchange Law and implement associated by-laws to remove all restrictions on payments and transfers for current international transactions consistent with Article VIII of the Fund's Articles of Agreement, liberalize capital transactions with the exception of investing and lending abroad and short-term capital movements; allow banks to conduct foreign exchange operations on their own account; repeal surrender requirements for banknotes; permit legal persons to trade freely outside the interbank market; and regulate banks' short-term foreign exchange liabilities and open positions.*	*2002 (May)*	IMF	NBY/Federal MOF

Federal Republic of Yugoslavia: Summary and Timetable for Potential Structural Measures Under the Extended Arrangement-Supported Program, 2002-2005[1]

Policy Area	Objectives and Targets	Selected Strategies and Measures	Implementation	Lead Agency Technical Assistance	National Agency Responsible
3.3 Payment system	(a) Upgrade payments system to international standards	(1) (F) Reduce the price of payment services and adjust pricing (currently an amount-based tariff) to better reflect actual per-transaction processing costs.	2002 (May)	IMF	NBY
		(2) (F) Approve by-laws for RTGS & GCC.	2002 (April)	IMF	NBY
		(3) (F) Finalize the strategy for dividing the functions of ZOP between the Ministry of Finance (treasury), Public Revenue Agency (tax collection), NBY (payments) and new private organizations.	2002 (June)	IMF	NBY, Serbian MoF
		(4) (F) Restructure NBY internal organization by creating a Payment System Department in the NBY (comparable to other central banks) and shifting dedicated technical support for PLATNET, RTGS, GCC, and other payment-related services from ZOP to the NBY.	2002 (June)	IMF	NBY
		(5) (F,S) Have in place laws and regulations to allow the operation of a modern payments system. Permit commercial banks to initiate and settle payments among themselves on behalf of enterprises and individuals without the mandatory intermediation of ZOP or any other agency.	*2003 (January)*	IMF	NBY, Serbian MoF
		(6) (F) Privatize retail services of ZOP (e.g. foreign exchange bureaus, IT services for NSB)	2003	IMF	NBY
3.4 Central bank structure and organization	(a) Strengthen internal audit and accounting	*(1) (F) Strengthen the Internal Audit Department and commission an independent assessment of the department.*	*2002 (March)*	IMF	NBY
		(2) (M) Prepare consolidated Central Bank of Montenegro balance sheet incorporating all ZOP (internal and external) and Central Bank accounts based on IAS.	2002 (March)	USAID	CBM

Federal Republic of Yugoslavia: Summary and Timetable for Potential Structural Measures Under the Extended Arrangement-Supported Program, 2002-2005[1]

Policy Area	Objectives and Targets	Selected Strategies and Measures	Implementation	Lead Agency Technical Assistance	National Agency Responsible
		(3) (F) Adopt the new Law on the National Bank of Yugoslavia to provide for a Supervisory Board.	*2002 (June)*	IMF	NBY
		(4) (F) Amend the Accounting Law to adopt the IAS as the permanent accounting framework for all financial institutions, including the NBY.	*2002(September)*	World Bank IMF	Federal MoF
		(5) (F) Publish IAS-based financial statements of the NBY.	*2002 (June)*	IMF	NBY
		(6) (M) Prepare IAS-based audited financial statements of the Central Bank of Montenegro incorporating all ZOP accounts.	2002 (May)	IMF	CBM
3.5 Banking supervision	(a) Ensure soundness of banking system	(1) (M) Through legislation, empower CBM to supervise the existing offshore banks in line with the rules and regulations applicable to onshore banks.	2002 (May)	IMF, USAID	CBM/MOF of Montenegro
		(2) (F) Prepare a comprehensive Supervisory Development Plan outlining medium- to long-term objectives, and legislative and institutional changes necessary to achieve these objectives.	2002 (April)	World Bank, USAID	NBY
		(3) (F) Adopt the new Law on the National Bank of Yugoslavia and amendments to the Law on Banks and Other Financial Institutions to establish a regulatory framework in line with international standards.	*2002 (June)*	IMF, World Bank	NBY
		(4) (F) Introduce prudential regulations covering capital adequacy, large credit exposures, exchange rate risk, liquidity, lending to connected parties and shareholders, loan classification and provisioning, internal control and audit functions, risk management, credit activities, and investment in	2002 (June)	IMF, World Bank, Bundesbank	NBY

Federal Republic of Yugoslavia: Summary and Timetable for Potential Structural Measures Under the Extended Arrangement-Supported Program, 2002-2005[1]

Policy Area	Objectives and Targets	Selected Strategies and Measures	Implementation	Lead Agency Technical Assistance	National Agency Responsible
		fixed assets as well as other bank and enterprise capital.			
		(5) (M) Adopt the Law on Anti-Money Laundering and issue supporting regulations.	2002 (June)	IMF	CBM/MOF of Montenegro
		(6) (F) Implement regulations governing reporting by financial institutions of suspicious and/or large cash transactions, and defining responsibilities of the NBY, in line with the Law on Anti-Money Laundering.	2002 (July)	IMF, World Bank, Bundesbank, USAID	NBY
3.6 Bank restructuring	(a) Establish a competitive banking system	*(1) (M) Adopt final decisions on the resolution of Montenegro Banka, Jugobanka and Podgorica, and Beranska Banka without direct or indirect fiscal resources except for appropriate social programs.*	*2002 (May)*		CBM
		(2) (F) Decide on(a) privatization plans for banks under NBY enhanced supervision and administration and (b) resolution of banks under control of the BRA.	*2002 (June)*		NBY
3.7 Non-bank financial sector	(a) Developing financial markets	(1) (M) Adopt the Law on Secured Transactions.	2002 (July)	World Bank/USAID	MOF/CBM
		(2) (F) Adopt a Federal Law on Secured Transactions and regulations on a Pledge Registry.	2002 (September)	World Bank, EBRD, USAID	Federal Ministry of Justice
		(3) (F) Enact Law on Securities Market	*2002 (June)*	IMF	NBY/Federal MoF
		(4) (F) Enact Law on Investment Funds	*2002 (December)*	IMF	NBY/Federal MoF
		(5) (F) Adopt legislation to eliminate restrictions on leasing operations.	2002 (December)	World Bank	Federal Min. of Justice & Center for Legal Reform under Serbian MIER

Federal Republic of Yugoslavia: Summary and Timetable for Potential Structural Measures Under the Extended Arrangement-Supported Program, 2002-2005[1]

Policy Area	Objectives and Targets	Selected Strategies and Measures	Implementation	Lead Agency Technical Assistance	National Agency Responsible
4. Private Sector Development					
4.1 Enterprise privatization	(a) Expedite privatization through tenders	(1) (S) Privatize some 100 large socially-owned companies through tender procedures:	2002-2005	World Bank	Serbian Ministry of Privatization/ Privatization Agency
		• Launch competitive investment tenders for at least 4 groups of the six World Bank pools.	2002 (June)	World Bank	
		• Launch competitive investment tenders for one more group of the World Bank pools.	2002 (September)	World Bank	
		• Launch competitive investment tenders for the last groups of the World Bank pools.	2002 (November)	World Bank	
		• Sign contracts with financial advisors (hired through competitive international tender) for investment tenders for privatization of 20 companies (including Beopetrol, Boza Tomic and sugar factories);	2002 (September)	World Bank/Dutch and Swedish grants	
		• Launch competitive tender for this group of 20 companies.	2003 (February)	World Bank/Dutch and Swedish grants USAID	
		(2) (M) Sell majority shares in companies to *strategic investors through international tenders*	2002-2005		Montenegrin Privatization Council
		• Sell shares in selected companies.	2002		
4.2 Enterprise restructuring	(a) Create viable companies that can be privatized	(1) (S) Restructure some 40 conglomerates prior to privatization under either tender or auction procedures:	2002-2006	World Bank, EAR	Serbian Ministry of Privatization/ Privatization Agency
		• Start implementation of restructuring plans in the first 3 conglomerates;	2002 (October)		
		• Start implementation of restructuring plan in the remaining conglomerates.	2003-04		
4.3 Legal and regulatory framework	(a) Strengthen creditor rights	(1) (F) Implement new bankruptcy law	2002-2003	World Bank	Federal Ministry of Justice/ Serbian Ministry of Privatization
		• draft new law;	2002 (June)		
		• adopt new law;	2002 (December)		
		• establish Bankruptcy Agency to license individual administrators.	2003 (December)		

Federal Republic of Yugoslavia: Summary and Timetable for Potential Structural Measures Under the Extended Arrangement-Supported Program, 2002-2005[1]

Policy Area	Objectives and Targets	Selected Strategies and Measures	Implementation	Lead Agency Technical Assistance	National Agency Responsible
	(b) Development of small and medium-sized enterprises	(F, S) Submit to Parliament proposed amendments to the Federal Enterprise Law and the Republican Law on Private Entrepreneurs to simplify the process of business registration.	2002 (April)	World Bank	Federal and Serbian Ministry of Justice and Ministry of Economy and Privatization
	(c) Liberalize labor market	(M) Adopt a labor law that improves labor market flexibility and brings budgetary commitments associated with labor market programs in line with available resources	2002 May	World Bank	Montenegrin Ministry of Labor
5. Sectoral Policies					
5.1 Energy sector	(a) Establish financial viability	*(1) (S) Increase average electricity price to cost recovery levels by the middle of 2004:*	2002-2004	World Bank	Ministry of Energy and EPS
		• *increase the price to 3 US$ cents per kWh;*	*2002 (June)*		
		• increase the price to 4 US$ cents per kwh;	2003 (June)		
		• increase the price to 4.5 US$ cents per kwh.	2004 (June)		
		(2) (M) Increase the average electricity , excluding KAP, to at least 46 Euro/MWh and reduce cross-subsidies.	2002 (December)	World Bank	Ministry of Energy and the electricity company
	(b) Improve profitability	(S) Contain the growth in the wage bill for electricity companies to no more than the rate of inflation.	2002-2005	IMF/ World Bank	Republican Ministries of Finance and Energy and electricity companies
	(c) Prepare for privatization after completion of the program	(S, M) Design and introduce a legal and institutional framework for an independent energy regulator.	2002-2003	World Bank	Republican Ministries of Energy
6. Trade Policy					
6.1 Merchandise trade	(a) Further liberalize foreign trade regime	(1) (F) Remove import quotas for steel products and export quotas on agricultural products, wood and raw hides:	2002-2004	World Bank	Federal Ministry of Trade

Federal Republic of Yugoslavia: Summary and Timetable for Potential Structural Measures Under the Extended Arrangement-Supported Program, 2002-2005[1]

Policy Area	Objectives and Targets	Selected Strategies and Measures	Implementation	Lead Agency Technical Assistance	National Agency Responsible
		• Eliminate all export quotas; • Eliminate all import quotas.	2003 (December) 2004 (December)		
		(2) (M) Remove import quotas and contingency licenses for agricultural products, iron, and selected household appliances, and export quotas for agricultural products, wood and hides: • Eliminate all export quotas • Eliminate all import quotas	2002-2004 2003 (December) 2004 (December)		Montenegrin Ministry of Trade
7. Statistical issues					
7.1 Collections of statistics	Improve the statistical base for macroeconomic decision-making	(1) (F, S, M) Make a decision with regard to participating in the GDDS, and nominate a GDDS coordinator.	2002 (April)	IMF	The Federal and Republican Statistical Offices
		(2) (F, S, M) Macroeconomic statistics will be reviewed in the context of a multi-sector GDDS mission, as a basis for further technical assistance.	2002-2005	Multi-sector GDDS mission scheduled for July 2002	Federal and Republican Statistical Offices
		(3) (F, S, M) Conduct household survey and poverty assessment.	2002 (December)	World Bank	Republican Ministries of Social Affairs and Federal and Republican Statistical Offices

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Policy Area	Objectives and Targets	Selected Strategies and Measures	Implementation	Lead Agency Technical Assistance	National Agency Responsible

Notes:
F – Federal; S – Serbia; M – Montenegro;
CBM – Central Bank of Montenegro;
EA – Extended Arrangement;
EPS – Electricity company of Serbia.
GCC – Clearing and Settlement Service;
GDDS – Generalized Data Dissemination Standard
IAS – International Accounting Standards;
LTU – Large Tax Payer Unit;
MOF – Ministry of Finance;
NBY – National Bank of Yugoslavia;
PAYG – Pay-as-you-go pension system;
PRA – Public Revenue Agency;
ROSC – Report on Standards and Codes;
RTGS – Real-time Gross Settlement system.

Federal Republic of Yugoslavia: Technical Memorandum of Understanding

I. Introduction

1. This memorandum sets out the understandings regarding the definitions of quantitative and structural performance criteria and benchmarks, as well as indicative targets, for the FRY program for which assistance has been requested in the form of an Extended Arrangement (EA), as well as the related reporting requirements. To monitor developments under the program, the Yugoslav authorities will provide the data listed in each section below to the European 1 Department of the Fund, in accordance with the indicated timing. The quantitative performance criteria and indicative targets will be monitored on the basis of the methodological classification of monetary and financial data that was in place on December 31, 2001, except as noted below. For program purposes, the public sector consists of the consolidated general government (comprising the federal, Serbian Republican and local governments, the Montenegrin Republican government, the Serbian and Montenegrin social security funds, and the Serbian special budgetary programs) and the National Bank of Yugoslavia (NBY). The authorities will inform the Fund staff of any new funds or special extrabudgetary programs that may be created during the program period to carry out operations of a fiscal nature as defined in the IMF's *Manual on Government Financial Statistics,* and will ensure that these will be incorporated within the definition of consolidated general government. Quantitative performance criteria and indicative targets for end-June, end-September and end-December 2002 are specified in Annex A-2 of the Memorandum of Economic and Financial Policies (MEFP).

II. Quantitative Criteria: Definitions and Reporting Standards

A. Floor for Net Foreign Assets of the NBY

2. **Definition.** Net foreign assets (NFA) of the NBY consists of foreign reserve assets minus foreign reserve liabilities.

- For purposes of the program, **foreign reserve assets** shall be defined as monetary gold, holdings of SDRs, the reserve position in the IMF, and NBY holdings of foreign exchange in convertible currencies. Any such assets shall only be included as foreign reserve assets if they are under the effective control of, and readily available to, the NBY. In particular, excluded from foreign reserve assets are: frozen assets of the Federal Republic of Yugoslavia (FRY), undivided assets of the Socialist Federal Republic of Yugoslavia (SFRY), long-term assets, NBY claims on resident banks and nonbanks, as well as Yugoslav commercial banks located abroad, any assets in nonconvertible currencies, encumbered reserve assets pledged as collateral for foreign loans, reserve assets pledged through forward contracts, and precious metals other than gold. Monetary gold shall be valued at an accounting price of US$277.50 per ounce, and SDRs at SDR1 = US$1.25447 based on gold prices and exchange rates prevailing on December 31, 2001. On December 31, 2001 the NBY's foreign reserve assets as defined above amounted to US$ 1,169 million, including gold valued at US$164.5 million.

- For purposes of the program, **foreign reserve liabilities** shall be defined as any short-term loan or deposit (with a maturity of up to and including one year), swaps (including any portion of the NBY gold that is collateralized), and forward liabilities of the NBY—in convertible currencies to residents and nonresidents; IMF purchases; and loans contracted by the NBY after December 31, 2001 from international capital markets, foreign banks or other financial institutions, and foreign governments, irrespective of their maturity. Undivided foreign exchange liabilities of SFRY are excluded. On December 31, 2001, the NBY's foreign reserve liabilities, as defined above, to nonresidents were US$272 million and to residents were US$302 million.

- All assets and liabilities denominated in convertible currencies other than the U.S. dollar shall be converted at their respective exchange rates against the U.S. dollar prevailing on December 29, 2001. All changes of definition or valuation of assets or liabilities, as well as details of operations concerning sales, purchases or swap operations with respect to gold shall be communicated to the Fund staff within one week of the operation.

3. **Reporting.** Data on foreign reserve assets and foreign reserve liabilities of the NBY shall be transmitted to the European 1 Department of the Fund on a weekly basis within four business days of the end of each business week. To facilitate program monitoring, the NBY will provide the data at the indicated constant prices and exchange rates, as well as at current exchange rates (Annex A). The NBY will report if any of the reported foreign reserve assets are illiquid or pledged, swapped, or encumbered.

4. **Adjusters**. For program purposes the reported net foreign assets will be adjusted downward pari passu to the extent that: (i) since January 1, 2002, the NBY has recovered frozen assets of the FRY, assets of the SFRY, long-term assets, and foreign-exchange-denominated claims on resident banks and nonbanks, as well as Yugoslav commercial banks abroad; and (ii) the restructuring of the banking sector by the Bank Restructuring Agency (BRA) involves a decline in NBY foreign-exchange-denominated liabilities to resident banks.

B. Ceiling on Net Domestic Assets of the NBY

5. **Definition.** For purposes of the program, net domestic assets (NDA) of the NBY are monitored on a monthly average basis and defined as the difference between reserve money (as defined in section E) and net foreign assets (as defined in section A), with the latter being converted from U.S. dollars into dinars at the program accounting exchange rate of US$1 = YUD 67.6702, which was the rate prevailing on December 29, 2001 and the exchange rates of the US$ *vis-a-vis* other currencies prevailing on that day. As of December 31, 2001, the domestic assets of the NBY so defined were valued at YUD 2,286 (Annex A). The monthly average of NDA is calculated as the difference of the monthly average of reserve money and monthly average of NFA. The monthly average of NFA (for the purpose of estimating

average NDA) will be adjusted so that the disbursements of World Bank program loans and EU macro-financial assistance are counted as if they occur on the first day of the month.

6. **Adjustor.** In the event of a budgetary foreign financing shortfall (excess) in Serbia which is not offset by higher (lower) than budgeted privatization revenue (specified in paragraph 10), of up to YUD 5 billion, the ceiling of NDA will be adjusted upward (downward) by 50 percent of the amount of the shortfall (excess). The basis for estimating the amount of the shortfall is presented in Section C.

7. **Reporting.** The ceilings will be monitored on the basis of daily data on the accounts of the NBY, reporting foreign reserves assets and liabilities as defined under section A and reserve money as defined under section E supplied to the European 1 Department of the Fund by the NBY, within four business days of the end of each business week. To facilitate program monitoring, the NBY will provide daily NBY's foreign reserves liabilities as well as the amount and date of the disbursements of the World Bank program and EU macro-financial assistance at the current and the agreed constant exchange rates.

C. Ceiling on the Net Credit of the Banking System to the Consolidated General Government

8. **Definition.** The banking system comprises the NBY, commercial banks in Serbia, and all banks in Montenegro. The consolidated general government was defined above.

- For program purposes, **net credit of the banking system to the consolidated general government** is defined as all claims (i.e., credits, securities, and other claims in both dinar and foreign currencies) of the banking system on the consolidated general government less all deposits of the consolidated general government with the banking system, including foreign currency deposits. Foreign currency deposits and foreign-currency denominated credits to the general government will be reported at the end-December 2001 exchange rates. Any holdings of government securities by commercial banks above the actual amounts held at end-December 2001 (YUD 394 million) will be included in the credit of the banking system to the consolidated general government. (Net bank credit to the consolidated general government in Montenegro will be monitored on the basis of data supplied by the Montenegrin authorities; at end-December 2001, net credit of the banking system in Montenegro to the consolidated general government in Montenegro amounted to € 23.1 million (equivalent to YUD1,378 million))

9. **Reporting.** The ceilings will be monitored from end-weekly data on the accounts of the banking system supplied to the European 1 Department of the Fund with a lag not to exceed two weeks.

10. **Adjusters.** For program purposes, the ceilings on net credit of the banking system to the consolidated general government will be adjusted downward by the cumulative increase in the stock of government debt held by the nonbank public (other than that related to the frozen foreign currency deposits), starting from January 1, 2002, and upward for any decrease. The ceilings will be adjusted to the extent that the credits of the banking system to

the consolidated general governments at end-December 2001 are revised from the currently-reported levels of YUD 741million in Serbia and € 23.1 million in Montenegro. In addition, in the event of a budgetary foreign financing shortfall (excess) which is not offset by higher (lower) than budgeted privatization revenue, of up to YUD 5 billion, the ceilings for Serbia will be adjusted upward (downward) by 50% of the amount of the shortfall (excess). For Montenegro, in the case of a budgetary foreign financing shortfall (excess), which is not offset by higher (lower) than budgeted privatization revenue, of up to US$10 million, the ceilings for Montenegro will be adjusted upward (downward) by 50% of the amount of the shortfall (excess).The estimation of the shortfalls (excesses) in foreign financing will be based on the following projections of foreign financing and privatization receipts (cumulative from the beginning of 2002):

Serbia (In billions of dinars)

	end-Mar.	end-June	end-Sep.	end-Dec.
Foreign financing	9.3	15.5	26.2	34.7
Privatization proceeds	0.0	8.6	0.0	11.4

Montenegro (In millions DM)

	end-Mar.	end-June	end-Sep.	end-Dec.
Foreign financing	10.0	24.0	61.9	100.9
Privatization proceeds	0.0	0.0	20.0	47.0

D. Ceiling on Change in Arrears

11. For program purposes, indicative targets will be set on the change in domestic arrears. Separate indicative targets will be set for the federal government, the consolidated general government of Serbia, and the consolidated general government of Montenegro.

12. **Definition**

- For the purpose of establishing compliance with this indicative target, the federal government is defined to comprise all budgetary institutions financed from the federal budget, including the federal army and the federal pension fund for retired military personnel. The consolidated general government of Serbia is defined to comprise all budgetary institutions financed from the Serbian republican budget, the Republican Pension and Invalidity Insurance Fund for Employees, the Republican Pension and Invalidity Insurance Fund for Self-employed, the Republican Pension and Invalidity Insurance Fund for Agricultural Workers, the Republican Health Insurance Fund, the Republican Labor Market Agency, all republican special directorates, , and all other budgetary and extrabudgetary funds created by the government of Serbia existing before or created during the period of the program. The consolidated general government of Montenegro is defined to comprise all budgetary institutions financed from the republican budget, the Republican Pension and Invalidity Insurance Fund, the Republican Health Insurance Fund, the Republican Labor Market Fund, and all other budgetary and extrabudgetary funds created by the government of Montenegro existing before or created during the period of the program.

- The outstanding stock of domestic arrears comprises wage and pension arrears; arrears with respect to accrued tax and social security contribution obligations, including personal income tax and social security contributions of employees withheld at source; arrears on social entitlement benefits (apart from pensions) to households; arrears incurred with respect to the purchases of goods and services from suppliers; and arrears related to the servicing of domestic debt.

- The outstanding stock of wage arrears at a particular date are defined as total accumulated unpaid wages of all employees on the regular payroll of all units belonging to the parts of the general government as defined above, up to the latest preceding regular pay date, which have not been settled by the test date. The total stocks of wage arrears, thus defined, are on a gross basis and are calculated by summing the wage arrears of all units of government with regard to their own employees; transfers between different levels of government for making wage or other payments are excluded from the estimates of these wage arrears.

- Pension arrears are defined as total accumulated pensions due but not disbursed by the pension funds concerned to all pensioners in the pension rolls up to the latest preceding pension disbursement date.

- The outstanding stocks of tax and social contribution arrears at a particular date comprise total accumulated accrued tax obligations of the parts of the general government as defined above that have not been paid by the test date. The total stocks of such arrears are on a gross basis and are calculated as the sum of such arrears.

- Social entitlement payments, apart from pensions, are defined as all cash payments due directly to, or on behalf of, the population in accordance with stipulations in the law and which are not contingent upon the provision of any services or sale of any goods or assets to the general government by such members of the population in return for these payments. The stock of such entitlement arrears are defined as total accumulated payments due but not disbursed by all units of government up to the test date. Thus defined, these arrears are also on a gross basis and do not include the netting out of any transfers made between different units of the general government for the payment of such entitlements.

- Arrears to suppliers comprise payments delayed beyond what was explicitly specified in relevant contracts, or in the absence of such specification, for two months from the date of submission of bills, for already-effected purchases of goods or services by the government concerned. These include, *inter alia*, arrears to utility companies, arrears incurred with respect to service and maintenance contracts, and payments not made for the purchase of goods and supplies such as equipment and furniture. These arrears are also defined on a gross basis and overdue tax and other obligations to the government of the relevant enterprises are not included in the calculation of the arrears of the government unless there is mutual agreement on the cancellation of debts. Netting out of any transfers made between different units of the general government for the payment of such arrears and obligations are also not taken into consideration.

- Arrears to domestic banks and nonbank lenders comprise all overdue payments related to financial contracts between the government and domestic banks, nonbank financial institutions, nonfinancial institutions, and private lenders.

- At end-December 2001, the stock of arrears of the Federal government was estimated at YUD 0 billion; and the stock of arrears of the consolidated general government in Serbia was estimated at YUD 26.123 billion.

- €denominated claims on government will be converted at the exchange rate of €1 = YUD 60.597055; claims denominated in currencies other than the € will first be converted at their respective exchange rates against the €prevailing on December 31, 2001. The change in arrears is defined as the change in the end-period stock of arrears. Changes in wage and pension arrears will be adjusted for the changes in the average wage and average pension in the economy relative to their respective values in December 2001.

13. **Reporting**. Before the last business day of each month, data on end-period stocks of arrears for the previous month will be supplied to the European 1 Department of the Fund by the Federal Ministry of Finance, the Ministry of Finance of Serbia, and the Ministry of Finance of Montenegro.

E. Definition of Reserve Money

14. **Definition.** Reserve money is defined as the sum of currency in circulation (NBY Bulletin, September 2000, Table 3A, column 8) and dinar reserves banks are required to hold, plus excess reserves of the commercial banks at the NBY. Shortfalls in reserves that banks are required to hold, will be included in required reserves (and therefore in reserve money), as well as in bank borrowing from the NBY. Reserves that banks are required to hold are set at 20 percent effective on April 11, 2002 of the base as defined in NBY Decision of March 28, 2002. The amounts that banks are permitted to hold in securities to satisfy the statutory reserve requirement will be limited to the amount that banks were holding as of December 31, 2000 (YUD 174.1 million). Excess reserves include commercial bank balances in Giro accounts 620, 621, 623, and 625 with the NBY and cash in commercial bank vaults.

15. Data on reserve money will be monitored from the daily indicators data of the NBY, which shall be supplied to the European 1 Department of the Fund weekly by the NBY with a three-day lag. Required reserves at end-December 2001 have been adjusted (a) downward

by YUD 357 billion to take into account that part of the deposits in Beobanka, Beogradska Banka, Jugobanka, Investbanka and Astra Banka will not be paid out; (b) an expansion in the dinar reserve deposit base; and (c) the lower reserve requirement ratio of 20 percent from 24.5 percent. Foreign exchange denominated reserves of commercial banks with the NBY are included in foreign exchange liabilities to domestic residents; they are not included in reserve money. On December 31, 2001, currency in circulation amounted to YUD 25,266 million while required reserves amounted to YUD 7,720 million, and excess reserves to YUD 8,167 million. Data on effective reserve requirements and the deposit base used in reserve requirement calculations will be supplied to the European I Department each week with a lag of less than a week.

16. **Adjusters.** For program monitoring purposes, reserve money will be adjusted as follows: Should the standard reserve requirement increase (decrease) from the level prevailing on April 11, 2002, the ceiling on net domestic assets would be increased (decreased) by an amount equivalent to the change in the standard reserve requirement ratio multiplied by the programmed deposit base used in the calculation of required reserves. Before making any such changes, the NBY will consult with Fund staff. Required reserves of banks placed under BRA administration or liquidation will remain part of reserve money for program purposes.

F. Ceiling on External Debt-Service Arrears

17. **Definition.** External debt-service arrears are defined as overdue debt service arising in respect of obligations incurred directly or guaranteed by the public sector, except on debt subject to rescheduling or restructuring. The program requires that no new external arrears be accumulated at any time under the arrangement on public sector or public sector guaranteed debts.

18. **Reporting.** The accounting of nonreschedulable external arrears by creditor (if any), with detailed explanations, will be transmitted on a monthly basis, within two weeks of the end of each month. This accounting will include, separately, arrears owed by the Federal, Serbian and Montenegrin governments, and other public sector entities; arrears owed by Yugoslav Airlines; and arrears owed to Paris Club creditors, non-Paris Club creditors, and other creditors. Data on other arrears, which are reschedulable, will be provided separately.

G. Ceilings on External Debt

19. **Definitions.** First, with regard to the ceiling on contracting or guaranteeing of new nonconcessional external debt by the public sector with original maturity of more than one year: This performance criterion applies not only to debt as defined in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt adopted on August 24, 2000 (Decision No. 12274-(00/85), see attachment to this Annex) but also to commitments contracted or guaranteed for which value has not been received. Excluded from this performance criterion are loans from, or other indebtedness to, the EBRD, the EIB and EU, the IBRD, the IMF, and the IFC. Concessionality will be based on a currency-specific discount rate based on the ten-year average of the OECD's commercial interest reference rate

(CIRR) for loans or leases with maturities greater than 15 years and on the six-month average CIRR for loans and leases maturing in less than 15 years. Under this definition of concessionality, only debt with a grant element equivalent to 35 percent or more will be excluded from the debt limit. Second, with regard to the ceiling on new external debt with original maturity of up to and including one year owed by the consolidated general government or guaranteed by the public sector, the term "debt" has the meaning set forth in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt adopted on August 24, 2000 (Decision No. 12274-(00/85). Excluded from this performance criterion are short-term import credits.

20. **Reporting.** A debt-by-debt accounting of all new concessional and nonconcessional debt contracted or guaranteed by the public sector, including the original debt documentation, as well as all relevant supporting materials, will be transmitted on a quarterly basis within four weeks of the end of each quarter.

III. Other Reporting Requirement for Program Monitoring

A. Macroeconomic Monitoring Committee

21. A macroeconomic monitoring committee, composed of senior officials from the Federal Government, Serbian and Montenegrin Ministries of Finance, the NBY, and other relevant agencies, shall be responsible for monitoring the performance of the program, informing the Fund regularly about the progress of the program, and transmitting the supporting materials necessary for the evaluation of performance criteria and benchmarks.

B. Developments on Structural Performance Criteria and Benchmarks

22. The authorities will notify the European 1 Department of the Fund of **developments on structural performance criteria and benchmarks** as soon as they occur. The authorities will provide the documentation, according to the dates in Annex B, elaborating on policy implementation. **The authorities will also notify the European 1 Department of the Fund of any economic developments or policy measures that could have a significant impact on the implementation of this program.**

C. Data Reporting

Production and prices

23. The following information will be transmitted at the time of their publication:

- The retail price index, the industrial price index, the industrial production index, wages and employment, and exports and imports.

24. Any revision to the national accounts data will be transmitted within three weeks of the date of the revision.

Public finance

25. Monthly data on public finance will require a consolidated budget report of the Federal and Republican governments comprising:

- The revenue data by each major item, including that collected by the federal and the republican governments;
- Details of the recurrent and capital expenditure of the federal and republican governments; and
- Details of budget financing, domestic, and external data will be transmitted within four weeks of the end of each month.

Monetary sector data

26. The following data will be transmitted on a daily/weekly/biweekly basis within one/five working days of the end of each day/week.

- Daily movements in gross foreign exchange reserves of the NBY at current exchange rates, indicating amounts sold/bought at the auction, purchases through ZOP, purchases on the interbank market, inflows of foreign grants, inflows of foreign loans, and repayments of frozen currency deposits.
- Daily movements in foreign exchange denominated liabilities of the NBY to (i) non-residents; (ii) Yugoslav banks; and (iii) Yugoslav residents.
- Daily movements in liquid foreign exchange assets of Yugoslav banks as reported by these banks to the NBY.
- Daily movements in reserve money, indicating currency in circulation, the basis upon which required reserves are calculated, required reserves, reserves held, and excess reserves.
- Treasury bill auction details (rates, amounts per maturity and number of banks participating in the auction per maturity); and
- Interbank foreign exchange rates and volume of transactions.
- Public sector borrowing and lending from commercial banks and the NBY.

27. The balance sheet of the NBY and the consolidated balance sheets of the commercial banks, including all banks in Montenegro, will be transmitted on a monthly basis within three weeks of the end of each month. The stocks of government and mandatory and voluntary NBY securities held by banks and by non-banks, as available to the NBY, detailed information on interbank money market transactions (terms, duration, and participating

institutions), and interest rate developments will be transmitted on a monthly basis within two weeks of the end of each month.

External data

28. The data below will be transmitted as follows:

- The interbank market exchange rate, as the simple average of the daily-weighted average buying and selling rates, will be transmitted on a weekly basis within five business days of the end of the week;

- Balance of payments data on services, private transfers, and capital account transactions will be transmitted on a quarterly basis within four weeks of the end of each quarter; and

- Detailed monthly data on the volume and prices exports and imports, including a separate report on imported petroleum products.

Executive Board Decision No. 6230-(79/140) (Guidelines on Performance Criteria with Respect to Foreign Debt) adopted August 3, 1979, as amended by Executive Board Decision No. 11096-(95/100) adopted October 25, 1995, and as amended on August 24, 2000

Point No. 9

(a) For the purpose of this guideline, the term "debt" will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows:

(i) loans, i.e., advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements);

(ii) suppliers' credits, i.e., contracts where the supplier permits the obligor to defer payments until some time after the date on which the goods are delivered or services are provided; and

(iii) leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the purpose of the guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair or maintenance of the property.

(b) Under the definition of debt set out in point 9(a) above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. However, arrears arising from the failure to make payment at the time of delivery of assets or services are not debt.

INTERNATIONAL MONETARY FUND

FEDERAL REPUBLIC OF YUGOSLAVIA

Staff Report for the 2002 Article IV Consultation, Third Review Under the Stand-By Arrangement, and Request for an Extended Arrangement

Supplementary Information

Prepared by the European I, Legal, and Policy Development and Review Departments

(In consultation with the Monetary and Exchange Affairs Department)

Approved by Carlo Cottarelli, François Gianviti and Shigeo Kashiwagi

May 10, 2002

1. This paper supplements EBS/02/73 (4/26/02) with information on (a) the implementation of the prior action for Board consideration of the third review under the stand-by arrangement and the request for a new extended arrangement; (b) the status of implementation by Montenegro of a structural benchmark for end-April 2002; and (c) a review of the exchange system of the Federal Republic of Yugoslavia (FRY).

2. The prior action for Board consideration—submission to parliament of a foreign exchange law and preparation of foreign exchange regulations to further liberalize the foreign exchange system (EBS/02/73, Annex B.2, page 69)—has been implemented. The foreign exchange law was submitted to parliament in early April and was approved on April 27, 2002. Implementing regulations, in line with understandings reached under the program, were promulgated on May 10, 2002.

3. A structural benchmark for end-April 2002—the adoption of legislation to enable the Central Bank of Montenegro to supervise the existing offshore banks in line with the rules and regulations applicable to onshore banks—has not been met yet. However, the Montenegrin authorities have informed the staff that they expect to resolve the issue satisfactorily, albeit with a delay owing to legal complications. They explained that the proposed legislation could not be adopted because the original law that established the legal framework for the offshore banks in 1996 included a provision precluding amendment for 15 years. The Constitutional Court has not yet decided on this issue as it awaits the opinion of the Parliament of Montenegro, which had not been in session for two months and has recently given priority to the issue of redefining the relations between Serbia and Montenegro.

4. The review by LEG of FRY's exchange system in the context of the 2002 Article IV consultation concluded that the Federal Republic of Yugoslavia maintains the following

restrictions on the making of payments and transfers that are subject to Board approval under Article VIII, Section 2(a):

- The Law on Foreign Investment (Article 12) makes the transferability of profits contingent on the fulfillment of "obligations under domestic law." To the extent that the transferability of profits is subject to the fulfillment of obligations other than income or profit taxes on the amounts to be transferred, an exchange restriction arises. The authorities have agreed to make the necessary changes to the Foreign Investment Law within the next 6 months, clarifying that the transferability of profits abroad is only subject to the payment of profit or income taxes, if any, due on the profits to be transferred. In light of the commitment of the authorities to take the necessary legislative action to eliminate the restriction arising from Article 12 of the Law on Foreign Investment, the staff recommends approval of the restriction until October 30, 2002.

- The FRY maintains a restriction on payments and transfers resulting from the blocking of pre-1991 foreign currency savings deposits. While the authorities have made progress on the timetable for the removal of this restriction, the timetable has not been finalized yet. The staff encourages the authorities to remove this restriction.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 02/56
FOR IMMEDIATE RELEASE
May 23, 2002

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Concludes 2002 Article IV Consultation with the Federal Republic of Yugoslavia (Serbia/Montenegro)

On May 13, 2002, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Federal Republic of Yugoslavia (Serbia/Montenegro).[1]

Background

The government that came to power in late 2000—after ten years of regional conflict, international isolation, and economic mismanagement—inherited exceptionally difficult starting conditions. Output stood at less than half its 1989 level; inflation exceeded 100 percent; confidence in the financial system had been decimated; the country's infrastructure was in disrepair; the enterprise and banking sectors were both deeply insolvent and isolated from the outside world; and external debt, mostly in arrears, had risen to the equivalent of 140 percent of GDP.

With the strong support of the international community, the authorities have been able to take major steps toward stabilizing and reforming the economy. Twelve-month inflation has come down sharply from 113 percent at end-2000 to 23 percent in April 2002. Real GDP rose further by an estimated 5½ percent in 2001, but remained about one-half of its 1989 level. GDP growth is attributed to a rebound in agricultural output after the previous year's drought, and increasing activity in services. Industrial production has been stagnant, reflecting capacity constraints after

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. This PIN summarizes the views of the Executive Board as expressed during the May 13, 2002 Executive Board discussion based on the staff report.

years of disinvestment and the ongoing economic restructuring. The overall balance of payments improved, as a large increase in the current account deficit was comfortably financed by foreign assistance and private capital inflows. The official foreign exchange reserves reached US$1.6 billion at end-April 2002 (2½ months of imports), up from US$0.5 billion at end-2000.

The macroeconomic policies underlying these improvements have emphasized strict limits on bank credit and wage restraint in the public sector. The fiscal deficit was 1.3 percent of GDP in 2001, against a target of 6.1 percent, with borrowing from the banking system limited to 0.7 percent of GDP. The fiscal overperformance is explained by higher-than-budgeted revenue (1¾ percent of GDP) and a compression of spending (3 percent of GDP, primarily foregone public investment) in response to delays in foreign financing and privatization proceeds. Revenue collections benefited from a major simplification of the tax system and curtailment of tax evasion by fighting corruption and smuggling. Wage bills in the public sector were kept broadly unchanged in real terms. Growth in the Net Domestic Assets of the National Bank of Yugoslavia (NBY) during 2001 was limited to 2 percent of end-2000 reserve money. Large foreign exchange inflows accounted for an almost 90 percent increase in reserve money, in an environment of declining inflation and market interest rates, apparently reflecting a stronger demand for dinars. Against the background of a persisting balance-of-payments surplus, the NBY has kept the exchange rate of the dinar broadly unchanged against the euro since the adoption of a managed float at the beginning of 2001. The resulting real appreciation of the dinar has restored its real value close to the level reached in 1997–98 (a sanctions-free period when exports had reached a peak level).

Macroeconomic policies were complemented by equally impressive progress in structural reform, with technical assistance from the IMF and the World Bank. Soon after coming to power, the new authorities in Belgrade freed most prices with the exception of public utilities; unified a system of multiple exchange rates; abolished most import quotas and lowered average import tariffs to under 10 percent; simplified the tax system and improved the transparency of the budgetary accounts; and substantially liberalized employment contracts and wage determination. In addition, legal and institutional frameworks for bank restructuring and enterprise privatization were put in place, allowing important progress in this area. In Montenegro—where reforms were initiated in 1999 with the support of bilateral donors—the authorities focused on fiscal reforms and privatization through a Mass Voucher Scheme.

The strengthened performance also reflected the international community's support of the FRY through foreign assistance and debt relief. Grant and loan disbursements amounted to US$8 million (8 percent of GDP) in 2001 compared with US$3 million in 2000. In November 2001, agreement was reached on restructuring Paris Club debt, involving a two-phase 66-percent write-off. The first phase (51 percent) is to enter into force with the approval of the Extended Arrangement (EA), while the second phase (the remaining 15 percent) will become effective upon successful completion of the EA. Debt restructuring negotiations with other official bilateral and London Club creditors are underway.

Executive Board Assessment

Directors commended the FRY authorities for the impressive achievements in stabilization and reform since late 2000, when the FRY succeeded to membership in the Fund. Directors noted, however, the daunting challenges that lie ahead, reflecting the exceptionally difficult starting conditions. They stressed the need for sustained policy implementation under the medium-term program supported by the Extended Arrangement, if the FRY is to remain on a path toward durable growth and external viability. The authorities' demonstrated commitment to reform augurs well for progress towards achieving these objectives. Directors also called on the authorities to continue to improve transparency and governance in all government institutions as a necessary precondition for improving the investment and business climate.

Directors noted that macroeconomic policies have been prudent, with fiscal and wage restraint underpinning a monetary policy geared to lowering inflation. They welcomed the improvement in tax collection stemming from wide-ranging tax reforms and the prompt containment of government spending in response to delays in foreign financing and privatization receipts. They welcomed the improvement in the fiscal position in Montenegro, after some slippage in the first half of 2001.

Directors commended the expeditious implementation of key structural reforms, in particular the streamlining of the price, exchange, trade, and tax regimes; the liberalization of the labor market; and the establishment of new legal and institutional frameworks to guide the restructuring of the economy. These measures had paved the way for the successful privatization of several large companies and the cleaning up of the banking system through the closure of four large insolvent banks.

Directors considered that the authorities' medium-term fiscal policy framework is consistent with achieving lower inflation and fiscal sustainability, while providing for critical restructuring and investment needs. They noted that the risks related to macroeconomic uncertainties and the challenges of reform could be addressed through prudence and vigilance in policy implementation to safeguard the inflation and external objectives. A strict wage policy will be important in this regard. Directors were concerned that the budget relied heavily on financing from privatization receipts and cautioned the authorities against using the central bank as a source of deficit financing.

Directors stressed that it will be important, for fiscal sustainability, to improve tax administration and streamline expenditure, by containing current spending through improved efficiency in the delivery of services and better targeting of benefits. In this regard, they welcomed the pension reform adopted recently in Serbia and the plans to adopt similar reforms in Montenegro.

Against the background of a continuing real appreciation of the dinar, Directors endorsed the NBY's intention to monitor developments in the foreign exchange market closely, and to keep exchange rate policy under close review in light of export and wage developments. They welcomed the further liberalization of the exchange system, which will pave the way for the acceptance by the FRY of obligations under Article VIII, section 2, 3, and 4, and envisaged a positive impact on the transparency and efficiency of the foreign exchange market. Directors also encouraged the authorities to strengthen the independence of the central bank.

Directors called on the FRY to put in place adequate anti-money laundering legislation and all necessary measures to combat the financing of terrorism.

Directors stressed that enterprise and bank reform, as well as an improved business environment, will be critical to foster private sector-led growth. The task of restructuring the decapitalized and overstaffed enterprise sector will be challenging, especially in light of limited fiscal resources to mitigate the restructuring costs. With the bulk of insolvency removed from the financial sector, development of an efficient banking system will hinge on the strengthening of banking supervision and on privatizing the remaining state-owned banks.

Directors welcomed the recent agreement between the federal and republican authorities on a plan for a new constitutional framework, which should provide a basis for normalizing relations between Serbia and Montenegro, streamlining joint institutions, and strengthening the custom and tax systems.

Directors emphasized that, in light of initial conditions, the medium-term economic outlook remains challenging, leaving little room for maneuver. The authorities must therefore persevere with reforms while the international community should remain supportive throughout the intensive medium-term restructuring effort. In this respect, Directors noted possible risks to the achievement of debt sustainability over the medium term.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board. The Staff Report for the 2002 Article IV Consultation with the Federal Republic of Yugoslavia (Serbia/Montenegro) is also available.

Federal Republic of Yugoslavia (Serbia/Montenegro): Selected Economic Indicators 1/

	1998	1999	2000	2001	2002
Real sector			(Changes in percent)		
Real GDP	2.5	-18.0	5.0	5.5	4.0
Retail prices (12 months average)	29.5	42.1	69.9	91.1	26.3
Unemployment rate (in percent) 2/	25.1	26.5	27.3	27.8	...
Gross national saving (in percent of GDP)	6.6	4.2	10.3	8.0	7.2
Gross domestic investment (percent of GDP	11.4	11.6	14.5	13.5	15.4
Public finance 3/			(In percent of GDP)		
Cash balance	...	...	-0.9	-1.3	-5.7
Commitment balance 4/	...	...	-3.0	-1.3	-5.7
General government debt	...	...	127.0	100.6	59.0
Money and credit			(End-period, annual rate, in percent)		
M1 (growth rate) 5/	...	47.2	85.2	114.3	53.0
M2 (growth rate) 5/ 6/	62.0	67.6	61.4	79.0	45.3
Discount rate	34.5	26.8	26.8	16.8	...
Lending rate (weighted average)	61.8	46.4	79.6	33.2	...
Deposit rate (weighted average) 7/	32.3	13.4	35.3	25.0	
Balance of payments			(In percent of GDP)		
Trade balance 8/	-13.1	-15.9	-22.2	-26.1	-25.8
Current account balance 9/	-4.8	-7.5	-4.2	-5.5	-8.2
Gross official reserves (US$ billion)	...	0.3	0.5	1.2	1.6
Reserve cover (months of imports of GNFS)	...	0.9	1.2	2.4	3.0
Exchange rate					
Exchange rate regime			Fixed rate with parallel rate through November 2000, managed float thereafter		
Present rate (dinar/euro, end-April 2002)			60.4		
Nominal effective rate (annual average 1997=100)	161.7	318.7	656.5	781.6	...
Real effective rate (annual average,1997=100)	79.2	58.9	45.2	71.6	...

Sources: Federal Statistical Office; National Bank of Yugoslavia; Ministry of Finance of the Federal Republic; Ministry of Finance of the Republic of Serbia; and IMF staff estimates.

1/ With the exception of money supply and foreign debt, data for 1999-2001 exclude Kosovo. GDP excludes Kosovo throughout.
2/ Excludes workers on "forced holiday."
3/ Fiscal operations of all levels of government, except for Montenegro where it excludes local government.
4/ Excludes arrears of local governments.
5/ From 1999 onwards excludes Montenegro.
6/ Frozen foreign-currency deposits are excluded and other foreign-currency deposits are valued at parallel market rates until September 2000 and current exchange rate thereafter.
7/ Excluding demand deposits as well as time deposits with maturities of less than 15 days or over 3 years.
8/ From 1996, includes previously unrecorded exports of about US$0.2. billion.
9/ In 2000-01, includes previously unrecorded transfers of US$0.6 billion.

INTERNATIONAL MONETARY FUND
EXTERNAL RELATIONS DEPARTMENT

Press Release No. 02/25
FOR IMMEDIATE RELEASE
May 13, 2002

International Monetary Fund
Washington, D.C. 20431 USA

IMF Approves US$64 Million Tranche Under Stand-By Credit and US$829 Million Extended Arrangement for the Federal Republic of Yugoslavia (Serbia/Montenegro)

The Executive Board of the International Monetary Fund (IMF) today completed the third and final review of the Federal Republic of Yugoslavia's (FRY) economic program supported by a stand-by credit. The completion of the review will enable the FRY to draw another SDR 50 million (about US$64 million) from the IMF immediately. The Stand-By Arrangement was approved June 11, 2001 (see Press Release No. 01/31) for SDR 200 million (about US$255 million), which will have been drawn in total. The Stand-By Arrangement will expire today.

The Executive Board today also approved an Extended Arrangement for SDR 650 million (about US$829 million) to support the FRY's economic program in 2002-2005. The approval will enable the FRY to draw SDR 50 million (about US$64 million) as soon as the Arrangement goes into effect on May 14, 2002.

Following the Executive Board discussion, Anne Krueger, First Deputy Managing Director and Acting Chair, said:

"The IMF commends the FRY authorities for the impressive achievements in stabilization and reform since late 2000, when the FRY succeeded to membership in the Fund, but noted the major challenges that lie ahead. The authorities' medium-term economic program, supported by the Extended Fund Arrangement, aims to achieve further progress in stabilization while providing for the restructuring and investment needs of the economy. In light of the exceptionally difficult starting conditions, the program will need to be firmly implemented if FRY is to remain on a path toward durable growth and external sustainability. The authorities' demonstrated commitment to reform augurs well for progress in achieving these objectives.

"Macroeconomic policies have been prudent, with fiscal and wage restraint underpinning a monetary policy that is geared to lowering inflation. Fiscal performance has been good, reflecting the revenue effects of wide-ranging tax reforms, and the prompt containment of government spending in response to delays in foreign financing and privatization receipts. The authorities moved with impressive speed to implement key structural reforms, notably streamlining the price, exchange, trade, and tax regimes; liberalizing the labor market; and establishing new legal and institutional frameworks to guide the restructuring of the economy.

These measures paved the way for the successful privatization of several large companies and the cleaning up of the banking system through the closure of four large insolvent banks.

"The authorities' medium-term fiscal policy framework is consistent with achieving lower inflation and fiscal sustainability. There are risks related to macroeconomic uncertainties and the challenges of reform, which could be addressed through prudence and vigilance in policy implementation, to safeguard the inflation and external objectives. It is critical for fiscal sustainability to improve tax administration and streamline expenditure through improved efficiency in the delivery of services and better targeting of benefits. The pension reform adopted recently in Serbia, and plans to adopt similar reforms in Montenegro, represent important steps in this direction.

"Against the background of a continuing real appreciation of the dinar, the National Bank of Yugoslavia appropriately intends to monitor closely developments in the foreign exchange market and to keep exchange rate policy under close review. The IMF welcomes the further liberalization of the exchange system which will pave the way for the acceptance by FRY of the obligations under Article VIII, Sections 2, 3, and 4.

"Enterprise and bank reform, as well as an improved business environment, will be critical to enable private sector-led growth. The task of restructuring the decapitalized and overstaffed enterprise sector will be challenging, especially in light of limited fiscal resources to mitigate the costs of restructuring. With the bulk of insolvency removed from the financial sector, development of an efficient banking system will hinge on strengthening bank supervision and privatizing the remaining state-owned banks.

"The IMF welcomes the recent agreement between the federal and republican authorities on a plan for a new constitutional framework, which provides a basis for normalizing relations between Serbia and Montenegro, streamlining joint institutions, and strengthening the custom and tax systems. In light of the initial conditions, the medium-term economic outlook remains challenging, leaving little room for maneuver. The authorities must therefore persevere with reforms, and the international community should remain supportive throughout the intensive medium-term restructuring effort," Ms. Krueger said.

ANNEX

Program Summary

The FRY has made satisfactory progress in stabilizing the economy, strengthening confidence in the currency, building the legal and institutional framework to guide transition, and securing debt relief. However, economic conditions remain difficult with output still at a historically very low level, a fragile macroeconomic and external outlook, a largely insolvent, decapitalized and overstaffed enterprise sector, an underperforming banking system, a large and inefficient government sector, and a dilapidated infrastructure.

The authorities' key economic objectives for 2002-05 are the achievement of low inflation with progress toward sustainable growth and external viability. The government is determined to continue prudent macroeconomic policies and accelerate structural reform.

Inflation in Serbia is targeted to decline rapidly, reflecting tight credit policy and the wearing off of administered price increases; the latter would also support disinflation in Montenegro. The real GDP growth objectives are somewhat higher than those experienced by successful transition economies in the 1990's but consistent with the potential for a "post-conflict" rebound and sizable amounts of foreign assistance.

The current account deficit (before grants) is expected to widen in 2002, reflecting a resumption in external debt service as well as higher project-related imports. The deficit will be financed by expected inflows of grants, loans from official creditors, and foreign direct investment. Over the medium term, the current account deficit is expected to narrow in relation to GDP on the basis of a recovery in exports to their real 1998 level. Despite rising foreign direct investment inflows, external financing requirements from donors and official creditors will remain significant.

The overall deficit in the FRY is projected to reach 5.7 percent of GDP in 2002, while trending downwards in subsequent years, in line with progress toward fiscal sustainability and lower inflation. The deficit will be financed mostly by foreign grants, concessional loans, and privatization receipts, while the government's resources to domestic financing will be contained under 1 percent of GDP throughout the arrangement.

Monetary policy will be geared to lowering inflation. Exchange rate policy will seek to strike a proper balance between inflation and external objectives. While the current level of the exchange rate appears appropriate, developments in the foreign exchange market as well as trends in exports, imports, and wages will be monitored closely. Exchange rate policy will be assessed during the program reviews. Wage policy in the government and state enterprises will continue to support monetary policy and protect external competitiveness.

Structural reforms will be broad-ranging, to be implemented with technical assistance from the IMF, the World Bank, and bilateral donors. Reforms in the fiscal sector envisage further institutional improvements and streamlining expenditure where little progress has been made so far. In the financial sector, the cleaning up of the banking sector has set the stage for important reforms: redesign of monetary policy instruments, further liberalization of the foreign exchange market, development of a market-friendly payments system, and strengthening of banking supervision. In the enterprise sector, with the establishment of an appropriate legal and institutional framework, the stage has been set for the difficult task of restructuring and privatizing the bulk of socially-owned enterprises.

With sustained policy implementation, good progress toward a viable external position and sustainable growth could be achieved during the Extended Arrangement. The envisaged policies are consistent with a substantial increase in domestic savings that would offset lower foreign savings and permit an increase in the investment/GDP ratio by about 5 percentage points during 2002-05. External debt as a share of GDP is expected to fall from 109 percent at end-2001 to 59 percent at end-2005 (to 85 percent excluding debt relief).

The FRY, effective December 14, 1992, succeeded as one of five successor republics to the IMF membership of the former Socialist Federal Republic of Yugoslavia. Its quota[1] is SDR 467.7 million (about US$597 million). The FRY's outstanding use of IMF credits totals SDR 266.9 million (about US$341 million).

[1] A member's quota in the IMF determines, in particular, the amount of its subscription, its voting weight, its access to IMF financing, and its allocation of SDRs.

Table 1. Federal Republic of Yugoslavia (Serbia/Montenegro): Selected Economic and Financial Indicators, 1998-2002 1/

	1998	1999	2000	2001	2002 Proj.
Real economy					
GDP, in billions of YUD	146.3	192.9	358.1	724.1	978.9
GDP, in millions of U.S. dollars	13,889	10,214	8,071	10,861	12,841
Average net real wage, 1997 =100	102	88	103	115	...
Average net wage in Euro	86	56	51	93	...
			(Percent change)		
Real GDP	2.5	-18.0	5.0	5.5	4.0
Industrial production	4.4	-24.4	11.1	0.0	3.0
Retail prices (annual average)	29.5	42.1	69.9	91.1	26.3
Retail prices (end of period)	44.5	49.9	113.5	39.0	20.0
Unemployment rate (in percent) 2/	25.1	26.5	27.3	27.8	...
General government finances 3/			(Percent of GDP)		
Revenue	...	...	39.2	41.6	43.0
Expenditure	...	...	40.1	43.0	48.7
Cash balance	...	...	-0.9	-1.3	-5.7
Foreign grants	...	...	0.8	0.7	1.0
Foreign loans	...	...	0.0	0.0	3.0
Privatization receipts	...	...	0.0	0.0	1.3
Domestic financing	...	...	0.2	0.7	0.5
Commitment balance 4/	...	...	-3.0	-1.3	-5.7
Money supply (end-of-period) 5/			(Percent change)		
M1	...	47.3	85.1	109.7	53.0
M2	...	67.6	61.4	86.3	45.3
Balance of payments			(In billions of U.S. dollars)		
Merchandise exports	3.0	1.7	1.9	2.0	2.2
Merchandise imports	-4.8	-3.3	-3.7	-4.8	-5.6
Trade balance	-1.8	-1.6	-1.8	-2.8	-3.3
Current account balance, after grants	-0.7	-0.8	-0.3	-0.6	-1.1
(In percent of GDP)	-4.8	-7.5	-4.2	-5.5	-8.2
Current account balance, before grants	-0.7	-0.8	-0.6	-1.2	-1.6
(In percent of GDP)	-4.8	-7.5	-7.6	-10.9	-12.8
Foreign debt (year-end) 6/	10.5	10.7	11.4	11.9	8.6
Gross official reserves	0.3	0.3	0.5	1.2	1.6
(In months of imports of goods and services)	1.1	0.9	1.2	2.4	3.0

Sources: Federal Statistical Office; National Bank of Yugoslavia; Federal and Republican Ministries of and IMF staff estimates.

1/ With the exception of foreign debt, data for 1999-2002 exclude Kosovo. GDP excludes Kosovo

2/ Excludes workers on "forced holiday."

3/ Fiscal operations of all levels of government, except for Montenegro where it excludes local

4/ Excludes arrears of local governments and most interest payments on foreign debt due but not paid.

5/ From 1999 onwards excludes Montenegro.

6/ For 2002, figures reflect the first phase of the Paris Club debt reduction, and comparable treatment from official bilateral and commercial creditors

Statement by Roberto F. Cippà, Executive Director and Srboljub Antic, Advisor to the Executive Director for the Federal Republic of Yugoslavia
May 13, 2002

Introduction

The authorities of the Federal Republic of Yugoslavia (FRY) welcome the staff report and thank the Executive Board for the continuous support. They are also grateful to management and staff, especially Mr. Zervoudakis and his team, who are performing an excellent job. Our authorities are fully committed to implement the policies defined in the Extended Arrangement (EA). The new agreement will be the third in a period of eighteen months, a period in which the policy orientation has shifted from crisis management to macroeconomic stabilization, to implementation of pro-growth policies.

On the political front, the process of redefining the relations between Serbia and Montenegro has started. The agreement signed in March 2002 foresees the drafting of a new constitutional charter by the end of June and its ratification by the federal and republican parliaments approximately by the end of the year. The agreement provides for a union state with one political identity, but recognizes two different economic systems. The gradual harmonization of the economic systems of the member states with the EU shall overcome the existing differences, primarily in the spheres of trade and customs policies. The federation and both republics are fully committed to the implementation of the agreement.

The pace of economic reforms in FRY has been faster than initially anticipated. In many areas, the results are above expectations. This outcome stems from very strong ownership combined with clear and prudent advice from staff. The authorities have demonstrated strong commitment to avoid partial solutions and to press ahead with bold reforms where and when justified, like for instance in the case of loss-making state owned entities. Severe resource constraints were also a factor for rapid structural reform.

Looking ahead, the authorities are fully aware of the dire state of the economy and the serious reform challenges. The low level of GDP (still 50 percent below the 1990 level) and industrial production (more than 60 percent lower) highlight the importance of stable and rapid economic growth. Rapid growth is also a condition for achieving a sustainable external position and for beginning to solve the problem of widespread poverty.

The main goals of the program under the EA are ambitious; to complete the transition process by 2005 and to prepare the ground for membership negotiations with the EU. This means establishing a competitive export-oriented market economy based on dominant private ownership and modern institutional arrangements, while preserving and fostering the already achieved macroeconomic stability.

Recent Economic Developments

Estimated GDP growth in 2001 was 5.5 percent. The main sources of growth were in the services and agricultural sectors. Industrial output stagnated throughout 2001, with big differences in recovery within the sector. In the first quarter of 2002, industrial production was slightly lower compared to the same period last year, but recent developments show signs of recovery. The service sector is still growing very fast. The authorities are confident that the projected GDP growth of 4 percent for this year will be achieved.

Inflation has declined steeply due to steadfast monetary policy. During 2001, a period in which administered utility prices were adjusted and indirect taxes raised, inflation was lowered by two-thirds to 39 percent. Core inflation was estimated at 15 percent. The declining trend in inflation continued for the four months in 2002, when inflation was 3.4 percent. While significant increases in administered electricity prices are planned before mid-year, the developments over the past four months bode well for the projected inflation rate of 20 percent at end-2002. The current account deficit was lower than projected mainly due to buoyant remittances. The foreign exchange reserves of the NBY reached US$1.2 billion (2.6 months of imports) at the end of 2001 and continued to grow in the first four months of this year.

Fiscal Policy

Fiscal policy has the difficult task of balancing the contradicting goals of ensuring the viability of the exchange rate regime and of providing the necessary resources for deep reforms in major expenditure areas. The support of economic recovery will have to be reconciled with the efforts to further reduce inflation and achieve fiscal sustainability. The fiscal deficits will remain sizable throughout the whole arrangement due to the high costs of maintaining an appropriate social safety net during the transition, the servicing of the large foreign debt, as well as the financing of growth-enhancing infrastructure investment. Foreign assistance and privatization proceeds will be the main sources of financing. In case that foreign assistance or proceeds from privatization do not materialize, the authorities have identified capital spending and subsidies as areas for expenditure cuts.

At the federal level, in line with the recent agreement on a new constitutional framework, large expenditure cuts can be expected. The reform of the military has been initiated with the objective to reduce the size of the officer corps and to shorten the conscription period.

A number of structural reforms have been initiated at the republican levels to further improve revenue collection and expenditure management. By introducing amendments to the Pension Law, better management of the health fund and social welfare programs, the Serbian authorities improved control over social spending, thus creating a sound base for further cuts. In Serbia, the authorities are continuing their efforts to reorganize the Public Revenue Agency, create a Large Taxpayer Unit and a unique taxpayer identification number. The basic functions of the Treasury will be established by the end of September 2002. On the revenue side, the authorities started preparation for the introduction of the VAT in 2004.

After significant problems in 2001, the Montenegrin authorities managed to improve the budget situation by widening the tax base and by cutting capital expenditures. Further fiscal reforms will concentrate on the pension and health care reform and on improving Treasury operations. The reform of the pension system aims at increasing the retirement age and shifting the indexation scheme to a more appropriate model. The Montenegrin authorities are in an advanced stage of establishing a fully functioning Treasury, which will further improve expenditure management and budget monitoring.

Monetary and Exchange Rate Policy

The National Bank of Yugoslavia (NBY) has continued to pursue a tight monetary policy in line with its goal of reducing inflation, thus creating conditions for economic recovery. This policy was successful in lowering the inflation rate and in raising real money balances, which reflects the growing confidence in the domestic currency. In order to create a conducive environment for banks to improve the efficacy of monetary policy, and to support the development of a money market, the NBY recently simplified considerably the reserve requirements system and reformed its credit window facility. The new foreign exchange law liberalizes foreign exchange market thus paving the way for FRY's acceptance of the obligation of Article VIII, Sections 2,3 and 4.

The exchange rate policy based on a managed float has served Serbia well in raising confidence in the dinar and containing inflationary expectations. This policy will continue in the future with some added flexibility. The aim is to have a balanced approach towards the disinflation objective of the program and the prevention of an unsustainable appreciation of the real exchange rate that could undermine external competitiveness. The authorities agreed with staff that the exchange rate policy has to be kept under close scrutiny taking into account not only the situation in the interbank market, but also developments in exports, imports and wages.

Bank Restructuring

The acute phase in restructuring the banking system that led to an initial concentration and to closures of banks will end in June 2002, with a final decision regarding the destiny of banks that are under the control of Bank Rehabilitation Agency (BRA) or directly administered by the NBY. The policy will focus on the privatization of the remaining state banks and the strengthening of banking supervision through regulation based on international standards. The BRA has already started a process of selling physical assets of closed banks. To underpin the support for a sound and resilient banking system, the authorities decided that state and state owned entities would no longer contribute capital to banks.

Real Sector

The authorities have embarked on actions that will create an environment favorable to business and investment. Some improvements have already been made with the liberalization of the labor market, where employment contracts and wage determination have become flexible. The taxation rate on wages was lowered, thus encouraging official rather than informal employment. Barriers to entry and foreign trade are also addressed and there are clear moves to simplify the process of enterprise creation and to reduce or remove unnecessary red tape. The changes in public administration, which are under preparation, will ease the fight against corruption. This is also the area where some progress has been achieved. To boost growth, the authorities intend to attract sizable official and private assistance and investment for major infrastructure projects of regional importance.

The combination of privatization efforts and the creation of a business friendly environment has improved the prospects for economic growth. Although the privatization process has been slower that expected, there are signs that privatization in Serbia will gain momentum in the near future. With the help of the World Bank, 27 companies are slated for privatization through tenders. The first privatization auction for smaller companies has been successfully closed, and the Action Fund has started to sell shares of companies that had been partially privatized under the old regulation.

The Montenegrin privatization has been more diversified. The sale of majority stakes in enterprises to strategic investors through tenders and auctions are accompanied by mass voucher privatizations for minority stakes in selected enterprises.

Poverty Reduction

With the assistance from the World Bank and the Fund, the I-PRSP strategy is in the initial phase of preparation. According to the first results from two studies prepared by NGOs, poverty in Serbia is widespread and results from the prolonged depression. It is mostly an urban phenomenon and many people who are formally employed are under the poverty line. In addition, many workers will lose their jobs in the transition process, so the strategy for fighting poverty has to define adequate preventive actions. In designing and implementing the strategy, the authorities will need financial support from donors and technical assistance for quite some time.

Debt Sustainability

The approval of the new arrangement with the Fund will trigger an agreement with the Paris club and will reduce the net present value of FRY foreign debt. Meanwhile, the FRY already signed bilateral agreements with five creditors from the Paris club. Negotiation with the London club and other bilateral and commercial creditors are under way, but so far without tangible results. Our authorities expect that the improvement in external debt indicators will continue after the expiration of the EA, as a result of phased debt reduction and the reliance on grants, concessional loans and FDI that will finance the current account deficits. A prudent policy of external debt management will underpin the progress towards external sustainability.

Conclusion

Our authorities wish to underscore the excellent cooperation with the Fund during the arrangements that have resulted in rapid and comprehensive reforms. They are fully aware that the new agreement provides an essential framework for completing the stabilization agenda and pursuing vigorous structural reforms. Therefore, the EA is of critical importance for the country. The authorities again stress their firm commitment to continue with the reforms in a transparent way.