INTERNATIONAL MONETARY FUND

Staff Country Reports

June 2003
IMF Country Report No. 03/151

Serbia and Montenegro: First Review Under the Extended Arrangement—Staff Report; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Serbia and Montenegro

In the context of the First Review Under the Extended Arrangement, the following documents have been released and are included in this package:

- the staff report for the first review under the Extended Arrangement, prepared by a staff team of the IMF, following discussions that ended on **February 12, 2003,** with the officials of Serbia and Montenegro on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on April 1, 2003**. 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 Press Release summarizing the **views of the Executive Board as expressed during its April 16, 2003 discussion** of the staff report that completed the review.

- a statement by the Executive Director for Serbia and Montenegro.

The document(s) listed below have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Serbia and Montenegro*
Memorandum of Economic and Financial Policies by the authorities of Serbia and Montenegro*
Technical Memorandum of Understanding*

*May also be included in Staff Report

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

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International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

SERBIA AND MONTENEGRO

First Review Under the Extended Arrangement

Prepared by European I and Policy Development and Review Departments

(In consultation with other Departments)

Approved by Carlo Cottarelli and Shigeo Kashiwagi

April 1, 2003

The discussions with the authorities of Serbia and Montenegro (SM, formerly Federal Republic of Yugoslavia) for the first review under the Extended Arrangement (EA) were held in Belgrade and Podgorica during October 23–November 7, 2002 and January 29–February 12, 2003.

The staff team—Mr. E. Zervoudakis (head), Mr. B. Horváth, Ms. X. Li, Ms. K. Alexandraki (all EU1), Ms. L. Cui (PDR), and Ms. M. Fouad (FAD)—was assisted by Mr. J. Charap, the Fund resident representative, and cooperated closely with World Bank staff. Mr. S. Antic, Advisor to the Executive Director for SM, attended the discussions.

The SM representatives included: (a) at the federal/union level, Deputy Prime Minister Labus (head of the SM delegation); (b) in Serbia, Finance Minister Djelic, Social Affairs Minister Matkovic, Privatization and Economy Minister Vlahovic, Energy and Mines Minister Udovicki, International Economic Relations Minister Pitic, and National Bank of Serbia (NBS) Governor Dinkic; and (c) in Montenegro, Finance Minister Ivanisevic and Chairman of the Central Bank Council Krgovic.

SM accepted the obligations under Article VIII, Sections 2, 3, and 4 on May 14, 2002.

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Appendices

ABBREVIATIONS AND ACRONYMS

BRA	Bank Rehabilitation Agency
CAMEL	Bank rating system based on Capital Adequacy, Management, Earnings and Liquidity
CBM	Central Bank of Montenegro
CIT	Corporate Income Tax
DBU	Direct budget user
EA	Extended Arrangement
EBRD	European Bank for Reconstruction and Development
EIB	European Investment Bank
EPS	Electricity Company of Serbia
FAD	Fiscal Affairs Department
FDI	Foreign direct investment
FFCD	Frozen foreign currency deposits
FRY	Federal Republic of Yugoslavia
GDP	Gross domestic product
GFS	Government Finance Statistics
IAS	International accounting standards
LTU	Large Taxpayers Unit
MEFP	Memorandum of Economic and Financial Policies
NBY(S)	National Bank of Yugoslavia (Serbia)
NDA	Net Domestic Assets
NFA	Net Foreign Assets
NPV	Net Present Value
PC	Performance criterion
PIT	Personal Income Tax
PRA	Public Revenue Agency
PRSP	Poverty Reduction Strategy Paper
SB	Structural benchmark
SBA	Stand-By Arrangement
SDP	Supervisory development plan
SM	Serbia and Montenegro
SNA	System of National Accounts
VAT	Value added tax
ZOP	Accounting and Payment Operations Office (Domestic payments service)

I. INTRODUCTION

1. On May 13, 2002, the Executive Board approved an extended arrangement (EA) for Serbia and Montenegro (SM) in the amount of SDR 650 million (or 139 percent of quota, Appendix I). SM has made two purchases, first upon Board approval of the arrangement and subsequently in August upon observance of the end-June 2002 performance criteria (PCs) and completion of a financing assurances review (considered by the Board on a lapse-of-time basis). The third and fourth purchases are contingent on completion of the first review under the arrangement.[1] The first review could not be completed by January 2003 as originally envisaged owing to the delayed adoption of a new constitutional framework, which forestalled implementation of a prior action (parliamentary approval of a revised Serbian budget, currently expected by early April 2003); in other respects, program implementation has been broadly on track.

2. In the attached letter of April 1, 2003, and the accompanying Memorandum on Economic and Financial Policies, the authorities outline policies for the period ahead, proposing PCs, indicative targets and structural benchmarks (SBs) through end-2003 (Appendix VI). On this basis, they request completion of the first review.

3. **The World Bank is involved closely in SM's reconstruction efforts** (Appendix II). Contingent upon policy performance, the Bank envisages concessional lending of up to $540 million for FY 2002–04 (predominantly in adjustment loans). Of this amount, $214 million has already been approved, in support of fiscal consolidation, private and financial sector development, and social sector reforms. An interim Poverty Reduction Strategy Paper (PRSP) was considered by the Boards of the Fund and the Bank last August, and a full PRSP is expected to be completed by mid-2003.

4. **While a new constitution has normalized relations between Serbia and Montenegro, political stability in Serbia has been tested by the assassination of Premier Djindjic on March 12.** The new constitution replacing FRY by the state union of "Serbia and Montenegro" came into force on February 4, 2003 (Box 1). Meanwhile, the federal and republican parliaments resumed work last November after a hiatus of several months, which had contributed to delays in passing reform legislation and ratifying loan agreements. This followed, in Serbia, political realignments that appear to have averted early elections and extended the life of the government; and, in Montenegro, parliamentary elections that returned the governing coalition to power with an absolute majority. The governing coalition in Serbia selected Mr. Zivkovic, a close associate of Mr. Djindjic, as the new Premier with the rest of the cabinet left essentially unchanged. The new government introduced a state of emergency through end-April to fight organized crime and political extremists and stressed its intention to ensure continuity in economic policies.

[1] The first review includes the second and third financing reviews under the arrangement (all purchases are subject to quarterly financing reviews).

Box 1. The New Constitutional Framework for Serbia and Montenegro

The new constitution for the state union of "Serbia and Montenegro" (SM) provides for common defense and foreign polices; acknowledges the existence of different monetary, exchange, customs, and tax regimes (consistent with a free trade area); and envisages harmonization of the economic systems of the two states with that of the EU. Serbia will continue to use the dinar, while Montenegro will use the euro as its sole legal tender. The National Bank of Yugoslavia (NBY) became Serbia's central bank and was renamed National Bank of Serbia (NBS). Montenegro's Central Bank, established in late 2000 and recognized by the new constitution, deals primarily with banking supervision. Each state will maintain customs controls to safeguard its customs and tax collections and contribute to the union budget, proportionally to its share in total GDP.[1] SM will be responsible for FRY's external debt, with the debt servicing burden being internally allocated between the two states.

An assembly of 126 deputies (91 from Serbia and 35 from Montenegro) elects SM's President and 5-member Council of Ministers (for Defense, Foreign Affairs, Foreign Economic Relations, Internal Economic Relations, and Human and Minority Rights). Pending a decision by the Council of Ministers, the Ministry of Foreign Economic Relations has been designated as SM's fiscal agent vis-à-vis IFIs, while the NBS will perform the role of the depository and handle financial transactions with the Fund. Under the constitution, after three years, each state may choose to gain independence following a referendum.

1/ Montenegro accounts for about 7 percent of SM's economy.

II. Recent Economic Developments

5. **Impressive progress has been made in lowering inflation, while the growth target was broadly met** (Table 1, Figures 1–2). Twelve-month *inflation* (retail prices) in SM declined by almost two-thirds to 14 percent by end-2002, against a 20 percent target. In Montenegro, which uses the euro as legal tender, inflation remained relatively high (9 percent), reflecting increases in administered prices and, given the dinar's stability vis-à-vis the euro, "imported" inflation from Serbia. According to preliminary estimates, SM's *real GDP* rose by 3½–4 percent in 2002, broadly as targeted; however, it remained at about one-half of its 1989 level, owing to capacity constraints after a decade of disinvestment and war damage. Industrial output rose by just 1¾ percent, notwithstanding a recovery since Q2 of 2002, while growth in services was higher than forecast.[2]

6. **The current account deficit widened in 2002 by more than envisaged under the program.** *Exports* in 2002 grew by 20½ percent in dollar terms (13 percent in euro terms) but remained at a historically low level, reflecting in part economic restructuring and still limited

[2] Official data may underestimate industrial output growth owing to incomplete coverage of new private firms. The stronger export performance supports this assertion.

access to networks abroad (Figure 3). *Imports* grew faster (30½ percent in dollar terms and 24 percent in euro terms) reflecting mainly the larger-than-expected impact on domestic demand of a higher fiscal deficit and rapidly increasing credit to the nongovernment sector, as well as a further real appreciation of the dinar.[3] Notwithstanding higher-than-expected *private remittances*, the *current account deficit* (before grants) widened by 3 percentage points to 13 percent of GDP in 2002 (9 percent after grants), compared with a program target of 12 percent. Based on preliminary data, the trade deficit narrowed sharply in January–February 2003, reflecting a decline in the volume of imports and buoyant exports compared to a year earlier.

7. **Foreign reserve accumulation in 2002 exceeded program expectations owing to large private capital inflows.** Notwithstanding a shortfall in official financing, the *capital account* was in a larger-than-expected surplus, entirely on account of private inflows. These included capital transfers from workers living abroad; reverse currency substitution and placement of foreign banknotes with local banks, which were facilitated by the euro conversion; and FDI inflows. The latter more than tripled to $562 million in 2002, on account of both greenfield investments (40 percent of the total) and privatization receipts, covering about two-fifths of the after-grants current account deficit. *Official foreign reserves* almost doubled to $2.3 billion (3.4 months of imports) by end-2002, against a target of $1.6 billion.

8. **Rapid remonetization continued under conditions of improved market confidence, but conditions have weakened in early 2003.** Real reserve money has doubled over the past two years in an environment of declining inflation and market interest rates (Figure 4). Meanwhile, the dinar has appreciated in real terms by about 44 percent against the euro (50 percent against a $/€(30/70) basket) since end-2000, when multiple exchange rates were unified at the rate prevailing in the parallel market and a managed float was adopted. The interbank foreign exchange market has been in surplus for most of this period, although net sales by the National Bank of Serbia (NBS) have occurred in recent months. These developments are apparently explained by a strengthening of money demand and the roughly unchanged NDA of the NBS, owing in part to limited government borrowing. The remonetization has facilitated a surge in bank credit to the economy (a real increase of 31 percent during 2002, equivalent to 3 percent of annual GDP). While this may be a welcome development after a long period of stagnation, its pace contributed to the widening trade imbalance and raises concerns about the quality of new lending.[4] Meanwhile, market sentiment seems to have changed in early 2003, as reflected in some NBS foreign reserve losses (by around $150 million, to $2.1 billion on March 20, or 3.2 months of prospective

[3] Consumer and investment goods imports both registered strong increases.

[4] About ¼ of the new lending was accounted for by households, another two-thirds by private enterprises, and the remainder (under 10 percent) by state and socially-owned enterprises. About 20 percent of total lending, largely to export-oriented firms, is denominated in—or indexed to—the euro.

imports) and a faster nominal depreciation (3 percent against the euro, in contrast to a broadly stable rate in 2001–02). Besides the peak in the trade deficit in late 2002, delays in foreign assistance linked to completion of the program review, and the effects on confidence of the Serbian Premier's assassination have contributed to these developments.

9. **Fiscal performance has been broadly in line with the program.** According to preliminary estimates, the overall deficit in SM reached 5 percent of GDP in 2002, slightly less than targeted (Tables 7A–D).[5] This represents an increase of about 3¾ percentage points from 2001, when the deficit had been constrained by a shortfall in foreign financing and privatization proceeds. Revenue increased by 3½ percentage points of GDP—or by 2 percentage points more than programmed—reflecting the full-year impact of tax reform in Serbia and the effects of buoyant domestic demand on sales tax and customs receipts. Expenditure increased by 7 percentage points reflecting higher capital spending as well as transfers and subsidies, in part to support bank and enterprise restructuring.[6] Higher-than-programmed privatization proceeds not only offset a shortfall in foreign financing but also allowed the government to reduce its indebtedness to domestic banks by the equivalent of ½ percent of GDP in 2002 (the program allowed for government borrowing from banks of up to ½ percent of GDP).

10. **Progress in structural reform has been satisfactory, despite delays in observing structural benchmarks.** Liberalization of the foreign exchange system last May paved the way for acceptance of obligations under Article VIII of the Fund's Articles of Agreement. Electricity prices in Serbia were raised by 50 percent on July 1, 2002 in fulfillment of a structural PC (Appendix VI, Annex C). Another structural PC was observed with the abolition of the payments monopoly of ZOP (the domestic payments service system) on January 1, 2003, which removed a key impediment to enhanced financial intermediation. Privatization proceeds reached \$420 million in 2002, almost twice the program amount. Ten out of 12 SBs for the period through end-December 2002 have been implemented, albeit with some delay owing to limited implementation capacity and the disruption of legislative activity for several months. The two remaining SBs refer to the adoption of pension

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[5] The target of 5.3 percent of GDP reflects an upward revision of nominal GDP since 2000; the original EA target was 5.7 percent of GDP.

[6] Expenditure was broadly as programmed in nominal terms but higher than targeted in relation to GDP by 1¾ percentage points, owing to the effects of inflation overperformance on nominal GDP. In Serbia, overspending—on subsidies, purchases of goods and services, and transfers to the Pension Fund—was offset by lower interest payments, social benefits, and capital expenditures, as well as surpluses at the federal and local government level. In Montenegro, higher-than-budgeted spending on net wages necessitated cuts in discretionary spending and led to the accumulation of some arrears, particularly in the government's contributions to social funds. Inadequate data on budgetary arrears in Montenegro, pending the full implementation of the Treasury, have complicated monitoring of budget execution.

legislation in Montenegro and of a new National Bank Law in Serbia and are expected to be met by end-April and end-December 2003, respectively.

III. Policy Discussions

11. **The authorities and the staff reached a common assessment of the policy achievements so far and the challenges ahead:**

- Regarding stabilization, while impressive progress has been made in lowering inflation and strengthening foreign reserves, significant risks remain, notably a growing external imbalance that requires policy correction. The imbalance has stemmed mainly from a larger-than-expected impact on domestic demand of the fiscal stimulus and rapid credit growth in 2002. In addition, although the sharp real appreciation since end-2000 reflects at least in part the correction of an initial undervaluation (see below), the current margins of competitiveness are testing the capability of the economy to maintain a balanced growth process. Moreover, the nature of some of the private capital inflows remains unclear, and there is a risk that they may be suddenly reversed. The recent assassination of the Prime Minister has heightened risks further, notwithstanding the authorities' demonstrated commitment to policy continuity.

- Regarding structural reform, significant progress has been made toward putting in place a market-oriented legal and institutional framework and toward economic restructuring, while protecting vulnerable groups through increased social spending. However, ahead is still the more difficult stage: following the success in privatizing some of the (few) profitable enterprises, there is now a need to restructure insolvent enterprises prior to privatization and to enforce bankruptcies, requiring difficult decisions on employment.

Against this background, the authorities and the mission agreed that an appropriate response to the growing external current account imbalance and intensified reform efforts were key to keeping the economy on the path of sustainable growth, even though political pressures for policy relaxation were building up.

12. **The authorities' economic objectives for 2003—consistent with the updated medium-term framework—envisage continued disinflation, sustained growth, and a strengthening of the external position** (Text Table 1).

- *Growth* of 3½–4½ percent in 2003 would reflect a further recovery in industry and sustained growth in services, based on the investment and restructuring of recent years, offsetting restructuring-induced temporary output losses.

- The *inflation* target of 9–11 percent for 2003 is ambitious—when taking into account administered price increases—but achievable. Monetary and wage policy targets are based on the lower end of the target range.

- The projected decline in the *current account deficit* (before grants) to 11 percent of GDP in 2003 would reflect import deceleration and continued export recovery, in response to tighter credit conditions and fiscal stance. The current account deficit is expected to be financed by foreign grants, official loans, FDI, and private capital inflows; the latter are conservatively projected to decline by two-thirds in 2003.

- *Official foreign reserves* are targeted to exceed the equivalent of 3.8 months of projected imports by end-2003.

Text Table 1: Key Macroeconomic Objectives and Policies, 2001–2005

	2001	2002		2003		2004	2005
	Actual	Prog.	Prel. Est.	Prog.	Proj.	Proj.	Proj.
				(Percentage change)			
Real GDP Growth	5.5	4.0	4.0	5.0	3½ - 4½	5.0	5.0
Inflation (end period)	39.0	20.0	14.2	12.0	9-11	7.0	5.0
Of which : Montenegro	24.0	12.0	9.4	8.0	8.0	5.0	3.0
				(In percent of GDP)			
Domestic investment	13.5	15.4	16.1	17.6	16.5	17.4	18.9
Domestic savings	-8.6	-6.4	-7.0	-3.4	-3.5	-0.9	2.2
National savings	8.0	7.2	7.2	8.1	8.3	9.5	12.5
Current account deficit (before grants)				(In billions of US$)			
US$ billion	1.1	1.6	2.0	1.7	2.2	2.0	1.8
In percent of GDP 1/	9.7	12.0	12.8	11.6	11.0	9.4	7.9
Excluding net interest payments (percent of GDP) 1/	9.0	9.8	11.7	9.2	8.9	7.1	5.4
Gross official reserves	1.2	1.6	2.3	2.1	2.7	3.1	3.5
In months of projected imports	2.4	3.0	3.4	3.5	3.8	4.1	4.4
				(In percent of GDP)			
Fiscal Deficit 1/	1.4	5.3	5.0	4.9	4.5	4.3	3.9
Government credit from the banking system	0.7	0.5	-0.5	0.5	0.0	0.6	0.9
			(In percent of year-beginning reserve money)				
NFA growth	86.8	24.6	52.4	...	12.8	...	...
NDA growth	2.3	11.9	-4.2	...	0.0	...	...
Reserve money growth	89.1	36.5	48.1	...	12.8	...	...

Sources: SM authorities; and IMF staff estimates.
1/ Program figures are adjusted to reflect the official revision of the GDP series.

13. **Consistent with these objectives, the 2003 program features some fiscal tightening and strict NDA limits.** The fiscal deficit is envisaged to decline by 0.5 percentage points to 4.5 percent of GDP in 2003, as lower current spending will make room for higher investment as well as a lower tax burden. Monetary policy will aim at slowing down the growth in bank lending. In the context of limited elasticity of capital inflows to domestic credit conditions, this tightening is unlikely to put undue pressure on the exchange rate. Wage bills in public enterprises will be contained in line with projected inflation.

14. **Ambitious structural reforms are envisaged for 2003.** They cover fiscal areas (tax policy and administration, expenditure management, and streamlining of social spending),

bank privatization, restructuring of large insolvent conglomerates, and enterprise privatization; for the latter, procedures will be streamlined to render financially weak enterprises more attractive to strategic investors.

15. **The public sector and external debt sustainability outlook has not changed significantly from April 2002 (EBS/02/73, 4/26/02).** Debt ratios are expected to improve steadily over the next 10 years under the baseline scenario, while debt service ratios would increase until 2009 and decline gradually afterwards, partly reflecting the increased debt service after the end of the grace period offered by the Paris Club (Appendix IV). This argues for a steady buildup of official reserves to guard against possible risks. Some of the external sustainability indicators have improved compared to the April projections, but this reflects mainly the larger-than-programmed real appreciation of the dinar that has raised dollar GDP. The fiscal sustainability indicators have also improved somewhat and suggest that the path of the debt-to-GDP ratio remains sustainable (Appendix V, and Figure 4).

A. Fiscal Policy

16. **Fiscal policy will be tightened in 2003 (¶11–14).**[7] The authorities decided to lower the fiscal deficit target to 4½ percent of GDP in 2003 (Text Table 2). Domestic borrowing will be eschewed except for seasonal budgetary needs, and the deficit will be financed externally and by privatization proceeds of 2.7 percent of GDP and 1.8 percent of GDP, respectively. The next review mission (May 2003) will assess whether using any excess privatization proceeds for restructuring and investment needs would be consistent with the program's economic objectives.

[7] Henceforth, unless otherwise noted, references to paragraphs pertain to the MEFP in Appendix VI.

Text Table 2. Consolidated General Government Fiscal Operations in 2000–2005 1/

(In percent of GDP) 2/

	2000	2001	2002		2003	2004	2005
		Prel.	Prog.	Prel.	Prog.	Proj.	Proj.
Total revenue	36.7	38.9	40.3	42.5	40.5	41.1	40.6
Tax revenue	33.1	35.5	37.5	39.4	37.8	38.4	37.9
Nontax revenue	3.6	3.5	2.8	3.1	2.7	2.7	2.7
Capital revenue	0.0	0.0	0.1	0.0	0.0	0.0	0.0
Total expenditure and net lending	37.6	40.3	45.7	47.5	45.1	45.4	44.5
Purchases of goods and services	17.4	17.4	16.5	18.3	17.5	17.3	16.7
Of which: Wages and salaries	9.4	9.5	9.4	10.4	10.2	10.2	10.0
Interest payment	0.6	0.7	1.7	1.0	1.1	1.5	1.6
Subsidies	2.1	3.1	4.0	4.3	3.2	2.9	2.6
Transfers to households	14.3	16.4	18.9	19.5	19.4	19.2	18.7
Capital expenditure	3.1	1.6	3.5	3.4	3.4	4.0	4.4
Other	0.2	1.0	1.0	1.0	0.5	0.5	0.5
Unclassified spending (incl. stat. discr.) 3/	0.0	0.1	0.0	0.6	0.0	0.0	0.0
Overall cash balance	-0.9	-1.4	-5.3	-5.0	-4.5	-4.3	-3.9
Financing	0.9	1.4	5.3	5.0	4.5	4.3	3.9
Domestic financing	0.2	0.7	0.6	-0.5	0.0	0.6	0.9
Foreign grants	0.7	0.7	0.9	1.1	0.7	0.6	0.4
Net foreign financing	0.0	0.0	2.5	1.8	2.0	1.9	1.5
Budgetary loans	0.0	-0.2	1.4	1.0	0.9	0.6	0.3
Project loans	0.0	0.2	1.1	0.8	1.1	1.3	1.2
Privatization receipts	0.0	0.0	1.2	2.6	1.8	1.1	1.0
Memorandum items:							
Social spending 4/	20.5	21.8	22.9	23.5	23.4	23.2	22.7
Overall cash balance excluding project spending	-0.9	-1.2	-4.2	-4.2	-3.4	-3.0	-2.7
Overall cash balance of:							
Serbian general government	-0.2	-0.9	-5.0	-4.7	-4.1	...	...
Montenegrin general government	-0.7	-0.4	-0.4	-0.3	-0.4	...	...
Overall cash balance of general government in Montenegro (in percent of its GDP)	-6.7	-4.7	-4.7	-4.0	-5.6	...	...

Sources: Federal and Republican Ministries of Finance; and IMF staff estimates.

1/ Consolidated general government includes union (previously federal) level operations, the republican and local governments, the social security funds and the extrabudgetary programs, except for local governments in Montenegro for which data are not available.

2/ Expressed in terms of GDP of Serbia and Montenegro excluding Kosovo.

3/ Difference between the deficit calculated from financing data and the reported deficit from above-the-line data.

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

Serbia

17. **The 2003 fiscal program in Serbia envisages continued fiscal consolidation together with a lowering of the tax burden (¶15–17).** The revenue/GDP ratio is projected to decline by 2.2 percentage points of GDP, as a result of tax relief measures to stimulate

investment and reduce distortions in financial transactions; a projected decline in the consumption tax base in relation to GDP; and conservative estimates reflecting the effects of the payments system reform and enterprise restructuring.[8] Noninterest current expenditure would decline by about 2.7 percentage points of GDP, mainly on account of reduced subsidies. Wage spending would decline slightly in relation to GDP, reflecting "corrective" real increases of basic wages in three sectors (education, health, and judiciary), which would be offset by wage restraint in other sectors and employment cuts mostly at the former federal level. In response to the mission's concerns about the government wage increases, the authorities noted the need to improve the quality of public services and the stricter limits on wage bills in state enterprises, where average wages are significantly higher. Expenditure includes temporary outlays of some 0.2 percent of GDP associated with the state of emergency.

18. **The above spending target will be achieved in part by keeping spending commitments below budgetary allocations (¶17).** The Finance Minster has publicly announced such cuts of 0.7 percent of GDP in accordance with provisions of the systemic budget law and has a good track record of maintaining spending commitments below budgeted allocations when financing is not available. In addition, in light of the uncertain macroeconomic outlook, as well as concerns about the effects of the payments system reform on tax revenue, the authorities will contain discretionary spending commitments strictly in the first half-year.

19. **Fiscal reforms in Serbia will enhance tax administration and the role of the treasury (¶18–19).** The recently established Large Taxpayers Unit (LTU) in Belgrade will be strengthened and new LTUs will be established for three other cities (SB-monitored). Tax identification numbers became operational in January 2003. The disruptions to revenue collection following the elimination of the domestic payments service (ZOP) in January 2003 have been addressed and revenue returned to normal levels by February. In the expenditure management area, the treasury is expected to gradually cover all direct budget users (SB-monitored) and incorporate a full payroll system.

Montenegro

20. **Montenegro's fiscal program for 2003 entails an adjustment effort of ½ percent of GDP (¶21).** The projected increase in the fiscal deficit by 1½ percentage points of GDP (to 5.6 percent of GDP) in 2003 compares with a new burden—stemming from increased

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[8] Corporate income and financial transaction taxes will be lowered (0.5 percent of GDP), the extra-profit tax will be abolished (0.3 percent of GDP), basic food items will be exempted from the 20 percent sales tax (0.2 percent of GDP), and some regional tariffs will be lowered (0.1 percent of GDP). At the same time, selected excise tax rates and administrative/customs fees will be raised (each 0.3 percent of GDP) Finally, the tax base for pension contributions will be widened (0.1 percent of GDP).

contributions to finance union-level spending—of around 2 percent of GDP. Adjustment to this new burden will be achieved by containing current spending, especially subsidies, lending to enterprises, and wages; the latter will be implemented in part through retrenchments that were originally envisaged to take place in 2002. Revenue is projected to rise in relation to GDP as a result of tax reforms and customs harmonization with Serbia (see below), although staff noted that the revenue projections were subject to some downward risks. The deficit will be financed mostly by privatization proceeds and foreign assistance, with borrowing from banks limited to 0.6 percent of Montenegro's GDP. The government will not incur new indebtedness to the CBM (an outstanding obligation to the CBM of €14 million was eliminated in February).

21. **Fiscal reforms in Montenegro will focus on tax policy and the pension system (¶22).** A VAT is expected to be introduced in April 2003. The staff cautioned that leakages could result from delays in registering VAT payers and in establishing proper border controls with Serbia, as Montenegrin exports would be subject to a VAT refund. A new pension law to be adopted soon will raise the retirement age and change the indexation formula (SB-monitored). Finally, all revenue from customs and indirect taxes as well as privatization proceeds will be channeled to the state budget, while the strengthening of the Treasury would improve expenditure management. These measures will enhance fiscal transparency and help prevent new expenditure arrears.

B. State Enterprises

22. **State enterprise profitability will improve through wage restraint, pricing measures, and operational streamlining (¶23–24).** The wage bill in 7 large state enterprises will be allowed to rise in line with projected inflation, as in 2002. By end-April 2003, the Serbian government will approve restructuring plans for these enterprises, aimed at streamlining operations and reducing overstaffing. Electricity prices in Serbia will be raised by at least 20 percent in mid-2003 to enable the electricity company to recover current costs (structural PC-monitored), while an independent energy regulator will be established by end-2003.[9] Montenegro raised electricity prices on April 1, 2003.

C. Monetary and Exchange Rate Policies

23. **Monetary policy in Serbia will be geared to achieving the ambitious inflation target (¶25).** During 2003, reserve money is targeted to rise by 13 percent driven entirely by increases in NFA (Text Table 3). The NFA targets reflect a projected decline in capital inflows in the form of reverse currency substitution and new foreign currency deposits with local banks, which were boosted last year by the euro-conversion. Authorities and staff

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[9] The authorities are also considering the option of (a) a somewhat lower but earlier electricity price increase and (b) cost-cutting measures to eliminate EPS losses. If they choose this option, they intend to request a modification of the structural PC in the next review.

expected that the envisaged tightening of credit policy—in part through higher reserve requirements and a shift of government deposits to the NBS—would not exert undue upward pressure on the exchange rate. Given uncertainties about money demand, the NBS will stand ready to keep NDA under the program ceiling and safeguard its foreign reserves.

Text Table 3. Monetary Indicators, 2000–2003

	2000	2001	2002				2003			
	Dec.	Dec.	Sep.		Dec.		Program			
	Act.	Act.	Target	Act.	Orig. Target	Act.	April	June	Sep.	Dec.
	(Cumulative contribution to reserve money growth based on monthly average, in percent)									
NFA 1/	147.7	86.8	18.9	52.0	24.6	52.4	-15.7	-3.2	6.3	12.8
NDA 1/	-56.6	2.3	10.4	-8.5	11.9	-4.2	14.0	7.7	4.4	0.0
Reserve money 1/	91.1	89.1	29.3	43.5	36.5	48.1	-1.7	4.4	10.7	12.8
	(Cumulative change during the year based on monthly average, in percent)									
Currency in circulation 1/	52.0	131.6	-30.9	48.8	45.0	49.4	-5.2	2.2	12.8	14.1
	(Cumulative change in millions of U.S. dollars from year-beginning; end-Dec.-previous year exchange rate)									
NFA	...	306.6	115.0	302.3	153.0	354.9	-184.0	-65.0	30.0	91.8
Gross official reserves	...	684.5	373.0	757.1	476.0	864.7	-34.1	93.4	330.7	388.0
	(Cumulative percentage change from year-beginning)									
Memorandum items:										
Retail prices	113.5	39.0	15.7	9.9	20.0	14.2	2.5	6.1	7.3	9.0
Velocity (GDP/Reserve money) 2/	37.6	25.7	...	17.4	19.0	18.2	21.5	19.7	18.7	19.0
Cumulative change	...	-31.6	...	-32.5	-26.2	-29.4	18.3	8.7	3.0	4.4

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

1/ In 2000 to 2002, actual changes are based on monthly averages with end-year data as the base. Adjusted for changes in the reserve requirement and bank closures.

2/ Based on estimated annualized monthly GDP and monthly average reserve money.

24. **The key issue in Serbian exchange rate policy is the balance between safeguarding the external position and supporting disinflation (¶26).**

- Regarding external competitiveness, the real exchange rate has appreciated by 45–50 percent on the basis of consumer prices since end-2000, and by even more on the basis of wage costs, albeit from a very low level (Figure 2). This, together with the relatively modest export performance and the widening current account deficit above the program target, suggest that the initial undervaluation of the dinar has been at least eliminated, thereby possibly jeopardizing the economy's ability to pursue balanced growth. But there is still no conclusive evidence of large currency overvaluation: wage data may be biased by data distortions;[10] the export performance reflects in part ongoing restructuring and supply lags; and the surge in imports stems largely from an excessive increase in domestic demand—owing to pent-up demand for imported goods after many years of sanctions, and the larger-than-anticipated impact of the fiscal stimulus and bank lending to the nongovernment sector. Indeed, the sudden slowdown in imports in early 2003 suggests the influence of domestic demand factors.

- Regarding disinflation, exchange rate stability has played an important role in stabilizing price expectations and, by hardening budget constraints, in enterprise restructuring.

Against this background, the authorities have decided to address domestic demand growth by tightening fiscal and credit policies. They will also keep exchange rate policy under close review, taking into account trade and wage developments as well as conditions in the interbank foreign exchange market. Exchange rate policy will be a key focus of the next review (in mid-2003).

D. Trade Policy

25. **Serbia and Montenegro will harmonize their trade systems, while converging them toward that of the EU (¶27).** Serbia has higher import tariffs but fewer QRs than Montenegro. The Serbian and Montenegrin authorities intend to agree by end-April 2003 on a timetable to harmonize their trade, customs, and excise regimes by end-2005 at the latest. Serbia eliminated all export quotas in early 2003 and Montenegro intends to do so by end-March 2003. Import quotas are to be eliminated by end-2004.

E. Bank Reform

26. **The main focus of bank reform in 2003 will be privatization and supervision (¶28–29).** Following the acquisition of controlling stakes in 16 banks (accounting for more than one-half of total bank assets) through debt-for-equity swaps in late 2002, the Serbian government has undertaken to offer three of these banks for sale by end-2003 and most of them by mid-2004 through transparent procedures, with World Bank technical assistance. In the run-up to privatization, control mechanisms have been put in place to preserve the banks' value. In Montenegro, the privatization of Montenegro Bank, formerly the largest bank in the

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[10] The officially reported average real wage growth (23 percent in 2002) is probably overstated, reflecting data problems. Survey-based data point to real wage growth of around 10 percent, compared with average productivity growth of about 8 percent.

state, is being finalized. In addition, stricter prudential regulations will be enforced in both states and IAS will be adopted also for Serbian banks. After some delay, legislation was adopted last November, enabling the CBM to supervise offshore banks in line with regulations applicable to onshore banks, with a view to terminating off-shore operations in Montenegro.

F. Enterprise Restructuring and Privatization

27. **Privatization is expected to accelerate.** Privatization in Serbia is pursued through tenders of large socially owned enterprises, auctions of smaller ones, and divestiture of remaining minority stakes (¶31). With the groundwork laid in 2001–02, privatization is set to accelerate in 2003, generating proceeds of about €550 million according to the Privatization Ministry (up to €1 billion if a mobile phone license is offered for sale). By end-2003, almost half of the socially owned enterprises are expected to have been offered for sale. To address the difficulty of attracting strategic investors in financially weak large enterprises sold through tenders, the authorities have lowered the length of guaranteed post-privatization employment from 3–5 years to one year (also applicable to small enterprises sold through auctions and to the large conglomerates subject to restructuring). Montenegro seeks to match its 2002 privatization performance, generating income of €70 million (¶32).

28. **Public enterprise restructuring will continue in 2003.** The process covers 49 enterprises with over 150,000 employees. After taking stock of the companies' assets, legal obligations and the magnitude of overstaffing, management and employment changes are implemented with a view to preparing the majority of these enterprises for privatization. With a view to preserving social peace, retrenchments involve substantial up-front budgetary costs (estimated at €100 million for 2003). The authorities envisage completing this process by end-2004.

29. **A broad array of measures seeks to create an environment conducive to the emergence of a vibrant private sector.** A new enterprise bankruptcy law, prepared with World Bank assistance, will streamline exit procedures and strengthen the position of creditors, contributing to an orderly reallocation of inefficiently used assets. This would supplement the adoption of a liberal labor law in late 2001. The creation of a real estate cadastre currently underway will facilitate the emergence of a real estate market.

IV. Financing Assurances

30. **Following the December 2001 Paris Club agreement, the authorities have sought restructuring agreements for the remainder of eligible debt.**[11] Negotiations with other official bilateral and London Club creditors are underway, with the authorities aiming for

[11] As of end-January 2003, 14 out 17 bilateral agreements with Paris Club creditors have been concluded or initialed.

terms broadly similar to those in the Paris Club agreement (66 percent NPV reduction). However, the prospects for an early agreement with the London Club remain unclear as these creditors have offered a NPV reduction of about 30 percent. Meanwhile, a detailed reconciliation of London Club debt data was achieved in February 2003.

31. **Overall, the external financing outlook remains satisfactory** (Table 3). The current account deficit is projected to decline in 2003. Excluding scheduled Fund purchases, total grants and loans are expected to reach $1.1 billion, including $333 million of budgetary/BOP assistance, which is expected to be secured based on existing commitments or indications from key donors. These inflows, together with FDI, other capital inflows and some further assumed debt restructuring, are expected to allow this year's financing needs to be covered, including a projected increase in gross official reserves to $2.7 billion (3.8 months of imports) at end-2003. In addition, the authorities have requested budgetary/BOP assistance from the EU and other donors to cushion the possible impact of the Serbian Premier's assassination on FDI and other private capital inflows. In the context of the second review, the next mission (in May) will reassess external prospects and the need for additional assistance.

V. Conditionality

32. **Policy conditionality is focused on areas of macroeconomic importance** (¶34). PCs and SBs have been proposed through end-2003. Annex B to the MEFP (Appendix VI) lists quantitative PCs and indicative targets, while Annex D contains prior actions, structural PCs and SBs. Structural conditionality focuses on: (i) tax policy and administration, public expenditure management, and further social benefit and pension reforms; (ii) bank privatization and payments reform; and (iii) state enterprise restructuring. The Fund's conditionality is closely coordinated with that of the World Bank (Appendix II). The focus of the next review will be the execution of the budget and the payment system reform, exchange rate policy, and progress in bank and enterprise restructuring and privatization.

VI. Staff Appraisal

33. **Serbia and Montenegro's economic and policy performance has remained good under the current EA, but daunting challenges lie ahead.** Macroeconomic policies need to be carefully calibrated to address potential risks to macroeconomic and financial instability, while the task of economic restructuring will be increasingly difficult. The recent assassination of Serbia's Premier has highlighted the challenges facing reform.

34. **2002 witnessed further achievements in stabilization and reform, but it also ushered in new risks.** Firm macroeconomic policy implementation contributed to rapid disinflation, a strengthening of foreign reserves, and a continued recovery in output and exports, albeit to levels that remain historically low. Meanwhile, some of the consequences of the initial gains in stabilization and improved confidence—real currency appreciation, the rapid remonetization of the economy, and the increased dependence on private BOP inflows to finance a higher trade deficit—are also potential sources of risk, underscoring the need for

cautious policies. Despite good progress in structural reforms, a lot remains to be done. In addition to legal and institutional reform, major steps were taken to implement economic restructuring, with the closure of large banks in early 2002 and a good start in privatization that generated higher-than-expected receipts. However, as the privatization process shifts from relatively profitable companies to insolvent ones, continued success will require great resolve to tackle difficult decisions on restructuring in a fiscally prudent manner. The Serbian authorities, under a new Premier, have appropriately emphasized the need for policy continuity and intensified efforts to strengthen the rule of law by rooting out organized crime.

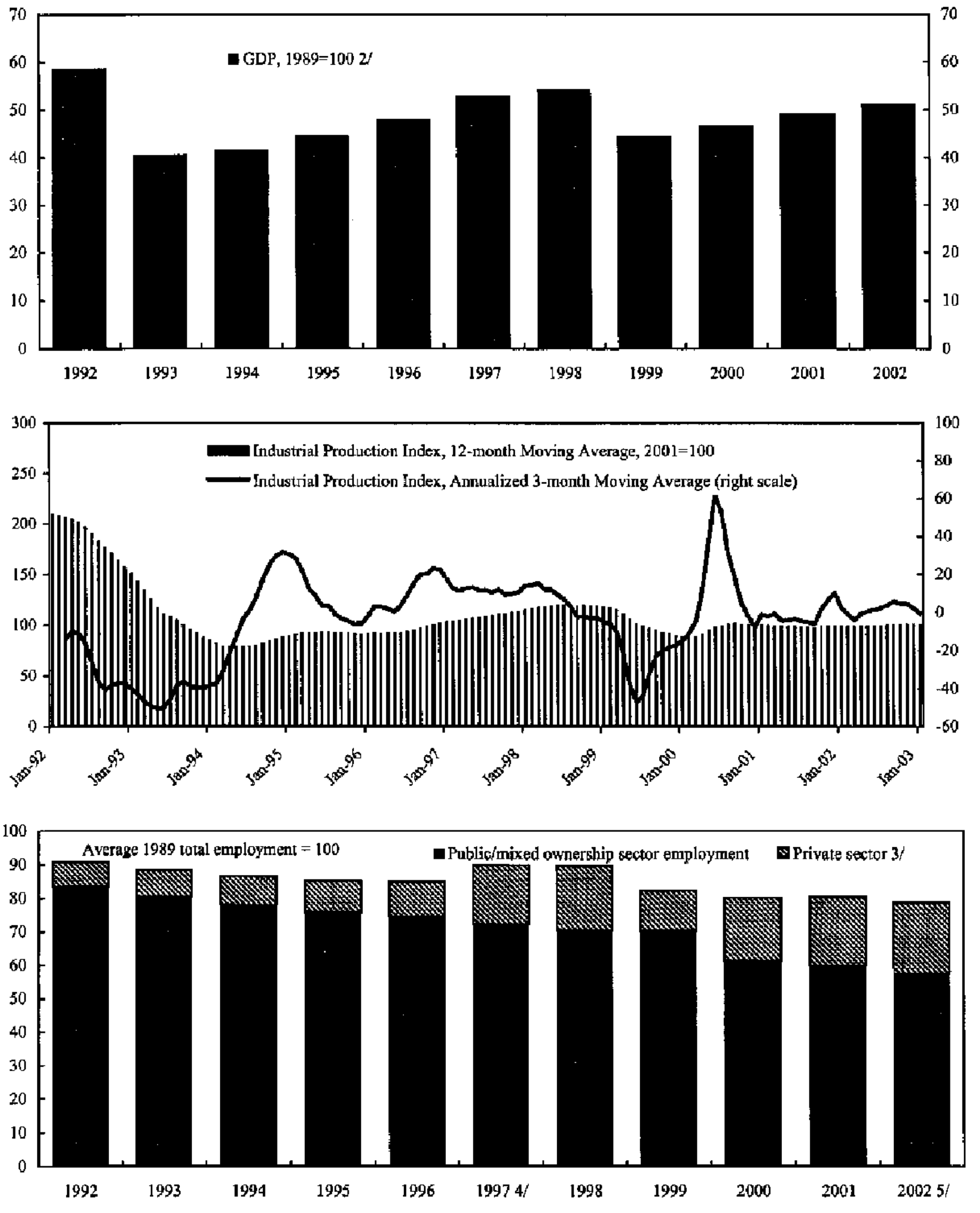
35. **The envisaged tightening of fiscal policy is appropriate.** The authorities have responded properly to indications of excessive growth in domestic demand by lowering the fiscal deficit target below the level envisaged under the medium-term fiscal framework. The 2003 fiscal program hinges on a number of commitments that should be adhered to on a timely basis, in light of risks related to the macroeconomic outlook and to the revenue effects of payment and tax system reforms. In this regard, staff welcomes the authorities' intention to contain discretionary spending commitments below program levels until the revenue prospects clarify; to have all privatization proceeds channeled through the budget; and to use any excess privatization proceeds to reduce the government's net indebtedness, pending assessment of macroeconomic prospects in the context of the next review. In Montenegro, staff notes the return of the budgeted wage bill to more sustainable levels, although this would require firm actions to implement retrenchments; and the extension of the coverage of the budget to include previously off-budget operations.

36. **Monetary and exchange rate policies in Serbia face new challenges**. The NBS has succeeded in raising confidence in the dinar. However, the correction of the initial currency undervaluation through nominal exchange rate stability, the buoyancy of domestic demand, and the persisting uncertainty about money demand underscore the need for caution. Staff therefore welcomes the NBS's intention to tighten credit conditions and support an improvement in external competitiveness with a view to achieving the inflation objective and safeguarding its foreign reserves. In light of the rapid increase in credit to the enterprise sector during 2002, bank supervision should be vigilant and more proactive, with strict enforcement of prudential regulations to ensure that new lending remains sound.

37. **The structural reform momentum should be maintained in 2003.** The staff welcomes the authorities' commitment to address delays in the adoption of reform legislation that led to nonobservance of some structural benchmarks, and notes the need to avoid new slippages. The authorities' plan to privatize the 16 nationalized banks, while ensuring proper governance in the meantime, is key to establishing a healthy banking system. In this regard, it will be important to set the stage through the early sale of the government stakes in a few large banks to reputable strategic investors. The streamlining of privatization procedures should help ensure investor interest in financially weaker enterprises and maintain the pace of privatization. Finally, the envisaged normalization of economic relations between Serbia and Montenegro under the new constitutional framework—notably by harmonizing the trade, customs, and indirect tax regimes—should help strengthen the fiscal systems and improve economic efficiency in both states.

38. **The staff recommends completion of the first review under the extended arrangement, including the financing reviews.** The SM authorities have broadly adhered to the implementation of the program supported by the EA, making further progress in stabilization and reform. They have also been negotiating in good faith with their London Club and other creditors with a view to restructuring their debt on terms comparable to those granted by the Paris Club. The external financing of the program is adequate. Moreover, the authorities have adopted economic objectives and policies for 2003 that are consistent with further progress toward sustainable growth and a viable external position.

Figure 1. Serbia and Montenegro: Selected Economic Activity Indicators, 1992-2003 1/



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

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.

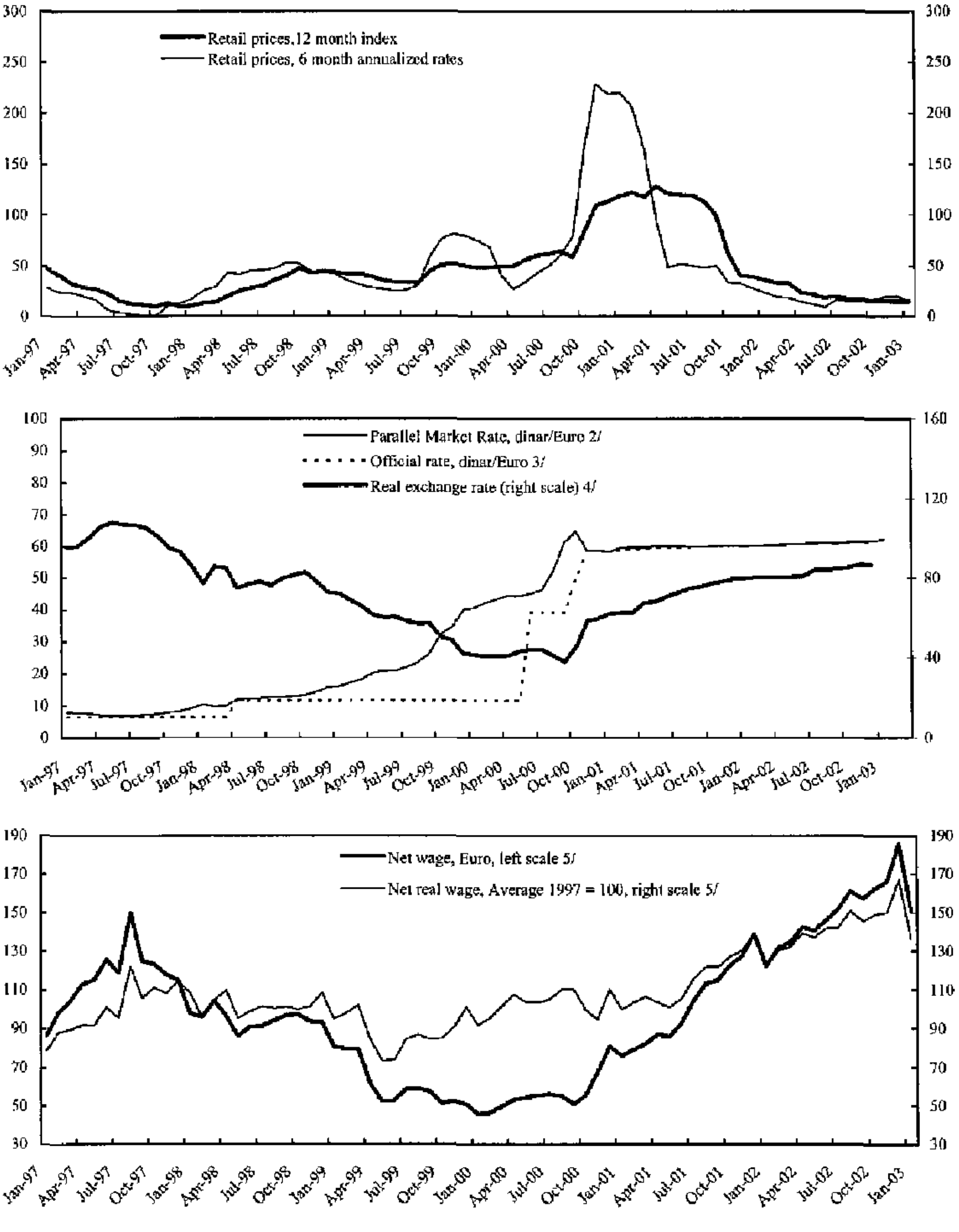
2/ Growth rates for 1990-94 refer to Gross Social Product (GSP), which excludes public and other services.

3/ The data exclude farmers and other self-employed. Including self-employed, the private sector accounted for about 45 percent of total employment in 2002.

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

5/ 2002 data up to June.

Figure 2. Serbia and Montenegro: Prices, Exchange Rates, and Wages
January 1997 - January 2003 1/



Sources: Federal Institute of Statistics; National Bank of Serbia; and IMF staff calculations.

1/ Data after February 1999 exclude Kosovo.

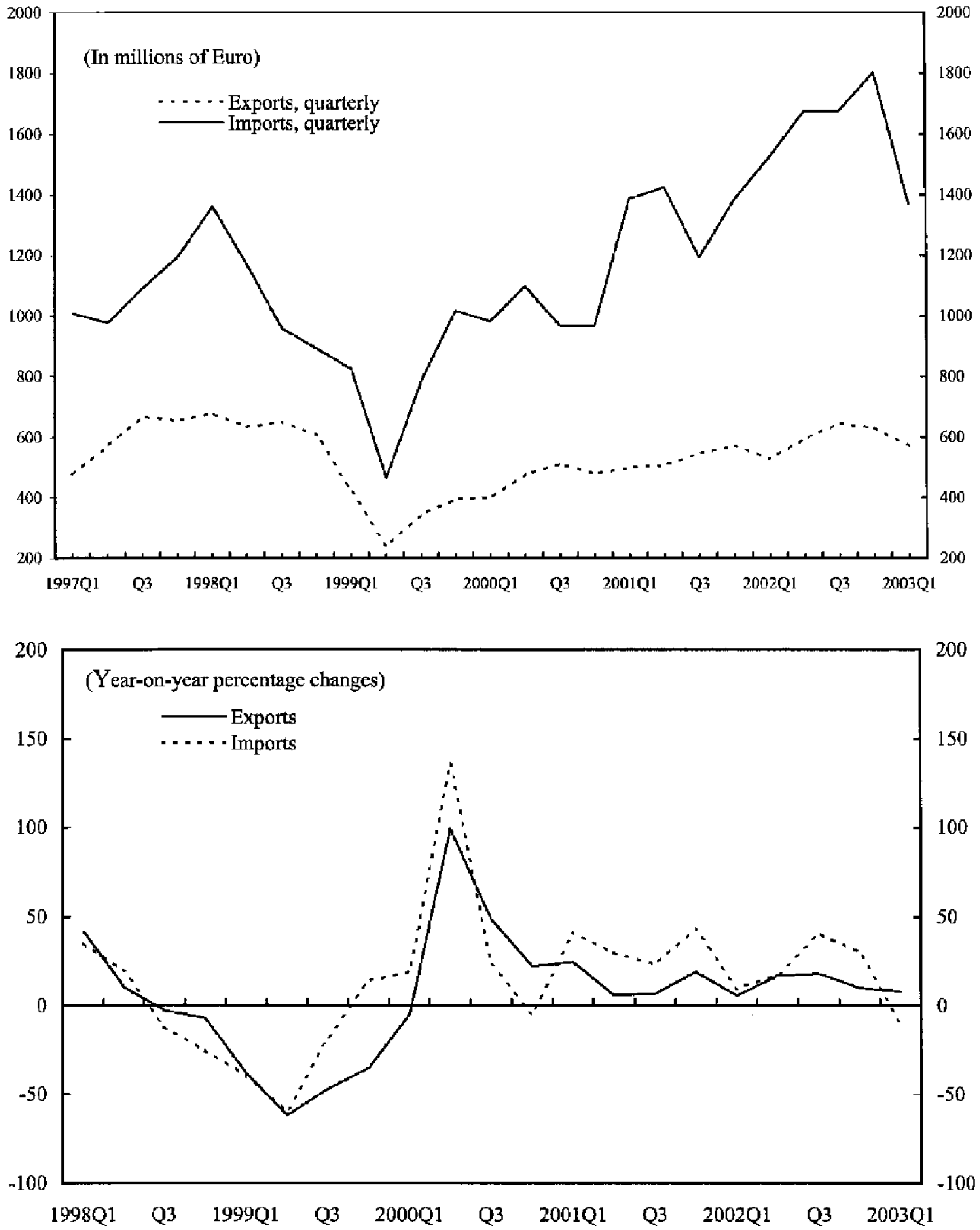
2/ Differences between official and parallel market rates have been negligible since December 2000.

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 SM retail price index and the Eurozone CPI to the average parallel market rate, and since December 2000 the official exchange rate. Increase denotes appreciation.

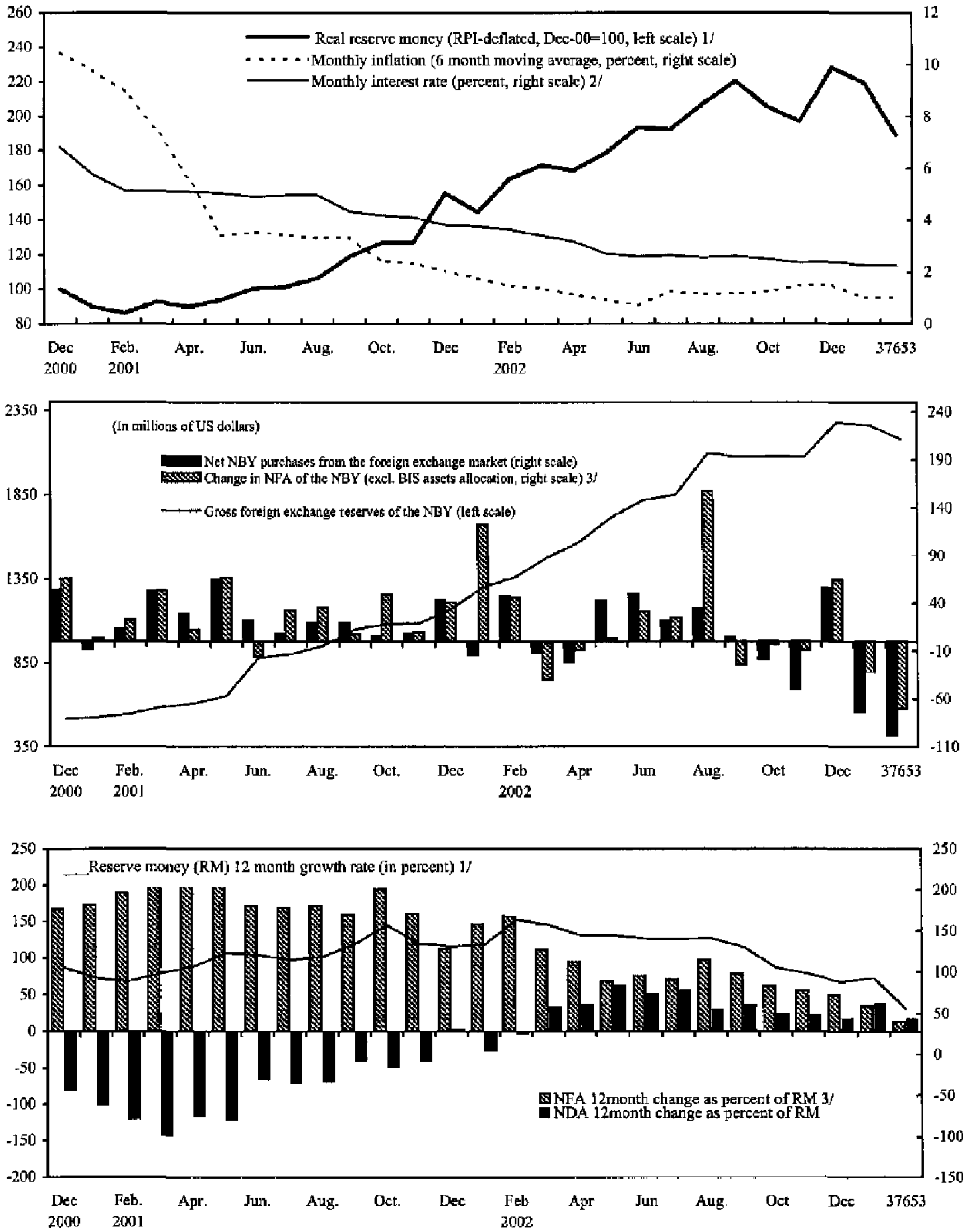
5/ Owing to a change in the definition of wages to include fringe benefits, the increase in the level of wages may be overestimated from June 2001. Until December 2000, the euro wage is based on the parallel market exchange rate.

Figure 3. Serbia and Montenegro: Exports and Imports, 1997-2003



Sources: Federal Office of Statistics; National Bank of Serbia; and IMF staff calculations.

Figure 4. Serbia and Montenegro: Real Reserve Money, Foreign Reserves, and Reserve Money Growth in Serbia, December 2000 - 2003



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

1/ Reserve money is adjusted to be comparable with the 20 percent required reserve ratio and widening of the reserve base, implemented in April 2002.

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 and write-off related to bank closures.

Table 1. Serbia and Montenegro: Selected Economic and Financial Indicators, 2000–2003 1/

	2000	2001	2002 Prog.	2002 Prel. est.	2003 Prog	2003 Rev. prog.
Real economy						
GDP, in billions of DIN	381.7	771.8	1,043.5	1,006.9	1,268.4	1,225.9
Average net real wage, 1997 =100	103	115	...	142	...	...
Average net wage in Euro	56	102	...	149	...	...
			(Percent change)			
Real GDP	5.0	5.5	4.0	4.0	5.0	3½ - 4½
Industrial production	11.1	0.0	3.0	1.7	...	...
Retail prices (period average)	69.9	91.1	26.3	21.2	14.3	12-13
Retail prices (end of period, 12-month)	113.5	39.0	20.0	14.2	12.0	9-11
Unemployment rate (in percent)	27.3	27.8	...	...	...	...
			(Percent of GDP)			
General government finances 2/						
Revenue	36.7	38.9	40.3	42.5	39.9	40.5
Expenditure	37.6	40.3	45.7	46.9	44.8	45.1
Cash balance	-0.9	-1.4	-5.3	-5.0	-5.0	-4.5
Foreign grants	0.7	0.7	0.9	1.1	1.0	0.7
Foreign loans (net)	0.0	0.0	2.8	1.8	2.3	2.0
of which foreign financed projects	0.0	0.0	1.1	0.8	1.2	1.1
Privatization receipts	0.0	0.0	1.2	2.6	1.2	1.8
Domestic financing (Net)	0.2	0.7	0.4	-0.5	0.5	0.0
Commitment balance 3/	-2.9	-1.4	-5.3	-5.0	-5.0	-4.5
			(Percent change)			
Money supply (end-of-period) 4/						
M1	85.2	114.4	45.0	80.3	...	13.9
M2	61.4	79.1	49.5	76.8	...	11.9
Balance of payments			(In billions of U.S. dollars)			
Merchandise exports	1.9	2.0	2.2	2.4	2.6	3.0
Merchandise imports	-3.7	-4.8	-5.6	-6.3	-6.1	-7.4
Trade balance	-1.8	-2.8	-3.3	-3.9	-3.5	-4.4
Current account balance, after grants	-0.3	-0.5	-1.1	-1.4	-1.3	-1.6
(In percent of GDP)	-3.9	-4.6	-7.7	-8.9	-8.9	-8.2
Current account balance, before grants	-0.6	-1.1	-1.6	-2.0	-1.7	-2.2
(In percent of GDP)	-7.1	-9.7	-12.0	-12.8	-11.6	-11.0
Foreign debt (year-end) 5/	11.4	11.9	8.6	9.6	9.3	10.4
Gross official reserves	0.5	1.2	1.6	2.3	2.1	2.7
(In months of imports of goods and services)	1.2	2.4	3.0	3.4	3.5	3.8

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

1/ With the exception of foreign debt, data exclude Kosovo. Program figures in percent of GDP are adjusted for an upward revision of the GDP series since 2000 by 6.6 percent.

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

3/ Excludes arrears of local governments and interest payments due but not paid on foreign debt still under restructuring.

4/ Excludes Montenegro.

5/ Figures reflect the first phase of the Paris Club debt reduction in 2002 and assume comparable treatment from other official bilateral and commercial creditors

Table 2. Serbia and Montenegro: Balance of Payments, 1997–2005

(In millions of U.S. dollars, unless otherwise indicated)

	1997	1998	1999	2000	2001	2002		2003	2004	2005
						Original Prog.	Prel. Est.	Revised Proj.	Revised Proj.	Revised Proj.
Trade balance	-2,070	-1,816	-1,619	-1,788	-2,834	-3,318	-3,908	-4,404	-4,374	-4,341
Exports f.o.b.	2,756	3,033	1,676	1,923	2,003	2,250	2,412	2,972	3,459	3,978
(percent growth)		10.1	-44.7	14.7	4.2	12.3	20.4	23.2	16.4	15.0
Recorded	2,677	2,858	1,497	1,723	1,903	2,250	2,275	2,907	3,459	3,978
Unrecorded	79	175	179	200	100	0	137	64	0	0
Imports f.o.b.	-4,826	-4,849	-3,295	-3,711	-4,837	-5,567	-6,320	-7,375	-7,833	-8,318
(percent growth)		0.5	-32.1	12.6	30.4	15.1	30.7	16.7	6.2	6.2
Services (non-factor services, net)	456	493	228	331	417	522	292	421	507	605
Receipts	818	914	471	624	740	904	829	1,021	1,144	1,281
Expenditure	-362	-421	-243	-293	-323	-382	-537	-600	-637	-677
Net factor income	25	8	-41	-1	-26	-300	-115	-330	-369	-431
Of which: Net interest	25	8	-41	11	-26	-300	-115	-330	-369	-431
Earnings	59	57	43	53	48	82	62	99	115	131
Payments 1/	-34	-49	-84	-42	-74	-383	-177	-429	-483	-562
Private remittances, net	310	655	668	848	1,324	1,450	1,719	2,124	2,254	2,408
Inflows	662	1,033	948	1,132	1,698	1,925	2,089	2,499	2,629	2,783
Recorded	465	688	501	632	1,578		1,919	2,317		
Unrecorded	197	345	447	500	120		170	182		
Outflows	-352	-378	-280	-284	-374	-475	-370	-375	-375	-375
Current account balance, before grants	-1,279	-660	-764	-610	-1,119	-1,646	-2,012	-2,189	-1,982	-1,759
(In percent of GDP) 2/	-7.7	-4.8	-7.5	-7.1	-9.7	-12.0	-12.8	-11.0	-9.4	-7.9
Official grants 3/	0	0	0	271	591	351	624	0	0	0
Foreign direct investment, net 4/	740	113	112	25	165	400	562	731	798	868
Foreign loans, net	283	-10	-25	180	374	577	536	215	263	164
Medium and long term, net	54	25	12	213	299	508	378	135	182	84
Disbursements	128	50	29	227	332	560	421	240	268	289
Of which: Official creditors 3/					205	420	343	135	0	0
Amortization 1/	-74	-25	-17	-14	-33	-52	-43	-105	-86	-204
Short term, net	229	-35	-37	-33	75	70	158	80	80	80
Other capital inflows 5/	139	78	30	49	629	50	982	292	50	50
Commercial banks, net					-274	-250	-144	-55	-55	-50
Capital account balance	1,162	181	117	255	894	777	1,936	1,184	1,055	1,031
Errors and omissions	-103	278	410	267	239	290	230	250	250	250
Overall balance	-220	-201	-237	183	605	-228	778	-755	-677	-477
Financing	220	201	237	-183	-5,981	-4,181	-855	-4,737	-247	-456
Net foreign assets (increase, -)	18	115	111	-246	-395	-164	-816	-140	-247	-456
Central Bank, net					-395	-164	-816	-140	-247	-456
Gross foreign reserves (increase, -) 6/	18	115	111	-227	-523	-476	-1,111	-387	-402	-407
Of which: IMF purchases				152	128	312	295	272	340	136
Gross foreign liabilities (increase +)	0	0	0	-19	128	312	295	248	155	-49
Arrears (reduction, -) 7/	202	86	126	63	-5,587	-4,018	-39	-4,597	0	0
Financing expected / to be secured						300	0	824	851	822
Official grants 3/						245	0	429	315	315
Official borrowing (excluding IMF) 3/						55	0	395	536	507
Residual gap					5,377	4,109	76	4,668	72	112
Arrears settlement with creditors 7/					5,377	4,018	39	4,597	0	0
Debt relief from creditors					0	92	37	71	72	94
Memorandum items:										
Current account balance, after grants	-1,279	-660	-764	-339	-528	-1,050	-1,387	-1,760	-1,667	-1,444
(In percent of GDP) 2/	-7.7	-4.8	-7.5	-3.9	-4.6	-7.7	-8.9	-8.9	-7.9	-6.5
Gross international reserves, USD mn (end period)			289	516	1,169	1,645	2,280	2,667	3,069	3,476
in months of prospective imports of goods & services			0.9	1.2	2.4	3.0	3.4	3.8	4.1	4.4
Debt service, cash	108	74	101	56	107	343	183	488	682	858
(In percent of GDP) 2/	0.7	0.5	1.0	0.6	0.9	2.5	1.2	2.5	3.2	3.8
Principal	74	25	17	14	33	52	43	130	271	390
Interest	34	49	84	42	74	291	140	358	411	468

Sources: SM authorities, and IMF staff estimates.

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

2/ Program figures are adjusted to reflect the official revision of the GDP series.

3/ 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.

4/ For 2003 net of the payment on Telekom Srbija.

5/ For 2001-2003, including sales of foreign exchange notes by the public (amount above the level implied by trend growth) reflecting currency substitution. For 2003 also including the $60 million inflows corresponding to the unfreezing of the accounts held abroad by SM banks.

6/ Representing changes in gross reserves at current exchange rates.

7/ Negotiations are on-going to clear all remaining external arrears (to the IFC, the London Club, other commercial creditors, and on short-term debt).

Table 3. Serbia and Montenegro: External Financing Requirements and Sources, 1998–2005
(In millions of U.S. dollars)

	1998	1999	2000	2001	2002 Est.	2003 Proj.	2004 Proj.	2005 Proj.
1. Gross financing requirements	**-720**	**-818**	**-1,074**	**-7,261**	**-3,204**	**-7,303**	**-2,654**	**-2,555**
External current account deficit (excluding official transfers)	-660	-764	-671	-1,119	-2,012	-2,189	-1,982	-1,759
Debt amortization	-60	-54	-47	-33	-43	-105	-86	-204
Medium- and long-term debt	-25	-17	-14	-33	-43	-105	-86	-204
Short-term debt 1/	-35	-37	-33	0	0	0	0	0
Repayment of arrears	0	0	0	-5,586	-39	-4,597	0	0
Gross reserve accumulation	0	0	-227	-523	-1,111	-387	-402	-407
IMF repurchases and repayments	0	0	-129	0	0	-25	-185	-185
2. Financing	**720**	**818**	**1,074**	**7,261**	**3,204**	**6,136**	**1,391**	**1,486**
Official grants 2/	0	0	271	591	624	0	0	0
Foreign direct investment (net)	113	112	25	165	562	731	798	868
Disbursement from private creditors	78	30	49	202	236	185	348	369
Medium and long-term financing	78	30	49	127	78	105	268	289
Short-term financing and other capital inflows	0	0	0	75	158	80	80	80
Disbursement from official creditors 2/	50	29	227	205	343	135	0	0
Multilateral 3/	...	...	...	205	285	135	0	0
Other	...	...	...	0	58	0	0	0
IMF disbursement	0	0	150	128	295	0	0	0
Accumulation of arrears (exceptional)	86	126	52	0	0	0	0	0
Debt Relief	0	0	0	5,375	76	4,597	0	0
Other flows 4/	393	521	290	594	1,068	487	245	250
3. Financing Gap	**0**	**0**	**0**	**0**	**0**	**1,167**	**1,264**	**1,070**
Expected disbursements of grants from donors 2/	0	0	0	0	0	429	315	315
EU	0	0	0	0	0	50	0	0
Others (mostly official bilateral creditors)	0	0	0	0	0	379	315	315
Expected disbursement of loans from donors 2/	0	0	0	0	0	667	875	643
World Bank	0	0	0	0	0	36	200	160
IMF	0	0	0	0	0	272	340	136
EBRD	0	0	0	0	0	130	105	105
EIB	0	0	0	0	0	128	105	105
EU	0	0	0	0	0	57	0	0
Others (mostly official bilateral creditors)	0	0	0	0	0	43	125	137
Debt relief	0	0	0	0	0	71	72	94
4. Residual Financing Gap	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**18**

Sources: SM authorities, and IMF staff estimates.

1/ Original maturity of less than 1 year.

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/ Not including amortization of the debt to IMF.

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

Table 4. Net Foreign Assets of National Bank of Serbia—Actual and Program Floors, December 2001–December 2003

(In millions of U.S. dollars at program exchange rates, end of period)

	2001	2002								2003					
	Dec.	June	September		Nov.	December				Jan.	Feb	April	June	Sep.	Dec.
	Ex. Rate	Act.	Prog.	Act.		Prog.	Act.	End-02 Ex. Rates		Prel.	Prel.				
	4/					Orig		EOP	Avg.						
Net foreign assets of the NBS 1/	797	1,138	913	1,304	1,306	950	1,411	1,613	1,535	1,544	1,467	1,443	1,571	1,681	1,755
Net foreign assets of the NBS for program purposes 2/	583	727	699	886	874	736	938	1,069	1,018	1,008	932	885	1,004	1,099	1,161
Gross foreign assets	1,169	1,697	1,542	1,926	1,928	1,645	2,034	2,280	2,202	2,211	2,134	2,246	2,373	2,611	2,668
Gold	...	...	...	...	...	...	...	...	...	...		...	...	...	...
Foreign currencies	...	...	...	...	...	...	...	...	...	...		...	...	...	...
Foreign exchange accounts abroad	...	...	...	...	...	...	...	...	...	...		...	...	...	...
Reserve-related liabilities (-)	372	560	629	622	622	695	622	667	667	667	667	803	803	930	913
Gross reserve liabilities for program purposes (-)	586	971	843	1,040	1,054	909	1,095	1,211	1,184	1,203	1,203	1,361	1,369	1,512	1,507
IMF	272	460	529	522	522	595	522	567	567	567	567	703	703	830	813
Other	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100
Loan from China deposited by a closed bank	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100
Adjustments for program purposes	214	411	214	418	432	214	473	544	517	536	536	558	566	581	594
Foreign currency liabilities to domestic banks	214	411	214	418	432	214	473	544	517	536	536	558	566	581	594
Forex deposits from commercial banks	116	9	2	7	5	2	5	6	6	6	6	6	6	6	6
Unpaid interest	4	6	3	4	1	3	2	2	1	2	2	2	2	2	2
Short-term loan from commercial banks	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Required reserve and payments related deposits	71	386	208	398	417	208	453	526	500	518	520	540	548	563	576
Transaction and transitory deposits	23	10	0	9	9	0	13	10	10	10	10	10	10	10	10
Old obligations commercial banks	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Foreign currency liabilities to nonbank						0	0	0	0	0	0	0	0	0	0
non-government residents	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Net foreign assets of commercial banks of Serbia 3/	580	778	859	753	749	916	709	709	...	727	709	725	735	752	766
Gross reserves	640	869	930	832	830	987	783	783	...	801	783	799	809	826	840
Reserve liabilities	59	91	71	79	81	71	74	74	...	74	74	74	74	74	74

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

1/ Exclude frozen assets and liabilities of Serbia; 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/ At current exchange rates.

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. Balance Sheet of the National Bank of Serbia, December 2001–December 2003 1/

(In millions of dinars; end of period)

	2001 Dec. EoP	2001 Dec. 01 ER EOP 9/	2002 June EOP	2002 June Avg	2002 September Prog.	2002 September EOP	2002 September Avg.	2002 November EOP	2002 November Avg.	2002 December Orig. Prog.	2002 December EOP	2002 December Avg	2002 December End 02 Ex. Rates EOP	2002 December End 02 Ex. Rates Avg. Adj.	2003 January Prel. Adj. EOP	2003 January Prel. Adj. Avg.	2003 February Prel. Adj. EOP Adj.	2003 February Prel. Adj. Avg.	2003 April	2003 June Program	2003 Sep. Program	2003 Dec. Program
Net foreign assets 2/	133	39,477	49,189	47,922	47,279	59,935	61,386	59,133	58,676	49,830	63,495	61,120	63,071	60,051	59,466	62,720	54,948	55,815	50,443	58,067	63,906	67,878
Net foreign assets in euro million	-2	661	824	803	792	1,004	1,026	990	983	835	1,063	994	1,056	976	996	1,050	920	933	820	944	1,039	1,103
Gross foreign assets 3/	65,623	79,100	114,863	113,086	104,341	130,333	131,628	130,466	129,797	111,311	137,614	133,324	134,491	129,879	130,409	133,901	125,891	126,758	126,926	138,744	151,666	156,814
Gross reserve liabilities (-) 4/	-65,756	-39,623	-65,674	-65,166	-57,062	-70,397	-70,242	-71,345	-71,121	-61,480	-74,119	-72,204	-71,420	-69,828	-70,943	-71,182	-70,943	-70,943	-76,483	-80,677	-87,759	-88,936
Net domestic assets 5/	41,494	1,864	4,461	2,936	-6,191	4,424	-924	318	1,013	7,666	5,829	116	6,253	1,185	7,713	4,642	3,404	6,720	9,744	5,885	3,885	1,185
Domestic credit	156,788	9,082	9,835	...	...	3,050	...	6,478	...	...	14,581	...	14,281	...	...	...	...	...	...		...	
Net claims on government	9,096	5,568	9,476	...	...	9,108	...	8,226		...	9,571	...	9,439	...	16,368	...	14,772	...	...	...	...	...
Claims	19,189	13,085	17,551	...		21,574	...	19,685	...	...	20,720	...	20,720	...	...	...	...	...	...	...	...	...
Dinar credits	10,681	13,085	17,551	...	...	21,574		19,685	...	...	20,720	...	20,720	...	24,076	...	22,632	...	...		...	
Foreign currency credits	8,508	0	0	...	...	0	...	0	...	...	0	...	0	...	...	...	...	...	...	...	...	...
Liabilities (-)	-10,093	-7,517	-8,075	...	...	-12,466	...	-11,459	...	...	-11,149	...	-11,281	...	-7,658	...	-7,860	...	...	...	...	...
Dinar liabilities	-3,113	-3,734	-3,489	...	...	-5,310	...	-5,666	...	...	-5,122	...	-5,122	...	-3,405	...	-3,392	...	...	...	...	...
Foreign currency liabilities	-6,980	-3,783	-4,586	...	...	-7,156	...	-5,793	...	...	-6,027	...	-6,159	...	-4,253	...	-4,468	...	...	...	...	...
Net claims on banks	135,646	3,468	329	...	...	-451	...	-922		...	5,928	...	5,688	...	...	...	...		...	...	...	...
Claims	146,423	4,245	5,607	...	...	4,101		4,110		...	7,748	...	7,508	...	...	...	...		...	...	...	...
Recourse to required reserves	2,786	169	1,118	...		-164	...	722		...	4,377	...	4,377		-551	...	2,190		...	...	...	...
Other dinar credits	1,820	1,740	1,769	...	...	1,655	...	1,037	...	...	962	...	962		...	...	...	...	...	...	...	...
Foreign currency credits	142,317	2,336	2,730	...		2,610	...	2,351	...	...	2,409	...	2,169	...	...	...	...	...	...	...	...	...
Foreign currency credits in euro million	2,426	39	46	...	...	44	...	39	...	...	40	...	36	...	...	...	...	...	...	...	...	...
Liabilities (-)	-777	-777	-5,308	...	...	-4,552	...	-5,032	...	...	-1,820	...	-1,820	...	...	...	...	...	...	...	...	...
Of which: Stock of NBS bills	-715	-715	-5,211	-5,187	...	-4,252	-4,943	-4,736	-4,975	...	-1,549	-3,431	-1,549	...	-1,813	-1,343	-2,462	-2,765	...		...	...
Net claims on the rest of the economy	2,046	45	30	...	...	-607	...	-880	...	...	916	...	-916	...	...	...	...	...	...	...	...	...
Claims	3,655	1,049	1,014		...	1,014	...	1,014	...	...	1,014		1,014	...	...	...	...	...		...		...
Dinar credits	3,453	1,049	1,014	...		1,014	...	1,014	...	...	1,014	...	1,014		...	...	...	...	...	...	...	
Foreign currency credits	202	0	0	...	...	0	...	0	...	...	0	...	0		...	...	...		...	...	...	...
Liabilities (-)	-1,609	-1,004	-984	...	...	-1,621	...	-1,694	...	...	-1,930	...	-1,930	...	...	...	...		...	...	...	...
Dinar deposits	-1,609	-1,004	-984	...		1,621	...	-1,894	...	...	-1,930	...	-1,930	...	...	...	...	...	...	...	...	...
Other assets, net	-115,294	-7,217	-5,374	...	...	3,626	...	-6,806		...	-8,754	...	-7,958	...	...	...	...	...	...	...	...	...
Reserve money (in dinar)	41,361	41,341	53,650	50,858	41,088	64,360	60,462	59,441	59,689	57,496	69,324	61,235	69,324	61,235	67,180	67,362	58,352	62,535	60,187	63,957	67,791	69,063
Currency in circulation	25,324	25,324	32,732	30,619	17,499	40,446	37,672	37,312	37,232	36,720	43,719	37,827	43,719	37,827	37,884	38,225	35,867	36,192	37,503	39,673	42,687	43,146
Reserve deposits	16,037	16,017	20,918	20,239	23,589	23,914	22,790	22,129	22,457	20,776	25,605	23,408	25,605	23,408	29,296	29,137	22,485	26,343	22,683	24,279	25,104	25,917
Required reserves	10,308	8,171	10,796	10,470	17,672	13,078	12,740	15,346	15,152	12,727	15,843	15,689	15,843	17,699	17,274	15,812	19,729	19,316	18,147	19,180	19,456	20,085
Shortfall (+) or excess (-) in required reserves 6/	2,286	169	1,118	-140	0	-464	485	727	308	0	4,377	403	4,377	403	-551	-1,165	2,190	1,657	0	0	0	0
Excess reserves 7/	5,729	7,846	10,127	9,769	5,917	10,836	10,049	6,783	7,305	8,049	9,762	7,719	9,762	5,709	12,021	13,325	2,756	7,027	4,537	5,098	5,648	5,831
Memorandum items (12 months growth rates, unless otherwise indicated)																						
Reserve money, nominal 8/	116.1	...	127.0	132.9	79.5	115.3	113.1	78.9	83.1	36.5	67.7	47.7	...	...	73.6	72.3	31.7	54.5	71.9	25.7	12.1	12.8
Reserve money, real 8/	55.5	...	92.6	97.6	54.6	85.0	84.9	55.0	58.6	21.3	46.8	29.3	...		51.9	50.7	15.7	35.7	9.4	8.4	0.5	3.5
Currency in circulation, nominal	131.6	...	128.6	140.4	-0.4	130.3	131.7	81.6	95.3	45.0	72.6	49.4	...		45.8	54.8	17.0	36.4	27.5	29.6	13.3	14.1
Currency in circulation, real	66.6	...	93.9	103.9	-14.4	97.9	99.2	59.9	69.2	28.9	51.2	38.8	...	...	27.5	35.4	2.7	19.8	12.6	11.7	1.6	4.6
Required reserves, nominal 8/	97.0	...	77.9	...	35.2	71.1	52.1	69.4	53.5	44.9	93.9	92.7	...	...	138.1	77.8	115.7	121.7	49.6	56.2	30.3	12.5
Required reserves, real 8/	41.7	...	50.9	...	16.4	47.9	30.7	46.7	33.0	28.1	69.8	68.8	...	...	108.3	51.2	89.4	94.7	37.2	34.6	16.8	3.2
Velocity (based on annualized monthly GDP)	21.9		18.7	18.2	25.6	16.3	17.4	18.5	18.4	17.7	16.0	18.2	...	...	17.0	16.9	19.8	18.4	19.6	19.5	18.7	19.0
Excess reserves, nominal	40.1	...	177.8	...	24.8	128.6	116.4	75.8	54.0	0.4	24.4	-3.5	...		128.5	133.2	-48.8	10.5	-61.4	-41.0	-37.1	-40.3
Excess reserves as a share of reserve deposits (percent)	35.7	49.0	48.4	48.3	25.1	45.3	44.2	30.7	32.5	38.7	38.1	33.0	38.1	24.4	41.0	45.7	12.3	26.7	20.0	21.0	22.5	22.5
Cash in circulation as share of quarterly GDP (percent)	13.1	...	14.7	...	7.4	17.1	15.9	15.1	15.1	15.4	17.4	15.0	...		14.9	15.0	14.0	14.1	13.9	14.2	14.6	14.1
Stock of NBS bills as share of reserve money (percent)	1.7	...	9.7	10.2	...	6.6	8.2	8.0	8.3	...		...	...	...	2.7	2.0	4.2	4.4		...	...	...

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

1/ At program exchange rates.

2/ Program figures are floors.

3/ Exclude frozen assets of FRY; undivided assets of SFRY; and 2001 figures at constant exchange rates also excludes 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 NBS account 201 to satisfy the dinar reserve requirement.

7/ Comprise balances in Giro accounts, business accounts,cash in commercial bank vaults, deposits at overnight accounts in NBS.

8/ The growth rates of reserve money (in dinar) 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;

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 2001–December 2003

(In millions of dinars; end of period)

	2001		2002							2003			
	December		June	September		Nov.	Dec.			April	June	Sep.	Dec.
		Dec.01 Exch. Rate 4/		Prog.	Act.		Prog. Orig	Act.	End-02 Ex. Rates Adj.				
Net Foreign Assets 1/	66,783	93,179	124,664	119,885	134,783	134,420	133,043	137,440	136,996	127,905	135,993	143,484	148,702
(NFA in euro m.)	1,138	1,561	2,088	2,008	2,257	2,251	2,228	2,302	2,227	2,079	2,211	2,333	2,417
Assets	106,049	122,375	168,100	167,274	181,779	181,512	178,111	183,927	180,694	179,621	187,710	202,719	206,934
NBS	65,623	79,100	114,863	104,341	130,333	130,468	111,311	137,614	134,491	132,479	139,997	154,000	157,376
Commercial banks	40,426	43,275	53,237	62,933	51,446	51,044	66,801	46,313	46,203	47,142	47,713	48,719	49,558
Liabilities (-) 2/	-39,266	-29,196	-43,436	-47,389	-46,996	-47,093	-45,068	-46,486	-43,697	-51,717	-51,717	-59,234	-58,232
NBS	17,686	-25,173	-37,861	42,585	-42,111	-42,111	-40,264	-42,111	-39,333	-47,352	-47,352	-54,870	-53,867
Commercial banks	-21,580	-4,023	-5,575	-4,805	-4,885	-4,981	-4,805	-4,375	-4,365	-4,365	-4,365	4,365	-4,365
Net Domestic Assets 3/	50,582	14,646	26,048	19,244	41,479	42,325	32,355	53,213	53,468	61,460	63,233	62,231	64,332
Domestic credit	233,366	97,006	106,716	...	128,556	136,366	...	143,425	145,664		...	...	...
Net credit to government 3/	4,567	1,258	4,518	3,301	-7,910	-11,165	6,710	-1,466	-10,172	858	3,628	-2,472	-10,172
Credit	22,984	16,429	20,712	...	25,496	25,183	...	25,247	25,198	...	...	...	...
Dinar credit	12,859	16,154	19,476	...	24,095	23,424	...	23,497	23,497	...	...	...	...
NBS	10,681	13,085	17,551	...	21,574	19,685	...	20,720	20,720	...	...	...	...
Commercial banks	2,178	3,069	1,925	...	2,521	3,739	...	2,777	2,777	...	...	...	...
Foreign currency credits	10,125	275	1,236	...	1,401	1,759	...	1,750	1,701	...	...	...	...
NBS	8,508	0	0	...	0	0	...	0	0	...	...	...	...
Commercial banks	1,617	275	1,236	...	1,401	1,759	...	1,750	1,701	...	...	...	...
Liabilities	-18,417	-15,171	-25,231	...	-33,406	-36,348	...	-26,713	-35,370	...	...	...	...
Dinar liabilities	-11,010	-11,052	-16,205	...	-24,816	-28,962	...	-19,530	-19,530	...	...	...	...
NBS	-3,113	-3,734	-3,489	...	-5,310	-5,666	...	-5,122	-5,122	...	...	...	...
Commercial banks	-7,897	-7,318	-12,716	...	-19,506	-23,296	...	-14,408	-14,408	...	...	...	...
Foreign currency deposits	-7,407	-4,119	-9,026	...	-8,590	-7,386	...	-7,183	-15,840	...	...	...	...
NBS	-6,980	-3,783	-4,586	...	-7,156	-5,793	...	-6,027	-6,027	...	...	...	...
Commercial banks	-427	-336	-4,440	...	-1,434	-1,593	...	-1,156	-9,813	...	...	...	...
Short-term government credits to banks	...	-768	-201	...	102	-83	...	-83	-83	...	...	...	...
Purchased bonds for repaying frozen deposit	...	...	152	...	214	428	...	609	565	...	...	...	...
Credit to the non-government sector 5/	228,799	96,515	111,283	...	136,354	147,186	...	144,364	155,356	172,663	171,666	176,763	186,565
Households	5,121	4,377	7,739	...	11,778	14,539	...	16,021	16,021	...	...	...	...
Non-profit and other sectors	29,896	2,658	3,138	...	3,555	4,081	...	3,891	3,876	...	...	...	...
Enterprises in dinar	46,557	40,416	52,167	...	70,013	76,308	...	70,892	70,892	...	...	...	...
Enterprises in foreign currency	147,225	49,064	48,238	...	51,008	52,258	...	53,560	64,567	...	...	...	...
Enterprises in foreign currency (euro million)	2,509	836 0	808	...	854	875	...	897	1,081	...	...	...	...
											...	...	
Other items, net	-182,784	-82,360	-80,668	...	-87,077	-94,040	...	-90,212	-92,196	-92,196	-92,196	-92,196	-92,196
Broad Money (M2)	117,365	107,825	150,712	139,128	176,261	176,745	165,198	190,654	190,464	189,365	199,227	205,715	213,034
Dinar-denominated M2	67,264	59,913	82,158	60,319	102,429	99,462	89,010	110,708	110,708	107,260	115,696	120,507	124,890
M1	57,803	52,686	72,830	51,149	90,499	85,575	77,792	94,981	94,981	92,187	99,764	104,346	108,206
Currency outside banks	25,324	25,324	32,732	17,499	40,446	37,312	36,720	43,719	43,719	39,577	43,101	46,869	48,869
Demand deposit	32,479	27,362	40,098	33,650	50,053	48,263	41,073	51,262	51,262	53,610	56,663	57,477	59,337
Time and savings deposits	9,461	7,227	9,328	9,170	11,930	13,887	11,218	15,727	15,727	15,074	15,932	16,161	16,684
Foreign currency deposit (non-frozen)	50,101	47,912	68,554	78,810	73,832	77,283	76,189	79,946	79,756	82,105	83,531	85,208	88,144
Foreign currency deposit (not-frozen), (euro million)	854	802	1,148	1,320	1,237	1,294	1,276	1,339	1,297	1,335	1,358	1,385	1,433
Memorandum items:													
12-months growth rates (in percent)													
Broad Money (M2)	79.1	...	100.7	55.2	96.6	78.9	49.3	76.8	...	40.0	32.2	16.7	11.9
Dinar-denominated M2	106.4	...	88.7	10.7	88.0	69.6	45.0	84.8	..	45.2	40.8	17.6	12.8
M1	114.4	...	99.0	11.2	96.8	74.1	45.0	80.3	...	41.3	37.0	15.3	13.9
Currency outside banks	131.6	...	128.6	-0.4	130.3	84.6	45.0	72.6	...	20.4	31.7	15.9	11.8
Foreign currency deposits	...	...	117.3	124.0	109.8	92.3	55.2	66.9	...	33.8	21.8	15.4	10.5
Velocity (M1)	13.4	...	12.2	18.5	8.3	10.8	12.2	10.6	...	11.7	11.2	11.2	11.3
Multiplier (Dinar M2/Reserve money)	1.6	...	1.5	1.5	1.6	1.7	1.5	1.8	...	1.8	1.8	1.8	1.8
Currency/Dinar deposits (in percent)	60.4	...	66.2	40.9	65.3	60.0	70.2	65.3	65.3	56.2	59.4	63.6	64.3
Required reserve ratio (effective, in percent)	24.6	...	21.8	41.3	21.1	24.7	24.3	23.7	26.7	26.7	26.7	26.7	26.7
Excess reserves/Dinar deposits (in percent)	13.7	...	20.5	13.8	17.5	10.9	15.4	14.6	11.6	6.6	7.0	7.7	7.7
Foreign exchange deposit/Time deposit	5.3	...	7.3	8.6	6.2	5.6	6.8	5.1	...	5.4	5.2	5.3	5.3
Dinar denominated M2/ annualized monthly GDP	7.4	...	8.4	5.7	9.8	9.1	8.8	10.0	...	9.1	9.4	9.5	9.5

Sources: National Bank of Serbia; 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 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 and excludes undivided assets and liabilities of SFRY.
5/ Data at 2001 exchange rates exclude 6 billion dinar of credit to the nongovernment sector that were added to balance sheet during 2002.

Table 7A. Serbia and Montenegro: Consolidated General Government Fiscal Operations in 2001–2003 1/

	Consolidated General Government Excluding Montenegro								Consolidated General Government Including Montenegro							
	2001	2002		2003	2001	2002		2003	2001	2002		2003	2001	2002		2003
	Prel	Budget	Prel	Prog	Prel.	Budget	Prel.	Prog.	Prel.	Budget	Prel	Prog.	Prel	Budget	Prel.	Prog.
	(Billion dinars)				(Percent of GDP) 2/				(Billion dinars)				(Percent of GDP) 2/			
Total revenue	277.1	392.1	402.7	463.1	35.9	37.6	40.0	37.8	300.4	421.0	428.3	496.7	38.9	40.3	42.5	40.5
Current revenue	277.1	390.9	402.7	463.1	35.9	37.5	40.0	37.8	300.4	419.8	428.3	496.6	38.9	40.2	42.5	40.5
Tax revenue	253.6	367.0	372.8	431.9	32.9	35.2	37.0	35.2	273.7	391.1	396.6	463.1	35.5	37.5	39.4	37.8
Personal income tax	32.9	48.6	53.4	63.8	4.3	4.7	5.3	5.2	36.2	53.1	56.9	68.5	4.7	5.1	5.7	5.6
Social security contributions	76.7	101.7	98.9	119.5	9.9	9.7	9.8	9.7	85.4	112.2	107.1	129.7	11.1	10.8	10.6	10.6
Corporate income tax	3.4	4.6	4.3	4.6	0.4	0.4	0.4	0.4	3.4	4.6	5.0	5.5	0.4	0.4	0.5	0.5
Retail sales tax	72.1	106.4	110.8	129.5	9.3	10.2	11.0	10.6	75.8	110.5	116.2	137.6	9.8	10.6	11.5	11.2
Excises	26.2	48.1	45.3	58.2	3.4	4.6	4.5	4.7	28.4	50.3	48.7	62.3	3.7	4.8	4.8	5.1
Taxes on international trade	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
and operations	14.3	21.7	24.6	28.3	1.9	2.1	2.4	2.3	16.0	23.9	27.0	31.3	2.1	2.3	2.7	2.6
Other taxes	27.9	36.0	35.5	28.0	3.6	3.4	3.5	2.3	28.6	36.4	35.8	28.2	3.7	3.5	3.6	2.3
Extrabudgetary taxes	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Nontax revenue	23.5	24.0	30.0	31.2	3.0	2.3	3.0	2.5	26.6	28.8	31.7	33.5	3.5	2.8	3.1	2.7
Capital revenue	0.0	1.2	0.0	0.0	0.0	0.1	0.0	0.0	0.0	1.2	0.0	0.1	0.0	0.1	0.0	0.0
Total expenditure and net lending	283.9	444.2	450.0	516.3	36.8	42.6	44.7	42.1	310.2	476.5	478.6	552.4	40.2	45.7	47.5	45.1
Current expenditure	266.7	399.3	407.8	471.8	34.6	38.3	40.5	38.5	290.6	429.4	434.2	504.7	37.6	41.2	43.1	41.2
Expenditure on goods and services	123.4	158.8	172.3	199.9	16.0	15.2	17.1	16.3	134.5	172.4	184.5	214.7	17.4	16.5	18.3	17.5
Wages and salaries	65.4	89.1	95.3	114.0	8.5	8.5	9.5	9.3	73.0	98.6	104.3	125.0	9.5	9.4	10.4	10.2
Other purchases of goods and services	58.0	69.7	77.0	85.9	7.5	6.7	7.7	7.0	61.6	73.8	80.2	89.7	8.0	7.1	8.0	7.3
Interest payment	5.6	16.5	8.8	12.0	0.7	1.6	0.9	1.0	5.7	18.0	9.6	13.2	0.7	1.7	1.0	1.1
Subsidies and other current transfers	137.7	224.1	226.7	259.8	17.8	21.5	22.5	21.2	150.4	239.0	240.1	276.8	19.5	22.9	23.8	22.6
Subsidies	23.1	40.4	42.6	38.0	3.0	3.9	4.2	3.1	23.9	42.0	43.7	38.9	3.1	4.0	4.3	3.2
Transfers to households	114.6	183.7	184.0	221.9	14.8	17.6	18.3	18.1	126.5	197.0	196.4	237.9	16.4	18.9	19.5	19.4
Capital expenditure	10.8	35.8	33.4	39.2	1.4	3.4	3.3	3.2	12.0	37.0	34.5	41.2	1.6	3.5	3.4	3.4
of which: financed by project loans	0.0	11.9	7.5	13.7	0.0	1.1	0.7	1.1	0.0	11.9	7.9	14.1	0.0	1.1	0.8	1.1
General reserves	0.0	9.0	1.8	4.5	0.0	0.9	0.2	0.4	0.4	9.3	2.5	5.1	0.1	0.9	0.3	0.4
Lending minus repayment	6.3	0.0	0.6	0.9	0.8	0.0	0.1	0.1	7.2	0.8	1.1	1.1	0.9	0.1	0.1	0.1
Net transfer to other levels of government	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Net transfer from Montenegro	0.0	0.0	0.0	2.6	0.0	0.0	0.0	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Unclassified spending (incl. stat. discr.)	0.6	0.1	6.3	0.0	0.1	0.0	0.6	0.0	0.6	0.0	6.2	0.0	0.1	0.0	0.6	0.0
Overall balance	-7.4	-52.2	-47.2	-50.7	-1.0	-5.0	-4.7	-4.1	-10.5	-55.6	-50.2	-55.8	-1.3	-5.3	-5.0	-4.5
Foreign grants	3.4	7.8	9.6	7.2	0.4	0.7	1.0	0.6	5.4	9.8	11.3	8.5	0.7	0.9	1.1	0.7
Overall balance including grants	-4.0	-44.4	-37.6	-43.4	-0.5	-4.3	-3.7	-3.5	-5.1	-45.9	-39.0	-47.2	-0.6	-4.4	-3.9	-3.9
Financing	4.0	44.5	37.6	43.4	0.5	4.3	3.7	3.5	5.1	45.8	39.0	47.2	0.7	4.4	3.9	3.9
Domestic financing	4.0	5.6	-1.9	0.0	0.5	0.5	-0.2	0.0	5.1	4.4	-4.8	0.6	0.7	0.4	-0.5	0.0
Bank financing	5.2	7.5	-1.9	0.0	0.7	0.7	-0.2	0.0	5.8	6.3	-4.8	0.6	0.7	0.6	-0.5	0.0
Non-bank financing	-1.2	-1.9	0.0	0.0	-0.2	-0.2	0.0	0.0	-0.7	-1.9	0.0	0.0	-0.1	-0.2	0.0	0.0
Foreign Financing	0.0	27.5	17.2	23.1	0.0	2.6	1.7	1.9	0.0	28.5	17.6	24.8	0.0	2.7	1.8	2.0
Privatization receipts	0.0	11.4	22.3	20.3	0.0	1.1	2.2	1.7	0.0	12.9	26.1	21.8	0.0	1.2	2.6	1.8

Sources: Federal and Republican Ministries of Finance; and IMF staff estimates.

1/ Consolidated general government includes the Union (former federal), the republican, and local governments (except for Montenegro), the social security funds and the extrabudgetary programs.

2/ Expressed in terms of GDP of Serbia and Montenegro excluding Kosovo.

Table 7B. Federal Republic of Yugoslavia: Federal Government Fiscal Operations, 1999–2002
(In percent of GDP) 1/

	1999	2000	2001	2002	
	Actual	Actual	Prelim.	Budget	Prelim.
A. Total revenue and grants (1+2)	7.3	7.1	6.4	6.3	7.1
1 Total revenue (1.1+1.2-1.3)	7.3	7.1	6.4	6.3	7.1
1.1 Current revenue (1.1.1-1.1.2)	7.3	7.1	6.4	6.3	7.1
1.1.1 Tax revenue (1.1.1.1+1.1.1.2+1.1.1.3)	6.1	6.4	5.6	5.5	6.1
1.1.1.1 Turnover (retail sales) tax	2.4	2.2	3.5	2.5	2.7
1.1.1.2 Taxes on international trade and operations	2.3	2.2	1.9	2.1	2.4
1.1.1.3 Excises	0.3	0.2	0.2	0.9	0.9
1.1.1.4 Extrabudgetary taxes	1.1	1.7	0.0	0.0	0.0
1.1.2 Nontax revenue	1.2	0.7	0.8	0.9	1.0
1.2 Capital revenue	0.0	0.0	0.0	0.0	0.0
1.3 Transfers from other level of government	0.0	0.0	0.0	0.0	0.0
2 Grants	0.0	0.0	0.0	0.0	0.0
B. Total expenditure and net lending (1+2)	7.3	7.1	6.2	6.3	6.9
1. Total expenditure (2+3+4)	7.3	7.1	6.2	6.3	6.9
2 Current expenditure (2.1+2.2+2.3)	7.3	7.1	5.7	5.1	5.8
2.1. Expenditure on goods and services (2.1.1+...+2.1.4)	6.5	6.2	4.0	3.2	4.0
2.1.1 Wages and salaries	0.7	1.0	1.7	1.7	1.7
2.1.2 Employer contribution	0.7	1.0	0.0	0.2	0.3
for pension funds	0.0	0.0	0.0	0.2	0.0
for health insurance	0.0	0.0	0.0	0.1	0.0
for unemployment insurance	0.0	0.0	0.0	0.0	0.0
2.1.3 Severance payments	0.0	0.0	0.0	0.0	0.0
2.1.4 Other purchases of goods and services	5.1	4.3	2.3	1.3	2.0
2.2. Interest payment	0.1	0.0	0.2	0.0	0.0
2.3. Subsidies and other current transfers	0.7	0.9	1.4	1.9	1.8
2.3.1 Transfers to households	0.0	0.0	0.5	0.7	0.7
Disability benefit	0.0	0.0	0.3	0.2	0.3
Other	0.0	0.0	0.0	0.1	0.0
Repayment of FFCD	0.0	0.0	0.2	0.3	0.3
2.3.2 Subsidies	0.0	0.0	0.0	0.1	0.0
2.3.3 Current transfers to other levels of government	0.7	0.9	0.9	1.1	1.1
Republican budget	0.0	0.0	0.0	0.0	0.0
Local Budgets	0.0	0.0	0.0	0.0	0.0
Pension Funds	0.2	0.2	0.2	0.3	0.4
Health Fund	0.0	0.0	0.0	0.0	0.0
Labor Market Fund	0.0	0.0	0.0	0.0	0.0
Pension transfer to Military Pension Fund	0.6	0.7	0.7	0.6	0.7
2.3.4 Other current transfers	0.0	0.0	0.0	0.1	0.0
3. Capital expenditure	0.0	0.0	0.5	0.9	1.0
4. General reserves	0.0	0.0	0.0	0.4	0.2
Overall budget balance	0.0	0.0	0.2	0.0	0.2
statistical discrepancy	0.0	0.0	-0.1	0.0	0.0
Financing	0.0	0.0	-0.3	0.0	-0.1
1 Domestic financing (net) (1.1+1.2)	0.0	0.0	-0.3	0.0	-0.1
1.1 Banking system (1.1.1+1.1.2)	0.0	0.0	-0.3	0.0	0.0
1.2 Nonbank	0.0	0.0	0.0	0.0	0.0
Memorandum items:					
Arrears	0.0	0.0	0.0	0.0	0.0
Total expenditure:	7.3	7.1	6.2	6.3	6.9
Army	0.0	0.0	3.6	3.4	3.7
Federal Administration	0.0	0.0	1.8	2.4	2.5
Nominal GDP (billion dinars)	192.9	381.7	771.8	1,043.5	1,006.9

Sources: Federal authorities; and IMF staff estimates and projections.
1/ Expressed in terms of GDP of Serbia and Montenegro (formerly FRY) excluding Kosovo.

Table 7C. Serbia: Republican Government Fiscal Operations, 1999–2003

(In percent of GDP) 1/

	1999	2000	2001	2002			2003		
				Budget	Prel. Jan.-Dec	Prel. incl.Union	Budget	Proj.	Prog. incl.Union
A Total revenue and grants (1+2)	**9.1**	**12.9**	**16.2**	**18.1**	**18.5**	**25.6**	**18.3**	**18.4**	**23.8**
1 Total revenue (1.1+1.2)	9.1	12.9	15.8	17.3	17.6	24.7	17.5	17.8	23.2
1.1 Current revenue (1.1.1+1.1.2)	9.1	12.9	15.8	17.3	17.6	24.7	17.5	17.8	23.2
1.1.1 Tax revenue (1.1.1.1+...+1.1.1.6)	9.1	11.6	14.8	16.4	16.7	22.8	16.7	16.8	21.4
1.1.1.1 Personal income tax	3.6	3.2	4.1	4.3	4.4	4.4	4.1	4.3	4.1
1.1.1.2 Corporate income tax	0.5	0.3	0.4	0.4	0.4	0.4	0.3	0.3	0.3
1.1.1.3 Turnover (retail sales) tax	3.1	3.2	4.9	6.5	6.7	9.4	7.3	7.3	9.2
1.1.1.4 Excises	0.5	2.1	3.2	3.7	3.6	4.5	3.9	4.0	4.7
1.1.1.5 Property taxes	0.4	0.2	1.3	0.8	1.0	1.0	0.3	0.3	0.3
1.1.1.6 Other taxes	1.1	2.5	0.9	0.7	0.6	0.6	0.7	0.5	0.5
1.1.2 Nontax revenue	0.0	1.3	1.0	0.9	0.9	1.9	0.8	1.1	1.8
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	0.4	0.7	1.0	1.0	0.8	0.6	0.6
B. Total expenditure and net lending (1+...+6)	**9.1**	**13.2**	**17.0**	**22.4**	**22.2**	**29.1**	**21.3**	**21.1**	**27.3**
1. Total expenditure (2+3+4)	9.1	13.2	16.2	22.4	22.1	29.0	21.2	21.0	27.2
2 Current expenditure (2.1+2.2+2.3)	8.7	11.5	15.7	19.4	20.2	27.1	19.4	19.2	23.5
2.1. Expenditure on goods and services (2.1.1+...+2.1.4)	7.8	6.4	6.7	6.6	5.9	5.9	6.2	6.1	6.2
2.1.1 Wages and salaries	3.7	3.5	3.5	3.9	3.5	3.5	3.8	3.6	3.6
2.1.2 Employer contribution	1.2	0.9	0.7	1.0	0.8	0.8	0.8	0.8	0.8
2.1.2.1 Contribution	0.0	0.0	0.0	0.7	0.6	0.6	0.7	0.7	0.7
2.1.2.2 Tax	0.0	0.0	0.0	0.3	0.2	0.2	0.1	0.1	0.1
2.1.4 Other purchases of goods and services	2.9	2.0	2.4	1.6	1.5	1.5	1.6	1.6	1.6
2.2. Interest payment	0.2	0.1	0.1	1.5	0.7	0.7	0.9	0.9	0.9
2.3. Subsidies and other current transfers	0.0	0.0	8.9	11.3	13.6	20.6	12.3	12.2	16.4
2.3.1 Subsidies	0.0	0.0	2.8	2.9	3.4	3.4	2.3	2.2	2.2
2.3.2 Transfers to households	0.8	5.0	2.8	3.0	3.2	3.2	3.6	3.5	3.5
Of which: Repayment for frozen foreign currey deposit	0.0	1.9	0.5	0.6	0.6	0.6	1.0	1.0	1.0
2.3.3 Current transfers to other levels of government	0.0	0.0	3.4	5.4	7.1	14.0	6.5	6.6	10.7
Federal budget	0.0	0.0	0.0	0.0	0.0	6.9 3/	0.0	0.0	4.2
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	0.1	0.1	1.3	1.3	1.0	1.0	1.0
Pension Funds	0.0	0.0	2.8	4.2	4.9	4.9	4.3	4.4	4.4
Health Fund	0.0	0.0	0.3	0.5	0.4	0.4	0.5	0.5	0.5
Labor Market Fund	0.0	0.0	0.1	0.2	0.3	0.3	0.4	0.3	0.3
3. Capital expenditure	0.7	1.3	0.5	2.4	1.9	1.9	1.4	2.2	2.2
Of which: Budget for recovery and reconstruction	0.0	0.0	0.0	1.1	0.7	0.7	0.0	1.1	1.1
4. General reserves	0.0	0.0	0.0	0.6	0.0	0.0	0.4	0.6	0.4
5. New Serbian expenditure	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	1.2
6. Lending minus repayment	0.0	0.0	0.8	0.0	0.1	0.1	0.1	0.1	0.1
Overall budget balance excluding grants	0.0	0.0	-1.2	-5.0	-4.6	-4.4	-3.8	-4.2	-4.1
Overall budget balance including grants (A-B)	0.0	-0.3	-0.8	-4.3	-3.6	-3.5	-3.0	-3.6	-3.5
Overall budget balance excluding grants and project loans	0.0	0.0	-1.2	-3.9	-3.9	-3.7	-3.8	-3.1	-3.0
Statistical Discrepancy/Gap	0.2	0.0	0.1	0.0	0.4	0.4	0.0	0.0	0.0
Financing (1+2+3)	0.2	0.3	0.9	4.2	4.1	3.9	3.0	3.6	3.5
1 Domestic financing (net) (1.1+1.2)	0.2	0.3	0.9	0.5	0.1	0.0	0.8	0.1	0.0
1.1 Banking system (1.1.1+1.1.2)	0.2	0.2	1.1	0.6	0.1	0.0	0.8	0.1	0.0
1.2 Nonbank	0.0	0.1	-0.2	-0.1	0.0	0.0	0.0	0.0	0.0
2 Foreign financing (net) (2.1-2.2)	0.0	0.0	0.0	2.6	1.7	1.7	1.0	1.9	1.9
2.1 Program	0.0	0.0	0.0	1.4	1.0	1.0	1.0	0.9	0.9
2.2 Project	0.0	0.0	0.0	1.1	0.7	0.7	0.0	1.1	1.1
3 Privatization receipts 2/	0.0	0.0	0.0	1.1	2.2	2.2	1.3	1.7	1.7
Memorandum items:									
Nominal GDP (billion dinars)	192.9	381.7	771.8	1043.5	1006.9	1006.9	1225.9	1225.9	1225.9

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

1/ Expressed in terms of GDP of Serbia and Montenegro excluding Kosovo.

2/ Total privatization receipts accruing to the republican government.

3/ Revenues of the federal government, classified as transfer for the sake of comparability with 2003.

Table 7D. Montenegro: Consolidated Fiscal Operations 2001–2003
(As a percent of GDP)

	2001 Outcome	2002 Prel. Est.	2003 Program
Total revenue	**38.0**	**36.5**	**36.9**
Current revenue	38.0	36.5	36.9
Tax revenue	32.9	34.2	34.4
Personal income tax	5.4	4.6	5.1
Social security contributions	10.8	11.9	11.2
Corporate income tax	0.6	1.0	1.0
Retail sales tax 1/	7.1	8.7	8.9
Excises	4.4	4.5	4.6
Taxes on international trade and operations	4.3	3.1	3.3
Other taxes	0.4	0.4	0.2
Extrabudgetary taxes	0.0	0.0	0.0
Nontax revenue	5.1	2.4	2.5
Capital revenue	0.0	0.0	0.1
Total expenditure and net lending	**42.3**	**40.6**	**39.7**
Current expenditure	38.6	37.3	36.3
Net wages, salaries and allowances	9.9	10.4	10.4
Payroll Tax	1.6	1.2	1.7
Employer contributions	0.0	0.0	0.0
Purchases of goods and services	5.9	3.9	3.7
Interest payment	0.1	1.0	1.3
Subsidies and other current transfers	20.7	20.1	18.7
Subsidies to enterprises	1.2	2.0	1.1
Transfers to households	19.5	18.1	17.7
Other non-interest current expenditure	0.5	0.7	0.5
Capital expenditure	2.0	1.6	2.3
General reserves	0.6	1.0	0.3
Net Lending	1.1	0.7	0.4
Transfer to the Union Budget	**0.0**	**0.0**	**2.9**
Overall balance	**-4.2**	**-4.0**	**-5.6**
Discrepancy	0.4	0.3	0.0
Overall balance before grants	**-4.7**	**-4.3**	**-5.6**
Foreign grants	3.1	2.2	1.4
Overall balance including grants	**-1.6**	**-2.1**	**-4.2**
Financing	**1.6**	**2.1**	**4.2**
Domestic financing	1.6	-3.5	0.6
Bank financing	0.8	-3.5	0.6
Nonbank financing	0.8	0.0	0.0
Net Foreign Financing	0.0	0.6	1.9
Program	0.0	0.0	1.5
Project	0.0	0.6	0.4
Amortisation	0.0	0.0	0.0
Privatization receipts	0.0	5.1	1.7
Memorandum item			
Montenegro GDP (Euro million)	1,049	1,250	1,400

Source: Montenegrin Ministry of Finance.

1/ From FY2002 onwards, retail sales tax includes revenues that were redirected to the Army and the Railway.

Table 7E. Montenegro: Republican Government Fiscal Operations, 2001–2003
(In percent of GDP)

	2001		2002			2003	
	Budget	Jan.-Dec. Est.	Budget	Jan.-Dec.	Jan.-Dec. (comparable with 2003) 1/	Program	Budget
A Total revenue and grants (1+2)	**20.9**	**23.3**	**23.9**	**20.3**	**26.7**	**26.7**	**27.4**
1 Total revenue (1.1+1.2)	18.0	21.9	21.6	18.1	24.5	25.3	25.8
1.1 Current revenue (1.1.1+1.1.2)	18.0	21.9	21.6	18.1	24.6	25.3	25.8
1.1.1 Tax revenue (1.1.1.1+1.1.1.2+1.1.1.3+1.1.1.4)	16.3	17.9	16.7	16.4	22.9	23.2	23.7
1.1.1.1 Personal income	5.3	5.4	5.4	4.5	5.3	5.1	5.4
1.1.1.2 Turnover (retail sales) tax	5.3	5.6	5.0	4.2	8.6	8.9	7.0
1.1.1.3 Excises	3.2	3.4	2.7	4.1	4.5	4.6	6.2
1.1.1.4 Taxes on international trade and transactions	0.0	0.0	2.6	2.2	3.1	3.3	3.7
1.1.1.5 Other taxes	1.7	2.6	0.3	0.4	0.4	0.2	0.2
1.1.1.6 Corporate income taxes	0.0	0.0	0.6	1.0	1.0	1.0	1.1
1.1.2 Nontax revenue	1.7	4.0	4.9	1.7	1.7	2.1	2.1
1.2 Capital revenue	0.0	0.0	0.0	0.0	0.0	0.0	0.0
2 Grants	2.9	1.4	2.3	2.2	2.2	1.4	1.7
B Total expenditure and net lending (1+2)	**21.6**	**24.3**	**25.8**	**20.8**	**23.0**	**23.7**	**24.6**
1 Total expenditure (1.1+1.2)	21.6	23.7	24.8	19.9	22.2	23.1	24.0
1.1 Current expenditure (1.1.1+1.1.2)	19.9	21.8	23.5	18.5	20.7	21.1	22.0
1.1.1 Interest	0.0	0.1	1.9	1.0	1.1	1.3	1.8
1.1.2 Non-interest (1.1.2.1+1.1.2.2+1.1.2.3+1.1.2.4)	19.8	21.8	21.6	17.4	19.6	19.9	20.2
1.1.2.1 wages and salaries	11.2	10.3	10.8	8.5	9.1	10.9	10.9
Net Wages 2/	5.2	4.8	5.0	5.5	5.5	5.0	5.0
Allowances	1.1	1.0	1.1	1.0	1.0	1.1	1.1
PIT	1.2	1.2	1.2	0.6	1.3	1.2	1.2
Contributions	3.4	3.2	3.3	1.2	1.2	3.3	3.3
1.1.2.2. Goods and Services	3.7	5.3	4.3	3.3	3.3	2.9	3.1
1.1.2.3 Transfers and Social benefits to individuals and NGOs	3.0	3.9	3.1	2.9	3.9	4.1	4.1
1.1.2.4 Subsidies to enterprises	1.1	1.2	2.1	1.5	2.0	1.1	1.2
1.1.2.5 Other non-interest expenditure	0.8	1.1	1.3	1.3	1.3	0.9	0.9
1.2 Capital expenditure	1.7	1.8	1.3	1.5	1.5	2.0	2.0
2 Net lending	0.0	0.6	1.0	0.8	0.8	0.5	0.6
C Net transfer to other levels of government	**0.0**	**0.4**	**0.5**	**0.7**	**5.0**	**6.6**	**6.6**
1 Transfers to the PIO	0.0	0.1	0.0	0.0	4.2	3.1	3.1
2 Transfers to the Health Fund	0.0	0.1	0.2	0.4	0.4	0.2	0.2
3 Transfers to the Employment Fund	0.0	0.2	0.3	0.3	0.3	0.4	0.4
4 Transfers to the Union Budget	0.0	0.0	0.0	0.0	0.0	2.9	2.9
Overall balance (cash) (A-B-C-A.2)	**-3.6**	**-2.8**	**-4.7**	**-3.4**	**-3.4**	**-5.0**	**-5.4**
D Discrepancy	0.3	0.2	0.0	1.1	1.1	0.0	0.0
Overall budget balance before grants (cash) (A-B-C-A.2-D)	**-3.9**	**-3.0**	**-4.7**	**-4.5**	**-4.5**	**-5.0**	**-5.4**
Overall budget balance after grants (cash) (A-B-C-D)	**-1.0**	**-1.6**	**-2.4**	**-2.3**	**-2.3**	**-3.5**	**-3.8**
Financing (1+2+3)	**1.0**	**1.6**	**2.4**	**2.3**	**2.3**	**3.5**	**3.8**
1 Domestic financing (net) (1.1+1.2)	0.0	1.6	-1.4	-2.6	-2.6	0.0	0.2
1.1 Banking system (1.1.1+1.1.2)	0.0	0.8	-1.4	-2.6	-2.6	0.0	0.2
1.1.1 Central Bank of Montenegro	0.0	1.0	-1.4	0.3	0.3	-1.0	0.0
1.1.2 Commercial banks	0.0	-0.2	0.0	-2.8	-2.8	1.0	0.2
1.2 Nonbank	0.0	0.8	0.0	0.0	0.0	0.0	0.0
2 Foreign financing (net) (2.1-2.2)	0.0	0.0	1.8	0.6	0.6	1.9	1.9
2.1 Disbursements	0.0	0.0	1.8	0.6	0.6	1.9	1.9
2.2 Amortization	0.0	0.0	0.0	0.0	0.0	0.0	0.0
3 Privatization receipts	1.0	0.0	1.9	4.3	4.3	1.7	1.7
Memorandum items:							
Gross wage bill on a commitment basis	11.2	10.3	10.8	11.5	11.5	10.9	10.9
Nominal GDP (Euro million)	1,049	1,049	1,250	1,250	1,250	1,400	1,400

Source: Montenegrin Ministry of Finance.

1/ Includes sales taxes that were earlier redirected to Pension Fund, Railway and Army; and assumes full payment of payroll tax by the government to itself on behalf of its employees.

2/ In 2003, the reported wage bill excludes wages of employees of the University of Montenegro; these are now included in "Transfers".

Table 8. Serbia and Montenegro: Macroeconomic Framework, 2000–2005

	2000	2001	2002 Prel.	2003 Proj.	2004 Proj.	2005 Proj.
GDP (DIN billion)	382	772	1,007	1,226	1,402	1,565
GDP (US$ million)	8,603	11,577	15,656	19,867	21,102	22,341
			(Percent change)			
End-period inflation (RPI)	113.5	39.0	14.2	9-11	7.0	5.0
GDP	5.0	5.5	4.0	3½ - 4½	5.0	5.0
			(In percent of nominal GDP)			
Gross domestic savings	-2.7	-7.2	-7.0	-3.5	-0.9	2.2
Non-government	-4.4	-7.8	-7.0	-3.8	-2.2	-0.4
Government	1.6	0.6	-0.1	0.3	1.3	2.6
Net factor receipts and transfers from abroad	13.0	16.3	14.2	11.8	10.4	10.3
Non-government	12.3	15.6	14.6	12.8	11.5	11.9
Government	0.7	0.7	-0.3	-1.0	-1.1	-1.6
Gross national savings	10.3	9.1	7.2	8.3	9.5	12.5
Non-government	7.9	7.8	7.6	9.0	9.3	11.5
Government	2.4	1.3	-0.4	-0.7	0.2	1.0
Gross domestic investment 1/	14.2	13.6	16.1	16.5	17.4	18.9
Non-government	12.2	11.7	12.2	12.9	13.2	14.2
Government	3.1	1.6	3.6	3.4	4.0	4.4
Savings-investment balance 1/	-3.9	-4.6	-8.9	-8.2	-7.9	-6.5
Non-government	-4.3	-3.9	-4.6	-4.0	-3.9	-2.8
Government	-0.7	-0.3	-4.0	-4.0	-3.8	-3.4
Foreign savings	3.9	4.6	8.9	8.2	7.9	6.5
Foreign savings including official grants	7.1	9.7	12.8	11.0	9.4	7.9
Net exports of goods and services	-16.9	-20.9	-23.1	-20.0	-18.3	-16.7

Sources: Data provided by the 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. Serbia and Montenegro: Indicators of Capacity to Repay the Fund, 2000-2011

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
				Projections 1/								
Fund repurchases and charges 2/												
In millions of SDRs	...	7.9	10.3	33.3	159.7	161.4	46.5	68.4	140.7	202.8	173.1	94.5
In millions of U.S. dollars	...	10.2	13.6	45.3	217.5	219.9	63.4	93.2	191.7	276.3	235.9	128.8
In percent of exports of goods and NFS	...	0.4	0.4	1.1	4.7	4.2	1.1	1.4	2.7	3.5	2.8	1.4
In percent of debt service	...	9.6	6.8	9.3	31.9	25.6	5.8	6.9	12.3	15.9	14.8	9.1
In percent of quota	...	1.7	2.2	7.1	34.1	34.5	9.9	14.6	30.1	43.4	37.0	20.2
In percent of gross official reserves	...	0.9	0.6	1.7	7.1	6.3	1.7	2.5	4.9	6.8	5.4	2.8
Fund credit outstanding												
In millions of SDRs	116.9	216.9	416.9	598.2	708.5	668.8	641.7	591.7	466.7	275.0	108.3	16.7
In millions of U.S. dollars	154.2	280.2	551.0	814.6	964.7	911.1	874.6	806.2	635.9	374.7	147.6	22.7
In percent of quota	25.0	46.4	89.1	127.9	151.5	143.0	137.2	126.5	99.8	58.8	23.2	3.6
In percent of GDP	1.8	2.4	3.5	4.1	4.6	4.1	3.7	3.3	2.4	1.3	0.5	0.1
In percent of gross official reserves	29.9	24.0	24.2	30.5	31.4	26.2	24.1	21.5	16.3	9.2	3.4	0.5
Memorandum items:												
Exports of goods and NFS (millions of US$)	2,547	2,743	3,241	3,993	4,603	5,259	5,879	6,484	7,104	7,786	8,487	9,253
Debt service, after debt relief (millions of US$)	56	107	201	488	682	858	1,088	1,354	1,557	1,735	1,594	1,414
Quota (millions of SDRs)	468	468	468	468	468	468	468	468	468	468	468	468
Quota (millions of US$)	617	604	618	637	637	637	637	637	637	637	637	637
Gross official reserves (millions of US$)	516	1,169	2,280	2,667	3,069	3,476	3,626	3,751	3,895	4,058	4,403	4,639
GDP (millions of US$)	8,603	11,577	15,656	19,867	21,101	22,341	23,433	24,630	26,715	28,920	31,277	33,793
U.S. dollar per SDR	1.32	1.29	1.32	1.36	1.36	1.36	1.36	1.36	1.36	1.36	1.36	1.36

Sources: SM authorities; and IMF staff estimates.

1/ As of end-January, 2003

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

Table 10. Serbia and Montenegro: Stock of External Debt at December 31, 2002 1/
(In millions of U.S. dollars)

Creditor	Total Debt	*Of which:* Arrears			
		Principal	Interest	Late Interest	Total Arrears
Total stock of external debt	11,839	2,647	1,358	591	4,596
Multilateral creditors 2/	3,701	75	65	55	194
IMF	565	0	0	0	0
IBRD	2,175	0	0	0	0
IDA	168	0	0	0	0
EUROFIMA	158	0	0	0	0
IFC	213	75	65	55	194
EIB	114	0	0	0	0
European Community	235	0	0	0	0
EUROFOND-CEB	31	0	0	0	0
EBRD	44	0	0	0	0
Official bilateral creditors	3,295	191	143	76	409
Paris Club	2,690	0	1	0	1
Other official bilateral creditors 3/	605	191	141	76	408
Commercial creditors	3,822	1,578	1,053	461	3,092
London Club	2,442	973	913	152	2,037
Other commercial creditors: convertible currencies	1,196	447	115	309	870
Other commercial creditors: non-convertible currencies	184	159	26	0	184
Short-term debt 4/	1,020	804	97	0	901
Trade arrears related to oil and gas imports 5/	513	416	97	0	513
Other short-term debt	508	388	0	0	388

Sources: SM authorities, and IMF staff estimates.

1/ Debt figures reflect the effect of the debt rescheduling agreement of November 2001, which envisaged phased NPV reductions in Paris Club debt of 66 percent in total (of which 51 percent came into force upon approval of the current Extended Arrangment in May 2002).

2/ In February 2002, debt owed to the MIB ($11 million of non-government debt) was transferred to a commercial creditor.

3/ Regular and late interest calculated in accordance with terms of original agreements.

4/ Debt is not owed by government and does not have government guarantees.

5/ Overdue obligations (trade credits) owed to oil and gas enterprises in Russia and China.

Table 11. Serbia and Montenegro: Indicators of External Vulnerability, 1997-2002 1/
(In percent of GDP, unless otherwise indicated)

	1997	1998	1999	2000	2001	2002
Financial indicators						
Public sector debt	...	...	...	119.1	123.2	84.5
Broad money (percent change, 12-month basis)	23.9	69.4	67.6	61.4	79.1	76.8
Private sector credit (percent change, 12-month basis)	...	...	128.4	68.6	7.6	45.3
Weighted interest rates (percent per month, December) 2/	6.3	7.0	3.9	6.8	3.8	2.4
Retail prices (percent per annum, end of period)	...	...	49.9	113.5	39	14.2
External Indicators						
Exports (recorded exports, percent change, 12-month basis in US$)	19.5	24.0	-44.7	14.7	10.4	19.5
Imports (percent change, 12-month basis in US$)	17.0	1.0	-32.0	14.4	30.4	30.7
Terms of Trade (percent change, 12-month basis)	...	-2.6	-4.4	0.0	...	...
Current account balance, before grants	-7.7	-4.8	-7.5	-7.1	-9.7	-12.8
Current account balance after grants and FDI	-3.3	-3.9	-6.4	-3.6	-3.1	-5.3
Errors and omissions	-0.6	2.0	4.0	3.1	2.1	1.5
Gross official reserves (in US$ million)	...	326	293	516	1,169	2,280
(in months of imports GS of the following year)		1.1	0.9	1.2	2.4	3.4
Central Bank short-term foreign liabilities (in US$ million) 3/	...	0	0	0	0	100
Gross reserves of the banking system (in US$ million)	...	774	659	882	1,809	3,063
(in months of imports GS of the following year)		2.6	1.9	2.1	3.2	4.6
Short term foreign liabilities of the commercial banks (in US$ million)	...	...	...	349	59	74
Foreign currency liabilities of the commercial banks (in US$ million)	...	...	...	871	715	1,409
Official reserves/Broad money (M2) (percent)	...	18	30	50	73	72
Official reserves/reserve money (percent)	...	59	126	164	191	199
Short term external debt by original maturity (in US$ million) 4/	1,048	1,021	987	1,153	1,026	1,020
Short term external debt by remaining maturity (in US$ million) 4/	1,073	1,038	1,001	1,186	1,069	1,150
Short term external debt to reserves by original maturity (in percent)	...	313.1	337.0	223.4	87.7	44.7
Short term external debt to reserves by remaining maturity (in percent)	...	131.9	149.8	130.7	56.7	33.3
Share of short term external debt to total debt by original maturity (in percent)	10.7	9.7	9.2	10.1	8.6	8.6
Share of short term external debt to total debts by remaining maturity (in percent)	11.0	9.8	9.3	10.4	8.9	9.7
Total external debt (in US$ millions)	9,770	10,539	10,744	11,403	11,948	11,839
Of which : Public and publicly guaranteed debt 5/	8,722	9,518	9,757	10,250	10,922	10,919
Total external debt (in percent of exports of G&S)	...	267	500	448	436	365
External interest payments, cash basis (in percent of exports of G&S)	...	...	...	1.6	2.7	4.3
External amortization payments, cash basis (in percent of exports of G&S)	...	...	...	0.0	1.2	1.3
Exchange rate, official (per euro, end of period)	3	12	12	59	61	61.5
Exchange rate, parallel (per euro, end of period)	5	16	21	30	31	61.5
REER (annual average, February-December 1994 = 100) 6/	100.4	91.7	66.9	51.4	82.0	91.5

Sources: SM authorities; and IMF staff estimates.

1/ All stocks are measured end-of-period. Excludes Kosovo, except for external debt.

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

3/ Excluding IMF and liabilities to domestic residents. In 2002, NBS assumed short-term external debt of commercial banks of $100 million.

4/ Includes overdue obligations on debt related to imports of oil and gas. Short-term external debt by remaining maturity also includes amortization due in the following year on medium- and long-term debt.

5/ Assuming all long- and medium-term external debt of banks and enterprises is government guaranteed.

6/ Increase denotes appreciation.

Table 12. Serbia and Montenegro: Schedule of Purchases
Under the Extended Arrangement

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

1/ The quota is SDR 467.7 million.

Serbia and Montenegro: Fund Relations
As of February 28, 2003

I. **Membership Status:** Joined: 12/14/1992; Article VIII accepted May 14, 2002

II. **General Resources Account:**	SDR Million	%Quota
Quota	467.70	100.00
Fund Holdings of Currency	884.64	189.15

III. **SDR Department:**	SDR Million	%Allocation
Net cumulative allocation	56.66	100.00
Holdings	0.66	1.16

IV. **Outstanding Purchases and Loans:**	SDR Million	%Quota
Stand-by arrangement	316.93	67.76
Extended arrangements	100.00	21.38

V. **Financial Arrangements:**

Type	Approval Date	Expiration Date	Amount Approved	Amount Drawn
EFF	5/14/02	5/13/05	SDR 650.0 million	SDR 100.0 million
Stand-by	6/11/01	5/31/02	SDR 200.0 million	SDR 200.0 million
Emergency Post-Conflict Assistance	12/20/00		SDR 116.9 million	SDR 116.9 million

VI. **Projected Obligations to Fund:**
Under the Repurchase Expectations Assumptions[1] (In millions of SDR)

	Forthcoming				
	2003	2004	2005	2006	2007
Principal	18.75	139.71	139.71	27.08	33.33
Charges/Interest	8.27	9.77	6.17	3.64	2.96
Total	27.02	149.48	145.88	30.72	36.30

VII. **Safeguards Assessments:**

Under the Fund's safeguards assessment policy, the National Bank of Yugoslavia (now NBS) was subject to a safeguards assessment with respect to the Extended Arrangement approved on May13, 2002, which is scheduled to expire on May 13, 2005. A safeguards assessment of the NBY was completed on November 29, 2001. The assessment concluded that substantial risks may exist in the financial reporting framework, internal audit mechanism, and system of internal controls as reported in EBS/02/73 (4/26/02). The proposed remedies by the mission are being implemented.

[1] This schedule presents all currently scheduled payments to the IMF, including repayment expectations where applicable and repayment obligations otherwise. The IMF Executive Board can extend repayment expectations (within predetermined limits) upon request by the debtor country if its external payments position is not strong enough to meet the expectations without undue hardship or risk.

VIII. **Exchange Arrangement**

Serbia and Montenegro (SM) accepted the obligations under Article VIII as of May 2002. The currency of Serbia is the Serbian dinar. On January 1, 2001, Serbia 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. Montenegro has adopted the euro as its sole legal tender.

IX. **Last Article IV Consultation**

The last Article IV consultation was held on May 13, 2002.

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
FAD	June-July 2002	Tax administration
FAD	September 2002	Treasury reform follow-up
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
MAE	December 2002	Integrated reform policies for a market-based

		financial system
STA	February 2001	Money and banking statistics
STA	May 2002	Money and banking statistics
STA	July 2002	Multi-sector mission

XI. Resident Representative

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

Serbia and Montenegro: IMF-World Bank Relations

Partnership in Serbia and Montenegro's Development Strategy

1. 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 International Bank for Reconstruction and Development (IBRD). FRY membership in the International Development Association (IDA) was confirmed on June 11, 2001. Following constitutional changes, FRY completed its transition to Serbia and Montenegro (SM) on February 4, 2003. The government of SM and its two constituent republics of Serbia and Montenegro have highlighted recent progress in structural reform and stabilization, and outlined their medium-term development strategies, in an Interim Poverty Reduction Strategy Paper (I-PRSP). This document, accompanied by a Joint Staff Assessment (JSA), was discussed by the Board of the Bank on August 8, 2002, and simultaneously considered by the Board of the Fund on a lapse of time basis. The full PRSP is expected to be completed by end-2003.

2. In the context of a program supported by a three-year Extended Arrangement (EA) the IMF takes the lead on macroeconomic (fiscal, monetary, and exchange rate) policies aimed at facilitating sustainable growth. In addition to macroeconomic targets, the Fund has established structural performance criteria and benchmarks in areas such as tax administration, payments system reform, banking reform, financial markets, foreign trade policy, and energy tariffs. Working together with bilateral donors, the Fund has also provided technical assistance in the first three areas.

3. As outlined more fully below, the Bank has complemented the Fund's work through support to structural reforms. In areas of direct interest to the Fund, the Bank leads the policy dialogue in: (i) public expenditure management; (ii) macroeconomically important sectoral reforms (e.g. in the energy sector), (iii) pension, health and social assistance reform; (iv) the restructuring and privatization of enterprises; and (v) legal reforms with a bearing on the business environment, including labor markets. The Bank and Fund have jointly led the policy dialogue in the financial sector, including on the restructuring and privatization of banks, and in foreign trade. The Bank's program of investment lending, representing about 20 percent of planned commitments and covering a range of sectors, is described more fully below.

Bank Group Strategy

4. The World Bank Group's operations assist the Government in achieving its overall goals of: (i) restoring macroeconomic stability and external balance; (ii) stimulating near-term growth and creating the basis for a sustained supply response; (iii) improving social well-being of the most vulnerable and building human capacity; and (iv) improving governance and building effective institutions.

5. The first stage of World Bank assistance commenced even before SM's membership. In view of its urgent needs, and concurrent with the arrears clearance process, the Bank established in May 2001 a Trust Fund for FRY (TFFRY) using US$30 million of IBRD

surplus net income to provide grant financing for selected priority activities. Five grants totaling US$30 million have been approved under the TFFRY and are currently under implementation. These grants, which were important in laying the foundations for the IDA-financed program, included (i) a private sector technical assistance grant for Serbia, (ii) a financial sector technical assistance grant for Serbia, (iii) a social protection grant for Serbia; (iv) an electric power emergency reconstruction grant for Serbia, and (v) an environmental infrastructure grant for Montenegro.

6. The second stage of assistance began on May 8, 2001, when the Bank's Board of Directors endorsed a first Transitional Support Strategy (TSS) for SM.[1] The TSS contained a three-year IDA envelope of up to $540 million for SM on a temporary and exceptional basis, with actual lending to depend upon performance against agreed benchmarks. It was envisaged that up to 80 percent of the program could support policy-based lending. A first year program of lending, economic and sector work and technical assistance was outlined. The Transitional Support Strategy Update, discussed by the Bank's Board on August 8, 2002, confirmed the overall approach (including the focus on policy-based lending), and laid out the Bank's program for FY03. A full Country Assistance Strategy (CAS) is expected to be completed in late 2003, following completion of the full PRSP.

7. Given the extensive *de jure* and *de facto* devolution of responsibility for economic policy to the member state level, the program of adjustment lending is focused at this level. So far, three operations have been approved. In Serbia, a multi-sectoral Structural Adjustment Credit (SAC) (approved in January 2002) was designed to enhance fiscal sustainability through reforms of public expenditure management, the energy sector, social protection, labor markets, and health care. A parallel Private and Financial Sector Adjustment Credit (PFSAC) (approved May 2002) focused on the growth promotion agenda, assisting the government in: (i) strengthening the financial system through the liquidation of troubled banks and an improved policy and regulatory environment; (ii) privatizing and restructuring socially-owned enterprises; and (iii) improving the investment and business climate. In Montenegro, a single multi-sectoral Structural Adjustment Credit (approved in August 2002) supports reforms critical to fiscal sustainability as well as economic growth in the areas of public expenditure management, pensions, energy, labor markets, and the business environment.

8. The Bank's program for FY03 envisages strong continuity in this agenda. In Serbia, a proposed Social Sector Adjustment Credit (negotiated December 2002), supports further reforms in pensions, health and labor, while enhancing the focus on social assistance and poverty monitoring. A proposed PFSAC II (under preparation for Spring 2003) continues the reform agenda begun under PFSAC I. In Montenegro, a proposed multi-sectoral SAC II is planned for fall 2003. Policy content remains to be determined, but is expected to focus on key reforms to enhance growth potential.

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[1] A plan to clear SM's arrears to the World Bank was approved with the membership packages that provided for the exceptional consolidation of SM's arrears and principal not yet due into a new package of IBRD loans. These Consolidation Loans were approved by the Board on December 13, 2001, and became effective in early-January 2002.

9. The Bank's program of adjustment lending has been underpinned by analytical studies. In June 2001, the Bank, working together with the European Commission and the federal and republican governments, completed an Economic Recovery and Transition Program (ERTP), which was presented to the Donor Conference held the same month.[2] In 2002, the Bank focused on three complementary studies—a Public Expenditure and Institutional Review (PEIR), a Country Financial Accountability Assessment (CFAA), and a Country Procurement Assessment Review (CPAR). Studies of the agricultural (Serbia) and environmental areas were also completed. The Bank is now focusing its analytical work on improving the monitoring and analysis of poverty. Recently completed Poverty Household Surveys for both republics will lay the foundations for a Poverty Analysis to be completed in the first half of 2003. In 2004, the Bank plans to complete a Country Economic Memorandum (CEM) focused on the agenda for sustained growth and employment creation.

10. In both republics, a program of selective investment lending has been designed to assist the authorities to tackle critical impediments to effective public sector management and private sector development, improve social policy and underpin reforms initiated under the Bank-supported adjustment programs. A Trade and Transport Facility for Southeast Europe and an Export Finance project have been approved which cover both Serbia and Montenegro's needs. In addition, IDA is supporting a Serbian Education project, a Serbian Enterprise and Bank Restructuring Technical Assistance operation and a Montenegrin Energy Efficiency Learning and Innovation Credit. Three other investment projects are under preparation for FY03 (Serbia Health Reform, Serbia Labor Markets Learning and Innovation Credit, and Montenegro Environment, and five for FY04 (Serbia Transport Rehabilitation, Serbia Energy Efficiency, Serbia Real Property Registration and Cadastre, Serbia Public Expenditure Capacity Building, and Montenegro Health Sector Reform). As of December 2002, 8 IDA credits totaling about $214.26 million had been approved for SM, with adjustment support comprising 80 percent of the total.

11. Since SM became a member of IFC in May 2001, 4 projects have been approved, two in financial markets and two in manufacturing, totaling for about US$30 million. In addition, new project development for SM is under way in garment-textiles, agribusiness mechanical industry, pharmaceuticals, retail distribution, and tourism. IFC is also exploring possibilities for public-private financing partnerships in infrastructure. MIGA has initiated programs in two areas: (i) guarantees for projects in SM (demand for MIGA coverage is currently in the area of US$200-US$300 million, representing projects in manufacturing, finance and infrastructure sectors), and (ii) investment marketing services. MIGA undertook a detailed assessment of the technical assistance needs of the Serbian Investment and Export Promotion Agency (SIEPA), and has proposed a program of assistance to support the start-up phase.

Bank-Fund Collaboration in Specific Areas

12. As part of its overall assistance to SM, the Bank combines lending, analytical work and technical assistance to support policy reforms, with a focus on the following areas:

[2] *Federal Republic of Yugoslavia—Breaking with the Past: The Path to Stability and Growth,* World Bank Report No. 22267-YU.

13. **Public expenditure management.** SM's weak systems of public financial management had long contributed to macroeconomic instability, a lack of transparency, and the inefficient use of public resources. In response, the governments of Serbia and Montenegro have prioritized reforms and institution building in this area. The Bank is taking the lead with a multi-pronged assistance program, which the Fund is complementing with policy conditionality and technical assistance. The Bank's program began with the completion in 2002 of the PEIR, CFAA, and CPAR (see above), which in turn helped to define significant public expenditure management components in the first SACs for Serbia and Montenegro. In Serbia, key reforms supported by the Bank included the adoption of the Law on the Budget System (Organic Budget Law), the first steps toward introducing a treasury system, and enhanced inspection, auditing and procurement procedures. In Montenegro, where legal and institutional reforms had reached a more advanced stage, key reforms include the establishment of a more comprehensive multi-year framework for budget preparation, continued implementation of the interim treasury system, and improvements in the internal audit. In Serbia, the Bank anticipates supporting the institutional strengthening agenda through preparation of a proposed Public Expenditure Capacity Building Project which could focus on implementation of an extended treasury system, as well as capacity building in debt management, public procurement and selected anti-corruption activities.

14. **Energy sector reform.** The combination of low power prices and collection rates, a decade of underinvestment and lack of maintenance, and war-related physical damage, led to power shortages and left SM with loss-making and inefficient electric utilities. As the largest single source of quasi-fiscal pressures, the power sector became an area of particularly close collaboration between the Bank and the Fund. While the Bank has taken the lead in developing the policy agenda, the sector's fiscal impact has also motivated limited but strong conditionality in successive Fund arrangements. The Bank program has combined support for policy reforms with investment loans/grants for critical needs in both Serbia and Montenegro, improved financial management and technical assistance. The SACs for both republics focused on improving the financial position of the republican power utilities through measures to enhance revenues (phased tariff increases and improved collections) or reduce operating costs (e.g. control of the wage bill). Progress in achieving tariff rate targets is being monitored closely both by the Bank and the Fund. In parallel, the electric power emergency reconstruction grant for Serbia under the TFFRY supported urgent repairs, improvements in the financial management of the electric power company, and legal and policy advisory services. The recently approved Montenegro Energy Sector Learning and Innovation Credit, will assess consumer response to the introduction of remote electricity metering and introduce automated billing and demand side management, facilitate the eventual privatization of distribution services and lay the basis for institutional strengthening in the energy sector.

15. **Pension, health and social assistance reform.** The state pension systems of both Serbia and Montenegro account for about one-third of consolidated public spending, and pension spending as a share of GDP is high by regional standards. Chronic arrears on pension payments and large budgetary transfers to the pension funds in both republics were further evidence that reforms were required to improve pension system financial balance and overall medium-term fiscal sustainability. This created a synergy between Bank and Fund programs. The Bank has taken the lead, including initial pension reforms in its adjustment operations in

both republics, and providing required technical assistance through the social protection grant under the TFFRY. The key elements of pension reforms were parametric adjustments to retirement ages and indexation rules which would bring immediate fiscal savings relative to the no reform scenario. The Fund has provided supporting fiscal analysis and included related structural benchmarks in its successive arrangements in SM. The recently negotiated SOSAC for Serbia supports the next reforms of the pay-as-you-go system, as well as preparatory steps for a more comprehensive revamping of the pension system. The proposed second SAC for Montenegro could includes a similar pension reform component.

16. In Serbia, the SAC also included initial reforms of the health care system designed to begin restoring fiscal balance in that sector, as a basis for improving its functioning and ability to provide basic health care services for all citizens. To this end, the SAC supported the introduction of modest co-payments, adoption of a more limited essential drugs list, the addressing of structural inefficiencies in the delivery system, and the laying of foundations for a new policy and legal framework. The proposed SOSAC will continue and deepen this reform agenda. The Bank's involvement in the health care sector in Montenegro has so far focused on analytical work, most recently under the PEIR. Further planned support includes a health project scheduled for FY04.

17. In Serbia, the Bank's work on reforming other components of the social safety net began with conditionality and technical assistance under the social protection grant under the TFFRY. The SAC supported pilot reforms to enhance the equity and coverage of the main program of social assistance (the so-called Material Assistance to Families), to improve the management of donor funds for such programs, and to begin development of a new Law on Employment regulating benefits for unemployed workers. These reforms are now being completed and deepened under the proposed SOSAC. The SAC for Montenegro also supported the enactment of a Law on Employment.

18. **Restructuring and privatization of enterprises and banks.** Beginning in late 2000 in Serbia, and earlier in Montenegro, SM has been engaged in far-reaching reforms of the enterprise and financial sector. In Serbia, the initial focus in the enterprise sector was on creating a transparent legal and institutional framework for privatization to attract strategic investors. The agenda in the banking sector focused on the need to address the deep insolvency of the banking sector in a permanent and fiscally responsible fashion. The Bank and the Fund have worked closely together to support the needed policy reforms, with the Bank taking the lead on the enterprise sector and sharing leadership in the banking sector. The Bank program has combined sectoral adjustment credits focused on these themes with parallel projects to provide technical assistance. The Bank has worked closely with the Fund to formulate the benchmarks in the PFSAC (and the proposed PFSAC II – FY03), which complement and reinforce the elements of the EA related to financial sector strengthening. Fund conditionality under the EA has focused on facilitating a brisk pace for privatization, ensuring that all privatization proceeds flow transparently through the budget, and putting in place control mechanisms in banks prior to their privatization. Under the TFFRY, the Bank provided early support through private and financial sector technical assistance grants. This work will be continued under the recently approved Privatization and Restructuring of Banks and Enterprises Technical Assistance Project. For reasons of selectivity and given the strong

role of other donors, the Bank has so far not had a major involvement in these areas in Montenegro. However, the proposed second SAC for Montenegro may support selective reforms in these areas.

19. **Legal reforms with a bearing on the business environment.** The Bank has taken the lead on business environment and general private sector development. The SAC for Montenegro supports the adoption and initial implementation of the enterprise law, bankruptcy law, and law on secured transactions. The PFSAC for Serbia supported enactment of laws on foreign direct investment and an SME agency, amendments to federal and republican enterprise laws, and preparation of a law on secured transactions. In addition, the SACs in both republics emphasized reforms of the legal framework for the labor market, promoting employment creation through greater flexibility, and promoting the financial sustainability and effectiveness of unemployment benefit programs. This complements Fund conditionalities related to securities and accounting legislation, and rationalizing employment clauses in social programs associated with privatization and enterprise restructuring. In FY02, the Bank prepared a diagnostic study of Serbia's legal judicial and institutional framework; a small grant supports the improvements in court administration.

Prepared by World Bank staff. Questions may be addressed to Ardo Hansson at 473- 9499; or Nancy Cooke at 473- 8727.

Serbia and Montenegro: Statistical Issues

1. Serbia and Montenegro's (SM) statistical database uses definitions that 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 the country was isolated from international developments. The authorities have, therefore, requested that the Fund send a mission to prepare the data module of the Report on the Observance of Standards and Codes (ROSC), which would include a comprehensive data quality assessment, as a basis for further technical assistance.

2. A multisector statistics mission visited Belgrade and Podgorica during July 10–31, 2002. The mission found that there was a critical need for Serbia and Montenegro to improve the quality of existing macroeconomic statistics by developing comprehensive data sources and by implementing sound statistical techniques. To streamline data compilation, federal statistics could be derived from information compiled on the two member states, without undertaking separate data collections, as is currently the case. To strengthen SM's statistical infrastructure, there is a need for relevant official agencies to work together in setting priorities, developing action plans, and coordinating statistical initiatives in a systematic manner. Except for monetary statistics for Serbia compiled by the National Bank of Serbia (NBS) as discussed in Section D below, SM does not report data to STA and does not have a page in *International Financial Statistics*.

A. Real Sector

3. Real sector statistics are compiled and published by the Federal Statistics Office (FSO), the Statistics Institute of Serbia (SIS), and the Statistics Institute of Montenegro (SIM). The FSO has been compiling national accounts statistics for the FRY, Serbia, and Montenegro since 1997. Current price estimates of GDP by activity and by expenditure approach are available for 1997–2000. In addition, a full sequence of accounts (generation of income account, allocation of primary income account, secondary distribution of income account, use of income account, and capital account) for the total economy and by institutional sectors is also available for 1997–2000. Generally, the methodology follows the *System of National Accounts (1993 SNA),* but there are problems with the scope of the accounts and the basis for recording that are not broadly consistent with the international standards. Also, the data sources are in need of improvement, given the closure, from January 8, 2003, of the Clearing and Payments Service of Yugoslavia (ZOP), which used to collect information from annual balance sheets and profit/loss statements from all legal entities. This was a key input to the national accounts. The statistics techniques used for the national accounts compilation need further improvement. A major problem is the lack of estimates for the informal activities. Statistical agencies are aware that improvements are needed, particularly in source data. These issues are being addressed in a master plan for the improvement of economic statistics, which is being developed with the assistance of EUROSTAT.

4. The FSO and SIS compile and disseminate, respectively for the union and Serbia, retail price indices (RPI), cost of living indices (COLI), producer price indices (PPI), and unit-value price indices for imports and exports. In Montenegro, the SOM compiles a RPI while the Institute for Strategic Studies and Prognoses, a nonprofit institution, also publishes

its own series based on surveys of household consumption. While the frequency and methodology of observation appear adequate, weighting, data storage, and dissemination could be improved.

B. Balance of Payments

5. Balance of payments statistics are currently compiled by the NBS and the Central Bank of Montenegro (CBM). Principal data sources are customs data on merchandise trade as processed by the FSO 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 NBS 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. Since 2001, the NBS has expended commendable efforts to improve its estimation of actual flows based on existing data.

6. However, the union's balance of payments statement is incomplete because not all information covers both constituent states and the statement shows large net errors and omissions. Although currently there is no balance of payments statement for Serbia, the NBS could compile such data by using existing information from the union's statement, adjusted for imports and exports of Montenegro and financial flows pertaining to transactions between the two constituent states covered under the financial account of the union's statement. Close coordination between the NBS and the CBM will be needed to compile balance of payments data for the union.

C. Government Finance

7. Fiscal statistics for Serbia are compiled by the Serbian Ministry of Finance and for Montenegro by the Montenegro Ministry of Finance. Principal data sources are the budget execution reports of the spending Ministries and first-level budget units and—until end-2002—ZOP reports. Revenue data are more timely and reliable than expenditure data, which are compiled with longer delays.

8. Data on the general government are not compiled, but, several initiatives will permit eventual development of these statistics. These have included: (1) the new budget laws provide ministries of finance with the legislative authority for budget execution, borrowing, issuing of guarantees, debt management, and budget accounting and reporting for all levels of government in the republics; (2) the establishment of a Treasury in Montenegro and in Serbia will facilitate the collection of sound source data for government finance statistics; and (3) the application of classifications set forth in the Government Finance Statistics Manual 2001(GFSM 2001) by the Serbian and Montenegrin Ministries of Finance for producing data on central government operations. In addition, new charts of accounts will be introduced at the federation level by January 2003.

9. During 2001, the government in Serbia made an effort to bring the existing budget reporting system in line with GFS methodology, but full compliance will require, *inter alia,* full implementation of the new chart of accounts (generally consistent with the classifications

of the *GFSM 2001*). Data on expenditure arrears are less reliable due to the lack of basic treasury functions in the existing system of expenditure management.

10. Fiscal data for the central government of Montenegro are based on the new GFS classification and are 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. A new chart of accounts was introduced in Montenegro in 2001 and needs to be fully implemented at the local level. No data are available for local governments.

11. The multisector mission recommended that (1) data on the republics be consolidated to produce information for the federation in accordance with international guidelines; (2) mechanisms be developed quickly to ensure the availability of source data for the compilation of government finance statistics following the discontinuation of data provision by the Clearing and Payments Service of Yugoslavia (ZOP) from January 8, 2003; (3) new charts of accounts be adopted at all government levels; (4) the classification of government debt be improved; and (5) government finance statistics be compiled and disseminated to the public and reported to STA for publication in the International Financial Statistics (IFS) and the Government Finance Statistics Yearbook.

D. Monetary Accounts

12. Monetary and financial statistics are compiled by the NBS and the CBM following broadly the methodology set forth in the *Monetary and Financial Statistics Manual*. The July 2002 multisector statistics mission found that the authorities have made good progress in implementing the recommendations of the 2001 and 2002 STA missions. Nevertheless problems persist related to inadequate disaggregation of the resident sector, especially the government sector, and the lack of clearly defined criteria for distinguishing residents and nonresidents in financial statistics. Although there is a methodological break for data prior to January 2002, the chart of accounts used since January 2002 will facilitate the production of consistent time series in the future. The NBS and CBM plan to introduce changes to their charts of accounts to provide additional details for the government sector, thereby increasing the accuracy and reliability of the data. With reference to periodicity and timeliness of data for the financial sector, both the NBS and the CBM meet the GDDS recommendations.

13. For the first time in over a decade, on November 29, 2002, the NBS reported to STA monetary statistics for the Republic of Serbia. The data included analytical accounts of the NBS, other depository corporations, and the banking system, as well as data on interest rates, compiled based on the recommendations made by the past three STA missions on monetary and financial statistics in 2001 and 2002. The data series included monthly data for January 2002-October 2002, annual data for 1998-2000 and quarterly data for 2001. In March 2003, the NBS sent to STA monetary statistics for December 2002.

Table 13. Serbia and Montenegro: Core Statistical Indicators
(As of February 28, 2003)

	Exchange rates	International Reserves	Central Bank Balance Sheet	Reserve Money	Broad Money	Interest Rates	Retail Price Index	Exports/ Imports	Current Account Balance	Government Balance	Gross Domestic Product	External Debt/ Debt Service
Date of Latest Observation	Feb. 27, 2003	Feb. 26, 2003	Dec. 31, 2002	Feb. 21, 2003	Dec. 31, 2002	Jan. 31, 2003	Jan., 2003	Dec. 31, 2002	Dec. 31 2002	Jan.-Dec., 2002	2000	Dec. 31 2001
Date Received	Feb. 27, 2003	Feb. 28 2003	Feb. 26, 2003	Feb. 25, 2003	Feb. 26, 2003	Feb. 27, 2003	Feb. 15, 2003	Feb. 2003	Feb. 2003	Feb. 2003	July 2002	Feb. 2003
Frequency of Data	Daily	Daily	Monthly	Daily	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Annually	Monthly
Frequency of Reporting	Daily	Daily	Monthly	Weekly	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Annually	Monthly
Source of Update	NBS	NBS	NBS	NBS	NBS	NBS	FBS	FBS	NBS	Ministries of Finance of Serbia and Montenegro	FBS	NBS
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	NBS
Confidentiality	Public	Confidential	Confidential	Confidential	Public	Public	Public	Public	Public	Public	Public	Confidential
Frequency of Publication	Daily	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Annually	Annually	Monthly

Serbia and Montenegro: External Debt Sustainability Analysis

1. This note (a) updates the medium-term balance of payments projections of EBS/02/73 (4/26/02) and (b) applies the standardized framework of SM/02/166 (5/28/02) to conduct stress tests.

A. Medium-Term Balance of Payments Projections

2. The baseline scenario assumes that: (a) exports will grow at an annual average rate of 17 percent in the first half and 10 percent in the second half of the 10-year projection period; (b) imports will grow at the same rate as nominal GDP; (c) FDI will rise steadily, reflecting progress in privatization and improving business environment; (d) commercial borrowing will increase steadily as the business environment improves; (e) official borrowing will increase moderately, with declining program support being offset by increasing project support; (f) there will be no IMF support after the current arrangement; (g) the London Club creditors and non-Paris Club official creditors will provide debt relief in early 2003 on terms comparable to those of Paris Club creditors; and (h) gross international reserves will build up to around 4.2 months of imports of goods and services.

3. Under the baseline scenario, the debt ratios improve over the next 10 years, although the improvement is more modest in the first half of the period. The debt-to-GDP ratio will average around 49 percent in the first 5 years and around 37 percent in the next five years. Debt service ratios, on the other hand, will increase until 2009 and decline gradually afterwards, partly reflecting the increased debt service after the end of the grace period offered by the Paris Club and other bilateral creditors. The rise of debt service ratios in the latter half of the projection period argues for a steady buildup of official reserves in early years to guard against possible risks, while keeping on schedule with the country's external obligations. The results are broadly similar to those in EBS/02/73, except that debt ratios are somewhat improved, mainly reflecting the larger-than-projected real appreciation of the dinar which raised dollar GDP.

4. Under an alternative scenario, it is assumed that FDI inflows will be half the amount projected under the baseline, owing mainly to shortfalls in privatization receipts, and that the import, export, and GDP growth rates are not affected. The resulting financing gap is assumed to be filled by additional commercial borrowing. On these assumptions, both the debt and debt service ratios would worsen significantly. It should be noted that, notwithstanding their many benefits, FDI inflows give rise to financial obligations to foreign investors, and cannot replace increased export capacity as the key determinant of a country's external debt sustainability.

B. Stress Testing Applying the Standardized Sustainability Framework

5. The challenge in applying the standard framework to SM is to find plausible shocks based on its own historical data. The historical data show large variations due to the breakup of former Yugoslavia, the sanctions, and the Kosovo war, and thus could not provide useful indication of plausible shocks in the future. In light of this difficulty, 2002 projected outturns

was used to replace historical averages, and the 1996–2001 data for 4 countries in the region, namely Albania, Bulgaria, Croatia and Romania, were used to derive the standard deviation.

6. If real GDP growth, nominal interest rate, dollar deflator, non-interest current account, and non-debt inflows are set as the estimates of the 2002 outturns, the external debt ratios would decline much faster than in the baseline case, owing to the more favorable GDP deflator and nominal interest rate in 2002 than in the outer years. This suggests that the baseline scenario may be relatively conservative.

7. Applying shocks to the parameters, the stress tests indicate that higher debt burden stemming from shocks to the external current account deficit, and/or a significant economic downturn would both increase the debt ratios substantially, before the ratios improve slightly following the end of the shocks. On the other hand, shocks to the interest rate and GDP deflator from the 2002 level do not have a significant impact on the debt ratios. The former reflects the fact that the interest rate in 2002 is relatively low, partly associated with the delayed start of debt service to the Paris Club creditors, while the latter reflects the still relatively high inflation in 2002. Owing to the starting conditions, stress tests for the interest rate and the GDP deflator do not cause major deviations from the baseline projections. The combination of smaller shocks of all the above variables would yield somewhat higher debt ratios than the baseline. Finally, a large one-time real depreciation would substantially worsen the debt ratios.

Table 14. Serbia and Montenegro: External Debt Sustainability Framework, 1998–2007

(In percent of GDP, unless otherwise indicated)

	Actual				Projections					
	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
					I. Baseline Medium-Term Projections					
External debt	73.9	105.8	132.5	103.2	75.6	51.1	53.2	50.0	46.9	44.9
Change in external debt	16.9	29.9	26.8	-29.3	-27.6	-23.5	1.1	-3.2	-3.1	-2.0
Identified external debt-creating flows (4+8+11)	15.3	33.7	26.6	-25.8	-17.6	-8.1	2.6	1.0	0.7	0.2
Current account deficit, excluding interest payments	4.4	6.7	6.6	9.0	12.0	9.2	7.4	5.8	4.3	3.6
Deficit in balance of goods and services	-66.4	-56.0	-76.3	-68.3	-64.5	-60.2	-62.0	-63.8	-66.0	-67.9
Exports	28.4	21.1	29.6	23.7	20.7	20.1	21.8	23.5	25.1	26.4
Imports	-37.9	-34.8	-46.5	-44.6	-43.8	-40.1	-40.1	-40.3	-40.9	-41.5
Net non-debt creating capital inflows (negative)	-0.8	-1.1	-0.3	-1.4	-3.6	-3.7	-3.8	-3.9	-3.7	-3.7
Net foreign direct investment, equity	0.8	1.1	0.3	1.4	3.6	3.7	3.8	3.9	3.7	3.7
Net portfolio investment,equity	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Automatic debt dynamics 1/	11.7	28.1	20.3	-33.4	-26.0	-13.6	-1.1	-0.9	0.1	0.2
Contribution from nominal interest rate	0.4	0.8	0.5	0.6	0.9	1.8	1.9	2.1	2.4	2.4
Contribution from real GDP growth	-4.7	18.6	-6.3	-5.4	-3.0	-2.4	-2.5	-2.5	-2.4	-2.2
Contribution from price and exchange rate changes 2/	16.0	8.7	26.1	-28.6	-23.8	-13.1	-0.6	-0.4	0.1	0.0
Residual, incl. change in gross foreign assets (2-3)	1.6	-3.8	0.1	-3.5	-10.0	-15.4	-1.5	-4.3	-3.8	-2.1
External debt-to-exports ratio (in percent)	267.0	500.4	447.7	435.6	365.3	259.4	244.0	212.4	186.9	70.5
Gross external financing need (in billions of US dollars) 3/	1758.1	1818.5	1624.1	2337.8	3123.1	3468.8	3372.6	3409.3	3500.9	575.7
in percent of GDP	12.7	17.9	18.9	20.2	19.9	17.6	16.1	15.4	15.1	14.7
Key Macroeconomic and External Assumptions										
Real GDP growth (in percent)	6.7	-18.0	5.0	5.5	4.0	4.0	5.0	5.0	5.0	5.0
GDP deflator (change in domestic currency)	29.0	60.8	88.5	91.7	25.5	16.0	8.9	6.3	4.8	3.5
Nominal external interest rate (in percent)	0.5	0.8	0.4	0.6	1.2	3.0	4.0	4.2	5.1	5.5
Growth of exports (US dollar terms, in percent)	10.4	-45.6	18.6	7.7	18.2	23.2	15.3	14.3	11.8	10.3
Growth of imports (US dollar terms, in percent)	1.6	-32.9	13.2	28.9	32.9	16.3	6.2	6.2	6.5	6.5
					II. Stress Tests for External Debt Ratio					
1. Real GDP growth, nominal interest rate, dollar deflator, non-interest current account, and non-debt inflows are at 2002 level in 2003-2007					75.6	50.7	45.1	38.2	33.4	31.4
2. Nominal interest rate is at 2002 level plus two standard deviations in 2003 and 2004					75.6	52.3	53.1	49.9	46.7	44.8
3. Real GDP growth is at 2002 level minus two standard deviations in 2003 and 2004					75.6	59.8	68.1	64.6	61.5	59.6
4. Change in US dollar GDP deflator is at 2002 level minus two standard deviations in 2003 and 2004					75.6	59.5	56.8	53.5	50.4	48.5
5. Non-interest current account is at 2002 level minus two standard deviations in 2003 and 2004					75.6	61.2	72.9	69.3	66.2	64.4
6. Combination of 2-5 using one standard deviation shocks					75.6	61.8	64.8	61.4	58.3	56.4
7. One time 30 percent nominal depreciation in 2003					75.6	82.2	82.6	78.9	75.9	74.0

Statistics of the key variables used for stress testing	2002 outturn Prel	Standard 4/ Deviation	Average 2002-07
Current account deficit, excluding interest payments	12.0	3.1	7.1
Net non-debt creating capital inflows	3.6	1.8	3.7
Nominal external interest rate (in percent) 5/	2.1	0.6	3.8
Real GDP growth (in percent)	4.0	5.3	4.7
GDP deflator in US dollars (change in percent)	30.0	11.1	8.8

1/ Derived as $[r - g - \rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock, with r = nominal effective interest rate on external debt; ρ = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as $[-\rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock. ρ increases with an appreciating domestic currency ($\varepsilon > 0$) and rising inflation (based on GDP deflator).

3/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

4/ The average of standard deviation of Albania, Bulgaria, Croatia, and Romania between 1996 and 2001

5/ Modified the standard framework by adjusting downwards the end-2001 debt stock by the amount of bilateral debt to be reduced. This would give a more reasonable basis for projection forward.

Table 15. Serbia and Montenegro: Medium-Term External Sustainability, 2000-2011

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Average 2003-06	Average 2007-11
	(In millions of U.S. dollars, unless indicated otherwise)													
Export growth (US$ terms, in percent) 1/	15.1	10.4	20.4	23.2	16.4	15.0	13.0	11.0	10.3	10.3	9.5	9.3	16.9	10.1
Import growth (US$ terms, in percent)	12.6	30.4	30.7	16.7	6.2	6.2	6.5	6.5	6.3	6.3	6.3	6.3	8.9	6.3
Current account balance, before grants	-610	-1,119	-2,012	-2,189	-1,982	-1,759	-1,590	-1,486	-1,303	-1,022	-907	-627	...	...
percent of GDP	-7.1	-9.7	-12.8	-11.0	-9.4	-7.9	-6.8	-6.0	-4.9	-3.5	-2.9	-1.9	-8.8	-3.8
Current account balance, after grants	-339	-528	-1,387	-1,760	-1,667	-1,444	-1,340	-1,286	-1,103	-822	-707	-426	...	...
percent of GDP	-3.9	-4.6	-8.9	-8.9	-7.9	-6.5	-5.7	-5.2	-4.1	-2.8	-2.3	-1.3	-7.2	-3.1
Gross official reserves	516	1,169	2,280	2,667	3,069	3,476	3,626	3,751	3,895	4,058	4,403	4,639	...	...
in months of imports of goods and services	1.2	2.4	3.4	3.8	4.1	4.4	4.3	4.1	4.0	4.0	4.7		4.1	4.2
External debt 2/		-	11,839	10,358	11,232	11,169	10,985	11,052	10,977	10,719	10,594	10,649	...	...
As percent of exports of goods and services	0	0	365	259	244	212	187	170	155	138	125	115	225.7	140.5
As percent of GDP	0	0	76	52	53	50	47	45	41	37	34	32	50.6	37.7
As percent of government revenue	0	0	178	129	130	123	115	112	103	93	84	79	124.2	94.3
External debt service 3/	56	107	201	488	582	858	1,088	1,354	1,557	1,735	1,594	1,414		
As percent of exports of goods and services	2.2	3.9	6.2	12.2	14.8	16.3	18.5	20.9	21.9	22.3	18.8	15.3	15.5	19.8
As percent of GDP	0.6	0.9	1.3	2.5	3.2	3.8	4.6	5.5	5.8	6.0	5.1	4.2	3.5	5.3
As percent of government revenue	1.8	2.4	3.0	6.1	7.9	9.5	11.4	13.7	14.6	15.0	12.7	10.5	8.7	13.3
Sensitivity Analysis														
Lower foreign direct investment scenario 4/														
Debt service to exports of g&s		...	...	13.0	16.5	18.6	21.4	24.1	25.4	26.0	22.6	19.2	17.4	23.4
Debt to exports of g&s		...	...	269	260	235	214	202	189	174	164	155	255	176.7
Debt to GDP		...	...	54	57	55	54	53	50	47	44	42	55	47.4

Sources: SM authorities, and IMF staff estimates.

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/ 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 from commercial creditors is utilized to cover the emerging financing gaps. Exports and GDP are assumed unchanged from the baseline

Serbia and Montenegro: Public Sector Debt Sustainability Analysis

1. Under the baseline scenario for fiscal debt sustainability analysis, SM's debt-to-GDP ratio would decline steadily from 84½ percent of GDP in 2002 to 50¾ percent of GDP in 2007 (Table 16). The debt-to-revenue ratio would decline by 68 percentage points over the same period, from 193½ percent in 2002. This baseline scenario is broadly unchanged from the one presented in EBS/02/73 (4/26/02), although the debt-to-GDP ratio in 2003 falls more sharply than previously (owing mainly to the larger-than-programmed real currency appreciation) and therefore, by 2007, the ratio is 9 percentage points of GDP lower than envisaged earlier. The scenario assumes a gradual fiscal adjustment during 2002–2007. Current primary spending would gradually decline as a share of GDP, while allowing for a small increase in real terms. This decline reflects the consequence of structural reform in public enterprises and the social security system, as well as a general reduction in the size of the government. As the revenue-to-GDP ratio would drop slowly, the primary deficit gradually falls from 2.2 percent of GDP in 2002 to reach near balance in 2007. Privatization receipts are projected to remain high in the coming three years (although below the authorities' expectations), then decline to lower levels.

2. Using the standardized methodology set out in SM/02/166 (5/28/02), but with modifications due to data constraints, stress tests were conducted. Because data prior to 2000 are either incomplete or unavailable, and because SM underwent a series of structural breaks, it was not possible to use historical averages or standard deviations. As a result, and as explained in Appendix IV, the 2002 projected outturn was used to replace historical averages, and the 1997–2000 data for 4 countries in the region, namely Albania, Bulgaria, Croatia and Romania, were used to derive the standard deviation. All stress tests show that even if the debt-to-GDP ratio peaks following a temporary shock, it reverts to a declining trend thereafter.

3. In the first stress test, real GDP growth rate, real interest rate, and the primary balance remain at the 2002 level. This scenario results in a much faster reduction in the debt-to-GDP ratio, which would decline by 63 percentage points of GDP by 2007. This is due mainly to nominal and real interest effects which were more conservative under the baseline scenario. This also indicates that the baseline scenario is rather conservative. A similar test, but using regional standard deviation instead of the 2002 outturn also yields a very similar result to the baseline scenario.

4. Most stress tests, namely (i) higher real interest rates in 2003–2004, (ii) lower GDP growth, (iii) lower primary balance; (iv) a 10 percent increase in other debt-creating flows; and (v) a 30 percent real depreciation in 2003 would not result in an increase in the debt stock from its 2002 level, but would make the debt-to GDP reduction slower than under the baseline scenario.

5. One test only, the real depreciation of 30 percent in 2003, would increase the debt-to-GDP ratio from its 2002 level in the depreciation year; the ratio would be declining thereafter through the projection period, but would still be higher than its starting level in 2007.

Table 16. Serbia and Montenegro: Public Sector Debt Sustainability Framework, 2001–2007

(In percent of GDP, unless otherwise indicated)

		Actual	Prel.	Projections				
		2001	2002	2003	2004	2005	2006	2007
				I. Baseline Medium-Term Projections				
1	Public sector debt 1/	123.2	**84.5**	**62.1**	**58.9**	**54.1**	51.7	50.7
	Of which : Foreign-currency denominated	113.3	77.6	60.9	53.8	49.6	47.1	44.1
2	Change in public sector debt	17.7	-38.7	-22.4	-3.2	-4.8	-2.5	-0.9
3	Identified debt-creating flows (4+7+12)	-25.1	-40.0	-15.5	-1.1	-0.8	0.0	0.2
4	Primary deficit	-0.2	2.2	2.8	2.2	1.9	1.3	0.8
5	Revenue and grants	39.6	43.7	41.2	41.7	41.0	40.9	40.3
6	Primary (noninterest) expenditure	39.5	45.9	44.0	43.9	42.9	42.2	41.1
7	Automatic debt dynamics 2/	-24.9	-39.7	-17.0	-2.2	-1.9	-0.8	-0.6
8	Contribution from interest rate/growth differential 3/	-52.6	-28.1	-14.3	-6.3	-4.6	-3.1	-2.1
9	*Of which* : Contribution from real interest rate	-49.7	-24.4	-10.9	-3.6	-1.9	-0.6	0.2
10	*Of which:* Contribution from real GDP growth	-2.9	-3.8	-3.5	-2.7	-2.6	-2.5	-2.4
11	Contribution from exchange rate depreciation 4/	27.7	-11.5	-2.6	4.2	2.7	2.3	1.6
12	Other identified debt-creating flows	0.0	-2.6	-1.3	-1.1	-0.8	-0.5	0.0
13	Privatization receipts (negative)	0.0	-2.6	-1.3	-1.1	-0.8	-0.5	0.0
14	Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0
15	Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0
16	Residual, including asset changes (2-3)	42.7	1.4	-6.9	-2.0	-4.0	-2.5	-1.2
	Public sector debt-to-revenue ratio 1/	310.8	193.5	150.7	141.2	131.9	126.2	125.8
	Gross financing need 5/	1.2	4.9	5.0	4.8	4.9	4.6	4.3
	In billions of U.S. dollars	0.1	0.8	1.0	1.0	1.1	1.1	1.1
	Key Macroeconomic and Fiscal Assumptions							
	Real GDP growth (in percent)	5.5	4.0	4.0	5.0	5.0	5.0	5.0
	Average nominal interest rate on public debt (in percent) 6/	1.4	0.9	1.6	2.7	3.0	3.7	4.2
	Average real interest rate (nominal rate minus change in GDP deflator, in percent)	-90.3	-24.8	-14.9	-6.2	-3.3	-1.1	0.7
	Inflation rate (GDP deflator, in percent)	91.7	25.7	16.5	8.9	6.3	4.8	3.5
	Growth of real primary spending (deflated by GDP deflator, in percent)	12.3	20.7	0.2	4.8	2.6	3.3	2.4
				II. Stress Tests for Public Debt Ratio				
	1. Real GDP growth, real interest rate, and primary balance are at 2002 projection in 2003-2007		**84.5**	**57.1**	**45.8**	**33.8**	**25.9**	**21.2**
	2. Real interest rate is at 2002 projection plus two standard deviations in 2003 and 2004		**84.5**	**67.6**	**63.9**	**58.9**	**56.4**	**55.4**
	3. Real GDP growth is at 2002 projection minus two standard deviations in 2003 and 2004		**84.5**	**69.2**	**72.9**	**67.9**	**65.4**	**64.5**
	4. Primary balance is at 2002 projection minus two standard deviations in 2003 and 2004		**84.5**	**65.1**	**65.4**	**60.3**	**57.8**	**56.8**
	5. Combination of 2-4 using one standard deviation shocks		**84.5**	**67.1**	**63.4**	**54.1**	**47.3**	**42.1**
	6. One time 30 percent real depreciation in 2003 7/		**84.5**	**121.0**	**115.8**	**109.2**	**105.9**	**104.4**
	7. 10 percent of GDP increase in other debt-creating flows in 2003		**84.5**	**72.1**	**68.6**	**63.5**	**60.9**	**59.9**

Variables used for stress tests	Standard Deviation 8/	2002 proj.		Average 2002-07
Primary deficit	1.8	2.2		1.8
Real GDP growth (in percent)	4.4	4.0		4.8
Nominal interest rate (in percent) 6/	11.1	3.1	9/	2.7
Real interest rate (in percent)	7.9	-22.6	9/	-8.3
Inflation rate (GDP deflator, in percent)	6.7	25.7		11.0
Revenue to GDP ratio	2.6	43.7		41.5

1/ Consolidated governments of Serbia and Montenegro. Covers gross external debt, and net domestic debt.

2/ Derived as $[(r - \pi(1+g) - g + \alpha\varepsilon(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; α = share of foreign-currency denominated debt; and ε = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

3/ The real interest rate contribution is derived from the denominator in footnote 2/ as $r - \pi(1+g)$ and the real growth contribution as $-g$.

4/ The exchange rate contribution is derived from the numerator in footnote 2/ as $\alpha\varepsilon(1+r)$.

5/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

6/ Derived as nominal interest expenditure divided by previous period debt stock.

7/ Real depreciation is defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

8/ Using average data for Albania, Bulgaria, Croatia, Romania, 1997-2001, subject to availability.

9/ Calculated excluding debt written off and domestic arrears stock.

April 1, 2003

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

Dear Mr. Köhler:

Firm implementation of our medium-term economic program supported by the Fund under the current extended arrangement has ensured significant progress toward lowering inflation as well as setting the foundation for sustainable growth, improved living standards, and external viability. To ensure continued progress, we have updated our economic and policy targets for 2003–05, as described in detail in the attached Memorandum on Economic and Financial Policies, to reflect the latest developments. On this basis, we request completion of the first review under the current extended arrangement, including a financing assurances review.

We believe that the policies and measures described in the attached memorandum are sufficient to achieve our program objectives, but we stand ready to take timely 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 continue to be reviewed by the Fund on a semiannual basis, with the second review expected to be brought to the IMF Board in June 2003. Implementation of the general government budget and the payment system reform, exchange rate policy, and progress in bank and enterprise reform will be the main subjects of the second review. The third and fifth reviews will focus in particular on the annual budgets and financial programs for 2004 and 2005, respectively. Moreover, each purchase under the arrangement will continue to be subject to a review of the financing of the program.

Yours sincerely,

Branko Lukovac /s/
Minister of Foreign Economic Relations
Serbia and Montenegro

Bozidar Djelic /s/
Minister of Finance
Republic of Serbia

Mladjan Dinkic /s/
Governor
National Bank of Serbia

Miroslav Ivanisevic /s/
Minister of Finance
Republic of Montenegro

Ljubisa Krgovic /s/
Chairman
Central Bank of Montenegro

SERBIA AND MONTENEGRO

MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES, 2003–2005

April 1, 2003

I. Introduction

1. **This memorandum updates the Memorandum of Economic and Financial Policies (MEFP) attached to the Letter of Intent of April 26, 2002.** The memorandum (a) reports on economic performance and policy implementation under the government's three-year program of stabilization and reform supported by the IMF under an Extended Arrangement (EA) approved on May 13, 2002; (b) updates the key economic and policy objectives of the three-year program; and (c) describes policy measures adopted recently and envisaged during the remainder of 2003. Annexes A and B, attached to this memorandum, contain information on the quantitative performance criteria and indicative limits for this period under the EA. Annexes C and D contain information on the structural performance criteria and benchmarks as well as prior actions. Annex E updates a detailed list of structural policy measures envisaged to be implemented during the EA. Annex F (Technical Memorandum of Understanding) defines the performance criteria and indicative targets and describes the reporting arrangements.

2. **Economic performance was generally favorable in 2002, even though a faster than programmed growth in domestic demand warrants close monitoring.** Annual inflation declined by almost two-thirds to 14 percent by end-2002 compared with a program target of 20 percent. Real GDP is estimated to have grown by 3½–4 percent in 2002, driven primarily by increasing activity in services. Industrial production has recovered since April 2002 and rose by 1.7 percent in 2002. The external current account deficit (before grants) reached $2.0 billion (13 percent of GDP), compared with an original program target of $1.6 billion (12 percent of GDP), reflecting mainly a stronger-than-expected domestic demand for consumer and investment goods that was offset partly by higher private remittances. The higher deficit in dollar terms was due in part to the valuation effect of the decline in the dollar vis-à-vis the euro, the main currency for foreign transactions. The overall balance of payments registered a surplus of $0.8 billion, $0.7 billion higher than targeted, owing to buoyant private capital inflows, including FDI. The foreign exchange reserves of the NBS reached $2.3 billion (3.4 months of projected imports of goods and services) at end-2002.

3. **Macroeconomic policies have been implemented firmly.** All quantitative performance criteria at end-September and end-December 2002 were observed. The fiscal deficit in Serbia and Montenegro (SM) amounted to about 5.0 percent of GDP in 2002 compared with the program target of 5.3 percent (on the basis of the revised GDP), while the government reduced its net indebtedness to the banking system by the equivalent of

½ percent of GDP (the program allowed for net borrowing of ½ percent of GDP).[1] Revenue/GDP was more than 2 percentage points higher than programmed in Serbia, while higher-than-expected privatization proceeds were used to offset a shortfall in foreign financing and reduce government indebtedness. In Montenegro, revenue was broadly in line with the program, while higher-than-budgeted net wage spending led to some accumulation of arrears, mainly towards the social funds. The NBS's NDA and NFA targets at end-September and end-December 2002 were comfortably observed, while the indicative target for wage bill growth in large state enterprises was exceeded by about 1 percent at end-September and end-December 2002 (Annex A). In addition, the indicative ceiling on the NDA of the banking system was exceeded at end-September and end-December 2002 owing to the more-rapid-than-envisaged remonetization of the economy and extension of bank credit to the nongovernment sector.

4. **Structural reform has advanced despite delays in the observance of some benchmarks.** In May 2002, SM's foreign exchange system was further liberalized with the adoption of a new foreign exchange law and implementing regulations, and the SM authorities accepted the obligations under Article VIII of the Fund's Articles of Agreement. In July, the average price of electricity was raised by 50 percent in Serbia, reducing sharply the need for budgetary subsidies to the electricity company. Work is advancing on the resolution of four large banks that were closed at the beginning of 2002 and on the privatization of 16 banks. In a major reform of the payments system, on January 1, 2003, the payments monopoly of ZOP (the domestic payments service system) was abolished, allowing commercial banks to initiate and settle interbank payments without the mandatory intermediation of any institution or agency. Privatization of large enterprises through tenders has progressed, and auction procedures were streamlined to accelerate sales through this method. In Montenegro, progress was made in improving public expenditure management, and in privatization. Out of the program's 12 structural benchmarks through end-December 2002 ten have been implemented, albeit often with some delay owing to limited implementation capacity and to political developments in Serbia and Montenegro, which disrupted the legislative activity of the federal and republican parliaments for several months (Annex C). The remaining two structural benchmarks are expected to be also met in 2003.

5. **The process of debt restructuring continues, with implementation of the agreement with Paris Club creditors and regularization of other debt.** Bilateral agreements have been concluded or initialed with 14 Paris Club creditors, with three remaining to be signed. Arrears of about €32 million to Eurofund, the only remaining multilateral creditor to which the SM government owed arrears at end-2001, were restructured in April 2002. Discussions with the London Club and other official bilateral

[1] The projection of nominal GDP in 2002 has been raised by 2.8 percent since the adoption of the program in early 2002, reflecting the net effect of new higher official estimates of nominal GDP in 2000 and lower-than-projected inflation in 2002. The fiscal deficit target in the original program was 5.7 percent of GDP.

creditors are ongoing, with the SM authorities continuing their efforts to obtain debt relief on terms similar to those agreed by the Paris Club creditors.

6. **Relations between Serbia and Montenegro have been reformed on the basis of a new constitutional charter, which established the Union of Serbia and Montenegro.** The charter, which came into force on February 4, 2003, acknowledges the status quo, including different monetary, exchange, customs, and tax regimes in the two constituent states. At the same time, it facilitates a streamlining of common administrative institutions and fosters a convergence in the economic systems of Serbia and Montenegro as they both harmonize their systems with that of the EU. The Serbian and Montenegrin authorities have agreed to resolve inter-state trade issues regarding customs, excises and VAT, and to adopt appropriate changes to institutions and policies to reflect the new constitutional charter.

II. Economic and Policy Objectives for 2003–2005

7. **The economic objectives for 2003–2005 have been updated to take into account recent developments and revisions to the national accounts** (Table). They are consistent with the achievement of sustainable growth, low inflation, and a viable external position.

- **Real GDP** is projected to grow by 3½-4½ percent in 2003 and 5 percent in 2004-05 reflecting increased domestic and foreign investment, as well as improved incentives stemming from enterprise restructuring and progress in privatization.

- **Inflation** should converge toward EU levels over the medium term, with the target for 2003 revised to reflect the favorable developments over the past year.

- The external **current account deficit** in SM is expected to decline as a share of GDP, as imports decelerate and exports recover to their historical levels. While the role of FDI inflows will increase as the privatization program and structural reforms reach an advanced stage, additional financing of about $0.9 billion annually is expected from bilateral donors as well as multilateral agencies including the EBRD, and EIB, and the World Bank during 2003–2005.

- **Official foreign reserves** are targeted to rise steadily, ensuring a strong external position in anticipation of a peak in debt servicing obligations in the second half of the decade.

Serbia and Montenegro: Key Macroeconomic Objectives and Policies, 2002–2005

	2002 Prel. Est.	2003 Rev. Prog.	2004 Rev. Proj.	2005 Rev. Proj.
		(Percentage change)		
Real GDP Growth	3 ½-4	3 ½-4 ½	5	5
Inflation (end period)	14	9-11	7	5
Of which: Montenegro	9½	8	5	4
		(In billions of US$)		
Current account deficit (before grants)	2.0	2.2	2.0	1.8
In percent of GDP	12.8	11.0	9.4	7.9
Gross official reserves	2.3	2.7	3.1	3.5
In months of projected imports	3.4	3.8	4.1	4.4
		(In percent of GDP)		
Fiscal deficit	5.0	4.5	4.3	3.9
Of which: Serbia	4.7	4.1	...	...
Montenegro	0.3	0.4	...	...
(in percent of Montenegro's GDP)	3.6	5.6	...	...
Fiscal deficit, excluding foreign-financed project spending	4.2	3.1	3.0	2.7
Government credit from the banking system	-0.4	0.0	0.6	0.9

8. **The policies for 2003 will be guided by the updated macroeconomic framework.** Given the uncertainty surrounding macroeconomic prospects, policy targets will be kept under close review and amended, if necessary to attain the economic objectives.

- The **fiscal deficit** is targeted at 4.5 percent of GDP in 2003, compared with an estimated outturn of 5.0 percent of GDP in 2002, with a view to containing the external current account deficit and supporting disinflation. The deficit will be financed largely by concessional foreign assistance and privatization proceeds, with no recourse to domestic financing except for seasonal budgetary needs.

- **Monetary and exchange rate policies** will be geared to lowering inflation while supporting economic recovery by safeguarding competitiveness. Excess bank lending will be curbed by a tightening of credit policy and a strengthening of banking supervision. Developments in the foreign exchange market and in the export sector will be monitored closely and exchange rate policy will be assessed regularly.

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

9. **The structural reform agenda in 2003 will aim at building public institutions, streamlining the state sector, and accelerating privatization.** Further fiscal reforms are planned in tax policy, notably preparations to introduce the VAT, in tax administration, and in expenditure management with the increasing role of the Treasury. The finances of the pension fund and the targeting of social services and transfers will also be improved. In the banking sector, the key objectives are a substantial strengthening of banking supervision and the timely implementation of the bank privatization program. Accelerated enterprise privatization is expected through a further streamlining of procedures to attract strategic investors.

10. **The PRSP process will continue to serve as guidance for the government's economic program.** An interim PRSP was completed in June 2002, and a full PRSP will be completed by mid-2003. In this connection, a recently completed household survey in Serbia will help determine the poverty line and better target social assistance. Social spending will continue to be protected to ensure a viable social safety net against restructuring costs throughout the restructuring process, while its effectiveness will be enhanced through improved targeting of benefits.

A. Fiscal Policy

Overview

11. **Fiscal policy in 2003 aims to contain the external imbalance, while continuing to support restructuring and an adequate social safety net.** The expenditure/GDP ratio is projected to decline by 2.4 percentage points to 45.1 percent in 2003. Noninterest current spending will be contained through structural reforms in the budgetary and enterprise sectors—involving the streamlining of the civil service as well as limiting spending on subsidies, disability pensions, and other social benefits—while capital spending will rise, reflecting increased budget allocations and accelerated implementation of foreign-financed projects. On the revenue side, the focus will be on improving tax administration and bringing an increasing share of private activity into the formal sector. As a result, the overall fiscal deficit is projected to decrease by 0.5 percentage points to 4.5 percent of GDP in 2003. To ensure transparency and accountability, all privatization proceeds will be channeled to the budget and spending will follow normal budgetary procedures. Excess privatization proceeds, after covering any shortfall in foreign budgetary financing, will be used to reduce net government indebtedness and—if consistent with achievement of economic objectives and in consultation with the Fund in the context of program reviews—to cover investment and restructuring costs.

12. **Constitutional reform will have implications for institutional arrangements and trade relations.** Savings will be realized through the streamlining of (formerly) federal institutions and the elimination of the duplication of functions. At the same time, the budget in Montenegro will have to cope with the planned annual transfer of over €40 million to finance joint functions such as defense and foreign diplomatic representation, proportional to Montenegro's share in union GDP. The Governments of Serbia and Montenegro have reached understandings on their trade relations that would formalize the existing customs borders between them, consistent with a free-trade area regime. Agreement has also been

reached on a broad plan to harmonize the trade, customs, and indirect tax systems over the next three years. A precise timetable for these measures will be agreed by end-April 2003 (to be monitored as a structural benchmark).

Union

13. **The federal budget for 2002 is estimated to have registered a surplus of 0.2 percent of GDP.** Revenue overperformance permitted a front-loaded retrenchment of about 1,900 federal employees and a settlement of arrears from previous years to suppliers and the pension fund.

14. **The budget of the Union for 2003, to be financed entirely by transfers from Serbia and Montenegro, will be streamlined and in balance.** The budget will involve a reduction in the expenditure/GDP ratio (relative to the federal budget)—even after allowing for a transfer of the obligation to service frozen foreign currency deposit (FFCD) bonds as well as other functions to the Serbian budget—and will be financed entirely by transfers from Serbia and Montenegro. Net savings of about 0.2 percent of GDP are expected from layoffs and other measures to eliminate the duplication of functions at the Union and Serbian levels. Defense spending (excluding transfers to the military pension fund) will decline by 0.3 percentage points to 3.4 percent of GDP in 2003.

Serbia

15. **The Serbian government is preliminarily estimated to have run a deficit of 4.7 percent of GDP in 2002, compared with a program target of 5.0 percent.** In the republican budget, revenue was about 0.4 percent of GDP higher than programmed, while spending was higher than in the program, as lower spending due to the aforementioned delay in disbursements of project loans was offset partly by higher allocations for transfers and subsidized lending to support restructuring. Higher-than-anticipated privatization receipts helped offset a shortfall in foreign financing. Local governments had a surplus of 0.2 percent of GDP.

16. **The 2003 republican budget brings Serbia closer to attaining its medium-term fiscal objectives while supporting external adjustment and growth.** It lowers the share of current noninterest expenditure while creating room for additional spending on debt service, infrastructure investment, and the social costs of restructuring. In addition, the budget supports growth by lowering the tax burden, especially on labor and corporate investment, by 1.5 percentage points of GDP. In particular, the CIT rate was lowered by 6 percentage points to 14 percent, and investment and employment credits were provided against this tax. Some basic goods (cooking oil, fat, and sugar) were exempted from the sales tax to assist the poor. The extra-profit tax will be phased out, while the financial transactions tax may be lowered and streamlined during 2003. Moreover, the excise tax on gasoline, diesel-fuel, and coffee will be raised as of April 1, 2003, generating additional revenue of about 0.3 percent of GDP. In addition, administrative fees will be raised, yielding 0.3 percent of GDP, and the tax base for contributions to the Pension Fund will be widened in the context of the pension reform, yielding another 0.1 percent. To minimize the potential disruptions resulting from the elimination of ZOP, the Serbian authorities have relied on the newly created Public Payments

Agency to support the treasury and have strengthened the Public Revenue Agency (PRA) by transferring additional staff from the ZOP. On the expenditure side, the budget envisages that wages will remain broadly constant as a share of GDP as real wage increases granted to the education and other sectors will be offset by containing other wages in line with targeted inflation and by reducing overstaffing and other inefficiencies; the latter will be based on a careful review of the payroll by the Ministry of Finance in cooperation with relevant line ministries. Subsidies and transfers will be reduced, notwithstanding the assumption by the government of FFCD bond repayment obligations from the federal budget, on account of the substantial reduction of subsidies to public enterprises (by almost 1 percent of GDP). Capital spending will increase, mostly driven by the availability of foreign financing.

17. **The fiscal program incorporates adjustments to the 2003 budget to ensure fiscal sustainability and attainment of the fiscal deficit target.** Contingency areas have been identified where expenditure commitments will be maintained below budget allocations by about 0.7 percent of GDP in the absence of revenue overperformance, in line with the provisions of the organic budget law (Article 34). These include: personnel costs, concessional lending for restructuring, subsidies to the railways and the road fund, and social transfers. On the basis of cautious revenue projections to reflect possible adverse effects from the implementation of a payments reform on January 1, 2003, discretionary budget spending in 2003 Q1 and Q2 will be maintained below the prorated annual allocation, thereby limiting total budgetary spending during the first half of the year to 45 percent of the total annual allocation. The Serbian government stands ready to adopt a supplementary budget should the deficit target or the program's macroeconomic targets be put at risk.

18. **Tax reform continues.** In tax administration, the Law on Tax Procedures and Administration was adopted by parliament in November 2002. The reorganization of the PRA has involved the introduction of a modern computerized system, the establishment of a Large Taxpayer Unit (LTU) in Belgrade—which is gradually becoming operational—and plans for additional LTUs for Nis, Novi Sad, and Kragujevac by end-September 2003 (to be monitored as a structural benchmark). The implementation of a single taxpayer identification number has started from January 2003 to facilitate tax and social contribution administration. Tax administration will also be improved through the introduction of fiscal cash registers, for which a subsidy is allowed for in the budget. In addition, technical preparations are underway for the introduction of the VAT in Serbia—the key remaining tax policy reform—by January 2005.

19. **Further progress is also envisaged in expenditure management and policy**. Building on the 2002 introduction of the new GFS classification, budget reporting and monitoring should improve substantially in 2003, facilitating the conduct of fiscal policy. In September 2002, a Treasury with cash management, debt management and central accounting divisions has been established. As of January 2003, the Treasury has begun following budget execution. Most line ministries and other direct budget users (DBUs) were brought under the treasury single account by April 1, 2003 with the remaining DBUs expected to be brought under the account by end-June 2003 (to be monitored as a structural benchmark). A centralized payroll for all DBUs will be established by end-December 2003 (also to be monitored as a structural benchmark), to streamline payroll spending and generate

savings. Preparations to move towards commitment accounting have begun, with a view to its implementation by 2004. The targeting of social welfare benefits has improved substantially with the tightening of means-testing for child benefit allowances. A pension law is currently under preparation with technical assistance from the World Bank, envisaging a tighter eligibility requirement for disability pensions, and a change in the formula for pension benefits that will reduce the accrual rate, lengthen work history to strengthen the link between contributions and benefits, and incorporate recent reforms at the federal level regarding pension age and indexation into republican legislation. Costs for the health fund have been reduced by introducing new criteria for medical service contracts, and with the adoption of a positive drug list eligible for state-subsidized purchase. The ongoing reform of social welfare programs will further streamline social spending through improved targeting. The planning and policy analysis capacity of the Serbian Ministry of Finance will be strengthened, including through support from USAID.

Montenegro

20. **The fiscal deficit was broadly in line with the program, although implementation was complicated by the accumulation of arrears, owed mostly by the government to itself.** Revenue was broadly in line with the program after allowing for (a) lower non-tax revenue caused by delays in the inclusion of some spending units in the new treasury system and (b) the nonpayment of payroll taxes by the government to itself on behalf of its employees. A higher than budgeted net wage bill has led to the incurrence of arrears in contributions to the social funds and necessitated cuts in discretionary spending (including subsidies and investment). The preliminary 2002 consolidated government cash deficit (before grants) was €50 million (4 percent of Montenegro's GDP), compared with a program target of €58.5 million (4.7 percent of GDP). Privatization proceeds, which reached €70 million, were the main financing source in 2002. Of this amount, €14 million was deposited with the Central Bank of Montenegro (CBM) on February 15, 2003 with a view to repaying an outstanding liability and safeguarding the integrity of the financial system.

21. **Montenegro's 2003 budget aims to underpin fiscal sustainability by containing non-interest current expenditure in relation to GDP.** At the state level, a net increase in non-discretionary expenditures in 2003, amounting to around 2 percent of Montenegro's GDP (resulting mainly from the envisaged transfer to the Union budget of over €40 million, has required containment of (non-interest) current spending to prevent the build-up of excessive budget deficits now and in the future. In this context, the government has explicitly linked the implementation of the envisaged increase in public employees' wages to a reduction in their number by 3,500 (i.e., by over 10 percent) in 2003. In addition, in the absence of revenue overperformance, expenditure commitments (in the areas of contractual services, subsidies to agriculture, and lending to enterprises) will be kept below their budgeted allocations by €6 million. Consolidated revenue (excluding grants) will be higher as a share of GDP, largely because of the introduction of VAT as of April 1, 2003 as well as the harmonization of some indirect taxes and import duties with Serbia. Montenegro's consolidated general government deficit (before grants) is targeted at €79 million (5.6 percent of Montenegro's GDP) in 2003, to be financed by foreign grants (€20 million)

and loans (€26 million), privatization proceeds (all of which will be channeled through the budget to enhance transparency), and borrowing from domestic commercial banks.

22. **Fiscal reforms in 2003 will concentrate on launching the VAT, improving Treasury operations, and reforming the pension system.** On the revenue side, the key reform will be the introduction of the VAT in April 2003, with the revenue impact to be ensured through the establishment of effective customs controls at Montenegro's borders. A new property tax—important in providing revenues to local governments—will also be introduced in 2003. On the expenditure side, further improvement in the functioning of the Treasury is envisaged, especially in the area of expenditure reporting, arrears monitoring, and debt management. The adoption of a new Pension Law—which may require amendments to the state budget—will be another key element of fiscal reform in 2003. It will shift the indexation of pensions from wage changes to a weighted average of price and wage changes (with the weight of wages not to exceed 50 percent) and raise the minimum retirement age by 5 years in a phased manner.

B. Wage and Pricing Policies

23. **Wage bills in state enterprises will continue to be controlled strictly to contain inflation pressures, and encourage restructuring through labor shedding.** The wage bill in state enterprises rose by about 27 percent in 2002, in line with the originally programmed (annual average) inflation. In 2003, the wage bill in state enterprises will be kept constant in real terms on the basis of the targeted rate of inflation, implying a maximum year-on-year increase of 13½ percent. By end-April 2003, the government of Serbia will approve restructuring strategies for the 7 large state enterprises aimed at improving their profitability through cost-cutting and streamlining measures (to be monitored as a structural benchmark), and will begin implementing these strategies from end-June 2003. Employment reductions would allow correspondingly higher average wages under the wage bill ceiling, properly adjusted for the spin-off of activities. Wage restraint in state enterprises will have a strong signaling effect for the remainder of the economy. Private companies are already facing a hard budget constraint, while new labor laws in both Serbia and Montenegro stipulate lower compulsory severance pay, as well as liberalized employment contracts and wage determination.

24. **Substantial progress has been made to bring administered prices for electricity closer to full cost-recovery levels, and this objective will be attained by 2004.** Electricity prices in Serbia were raised by 50 percent in mid-2002 to an average of about US¢3.1 per kWh. At the same time, generation, transmission and distribution costs were contained and the current collection rate was increased to over 80 percent of billings. With a view to fully covering operational costs as well as a portion of investment and debt servicing outlays, the average electricity price will be raised further by at least 20 percent in dinar terms by July 1, 2003 (to be monitored as a performance criterion). As a result, budgetary subsidies to the electricity company (EPS) will be reduced to well under 0.1 percent of GDP in 2003 (DIN 0.7 billion) compared with 0.4 percent of GDP in 2002. To facilitate further restructuring of the electricity sector, non-core activities in EPS will be spun off. In addition, accounting separation of key profit centers is envisaged by mid-2003 which, together with strengthened

management control over core activities, would pave the way for effective cost control and a subsequent restructuring of EPS. In Montenegro, electricity prices were raised on April 1, 2003 to 4.6 € cents/kWh for all users other than the aluminum plant (KAP).

C. Monetary and Exchange Rate Policy

25. **Monetary policy in Serbia will seek to curb excess bank lending and lower inflation, with reserve money growth driven entirely by increases in NFA.** In particular, end-2003 NDA of the National Bank of Serbia (NBS) will remain at its end-2002 level. Reserve money will be targeted to increase by 12.8 percent. Consistent with this policy target, the reserve requirement was raised by 3 percentage points to 23 percent as of March 1, 2003 and some government deposits will be shifted to the NBS. In the event of higher-than-projected NFA, the NBS will consult with the Fund staff on the implications for credit policy and—if the NFA overperformance does not appear to reflect increased money demand—will maintain NDA below the program ceiling to avoid overshooting the reserve money growth target. The NBS will conduct auctions of its securities in quantities consistent with the NDA target, and accept the resulting interest rates. Although the rapid expansion of credit to the non-government sector after many years of stagnation represents a welcome development, it also poses potential risks for the inflation objective as well as the soundness of the banks' loan portfolios. Accordingly the NBS will follow credit developments closely and, through its supervision department, strictly enforce prudential regulations to ensure that new lending decisions are sound.

26. **Exchange rate policy in Serbia will safeguard the external position while continuing to support disinflation.** The stability of the nominal exchange rate of the dinar against the euro since the beginning of 2001 has contributed to the substantial reduction in inflation, while the NBS was a net purchaser in the interbank foreign exchange market (i.e., excluding autonomous net foreign exchange inflows such as cash foreign assistance and privatization receipts) in 2002. During 2003, exchange rate policy will ensure the right balance between the inflation and external objectives, while aiming at a continuation of the disinflation process. The adoption of a new foreign exchange law in May, following which the SM authorities accepted Article VIII of the Fund's Articles of Agreement, has contributed to a deepening of the foreign exchange market, which nevertheless remains relatively thin. One of the two remaining restrictions subject to approval under Article VIII (Sections 2, 3 and 4)—pertaining to the transfer of profits abroad—was eliminated through an amendment of the Law on Foreign Investment in December 2002. (This was originally envisaged by October 30, 2002.)

D. Foreign Trade System

27. **The systematic removal of trade barriers will continue in both Serbia and Montenegro.** Following the mid-2001 elimination of most quantitative trade restrictions and the reform of the tariff system at the federal level, all export quotas have been eliminated in Serbia and the remaining insignificant ones in Montenegro will be eliminated by end-April 2003. This will be followed by the elimination of all quantitative import restrictions in Serbia and Montenegro—other than those maintained for health, environmental and security

reasons—by end-2004. Besides fully harmonizing trade relations between Serbia and Montenegro, free trade agreements will be signed with neighboring countries.

E. Bank Restructuring and Financial Sector Supervision

28. **Bank reform in Serbia emphasizes restructuring and privatization.** Following the acquisition of shares by the Serbian government of 16 banks under the laws on Paris and London Club debt-for-equity conversion and on frozen foreign currency savings, the authorities have formulated and begun to implement a strategy through the Bank Rehabilitation Agency (BRA) for their efficient transfer to private ownership, with technical assistance from the World Bank. The strategy was adopted by the Government of Serbia in February 2003 with a view to offering controlling stakes in most of these banks to reputable strategic investors by mid-2004. Tenders offering majority or controlling stakes for one bank will be launched by end-June 2003 and for another two banks by end-2003. In the meantime, with effect from December 15, 2002, the NBS and the government have put in place monitoring and control mechanisms (including a government-appointed management board and the obligation to undergo audit in March 2003 and submit monthly reports on cash flow and profit) to preserve the value of state-owned banks prior to their privatization. Regarding banks under the explicit control of the BRA, rehabilitation expenditures will be maintained within the fiscal envelope agreed under the program. The BRA has made significant progress in asset resolution of the four large banks closed in January 2002 and has prepared a rehabilitation plan for Niska Banka.

29. **Strengthened financial sector supervision and regulation will complement the bank restructuring measures.** The NBS has moved toward enforcing its stricter prudential regulations in line with international standards. These include asset classification and provisioning, through both on-site and off-site supervision. The banking supervision department will also cooperate with the monetary and research departments with a view to compiling high-frequency data on banking system developments to enable a timely response. The NBS will increase the frequency and depth of on-site inspections, while a new recommendation will be issued regarding asset classification in general, and the treatment of loans provided in the course of privatization in particular. The supervision department will be developed to move from compliance-based toward risk-based supervision, with a view to strengthening the latter and over time making this the organizing principle for banking supervision. In this connection, the NBS will assign responsibility for supervision of each bank to an individual supervisor. A new Accounting Law has been adopted, which prescribes IAS as the permanent accounting framework for all banks, including the NBS (monitored as a benchmark); bank preparations for implementation of this measure are well advanced. A Supervisory Development Plan (SDP), prepared with the assistance of the World Bank and bilateral donors, has been adopted. The CAMEL rating system will be piloted and formally adopted. A new Supervisory Council will be established to increase management oversight of banking supervision.

30. **In Montenegro, bank restructuring has been accompanied by measures to strengthen supervision.** The sale of Montenegro Banka is expected to be completed by end-April 2003. The government will actively seek to collect the claims and negotiate a discount

on the repayment of the €11.5 million liabilities assumed in connection with the privatization of Montenegro Banka. The bankruptcy procedure for Jugobanka Podgorica is moving forward, while Beranska Banka was merged with another bank in December 2002. After some delay, legislation was adopted in December 2002 to enable the Central Bank of Montenegro to supervise effectively offshore banks in line with the rules and regulations applicable to onshore banks (monitored as a structural benchmark). To monitor effectively existing offshore bank activities, the Ministry of Finance will transfer all the data on off-shore banks to the CBM by end-April 2003. In addition, a number of decisions have been passed that raised the minimum capital requirement, prescribed stricter standards on assets classification and provision, tightened risk assessment regulation, established consolidated bank supervision, and required reporting by banks of suspicious transactions. Preparations for introduction of IAS in banks are well underway, and risk-based supervision is being enhanced. Laws on anti-money laundering and public debt are expected to be adopted by end-April 2003.

F. Enterprise Restructuring and Privatization

31. **The pace of privatization and public enterprise restructuring has picked up in Serbia.** Twelve contracts totaling €173 million for the sale through international tenders of large socially owned companies had been signed by end-2002, sales of minority state shares in 48 companies yielded €82 million, and the pace of auctioning enterprises has accelerated since September, with several hundred sales in the last four months compared with about 20 in the preceding eight months. Total privatization receipts amounted to €332 million in 2002. In 2003, Serbia will offer for sale through international tenders a further 20 viable large socially-owned enterprises, 1,000 smaller ones through auctions, and continue the sale of its minority shareholding stakes. Total privatization revenue is expected to amount to at least €550 million in 2003. In addition, some three dozen socially sensitive conglomerates are being restructured prior to privatization to ensure an orderly transfer of ownership and retrenchment of employment. With a view to facilitating the privatization of less profitable firms through international tenders, with technical assistance from the World Bank, the length of guaranteed post-privatization employment has been reduced from 5 years to one year (as in the case of enterprises offered for privatization through auctions) and the overall cost of redundancies will be contained. The contribution of the budget (including privatization proceeds) to retrenchment costs will be limited to the amounts allocated in the budget for this purpose. To ensure transparency in the privatization and restructuring process, all privatization proceeds will be channeled to the budget and spending will follow normal budgetary procedures.

32. **Montenegro has moved on from Mass Voucher Privatization of minority stakes in enterprises to attracting strategic investors through tenders and auctions for majority stakes in selected enterprises.** In October 2002, Yugopetrol Kotor was sold to a foreign investor for €65 million, in addition to undertakings to invest in the company and provide severance payments to workers laid off, and total privatization proceeds amounted to €71 million in 2002. Privatization sales are expected to yield €70 million in 2003; however, for caution, one-third of this amount has been budgeted.

33. **Further improvements will be made in the provision of statistical data.** The implementation of the recommendations of the July 2002 multisector statistics mission from the IMF will help prioritize statistical activities, facilitating early conversion to the SNA 1993 methodology for compiling national accounts, and improving timeliness. The envisaged implementation of international standards (BPM5) for the compilation of the balance of payment statistics—which has already begun in Montenegro—should improve the coverage and quality of the external sector data. In addition, efforts to bring the budgetary reporting system in line with the GFS methodology have continued, and a consistent monetary survey for Montenegro will be developed shortly.

III. Program Monitoring

34. Macroeconomic policy performance under the EA will continue to be monitored on the basis of quarterly quantitative performance criteria and indicative targets (Annex B). Progress in structural reform will be monitored through structural performance criteria and benchmarks on key policy measures (Annex D).

Serbia and Montenegro: Quantitative Performance Criteria and Indicative Limits for 2002 Under the 2002-2005 Extended Arrangement 1/
(In millions of dinars, unless otherwise noted; end of period)

	2001	2002							
		Mar.	June	Sep.			Dec.		
	Actual	Act.	Act.	Ori. Tar.	Tar. w/ Adjustor	Act.	Ori. Target	Ori. Target w/ Adjustor	Act.
A. Quantitative performance criteria									
Floor on the net foreign assets of the NBS 2/	583	712	727	699	699	886	736	736	938
Ceiling on net domestic assets of the NBS 3/	1,864	-1,296	2,936	6,178	6,178	-924	7,666	3,961	116
Ceiling on net credit of the banking system to the consolidated general government 4/ 5/	1,880	-13,569	-4,218	4,650	3,574	-7,662	7,850	1,791	-3,486
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	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	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	0	0	0
Ceiling on outstanding external debt service arrears 2/ 9/	...	0	0	0	0	0	0	0	0
B. Indicative targets									
Ceiling on net credit of the banking system to									
consolidated general government of Serbia 4/ 10/	1,258	-13,889	-4,518	3,301	3,301	-7,910	6,730	3,025	-1,466
consolidated general government of Montenegro 4/ 10/	621	320	300	-172	273	248	-401	-1,234	-2,020
Ceiling on net domestic assets of the banking system 11/	14,646	6,304	26,048	35,616	35,616	41,479	32,155	32,155	53,213
Ceiling on change in the arrears of									
the federal government	...	...	...	0	0	...	0	0	...
the consolidated general government in Serbia	...	-11	-12	0	0	-12	0	0	-8.9
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	5,485	11,171	17,021	17,021	17,049	23,070	23,070	23,306

1/ Quantitative performance criteria and indicative targets are defined in annex F.

2/ In millions of U.S. dollars.

3/ Monitored on the basis of monthly averages as defined in Annex F. For Dec. 2002, subject to the same adjustment as for external financing of the Serbian government defined in 4/.

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 percent 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 percent 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, the National Bank of Serbia and the Central Bank of Montenegro.

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 5/; the rest of entities under 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 Srbija, JP PTT Srbije, JP Jugoslovenski Aerotransport, JP Zelenicko Transportno Preduzece Srbije, JP Radio Televizija Srbije, JP Srbija Sume, and JP Srbija Vode.

Serbia and Montenegro: Quantitative Performance Criteria and Indicative Limits for 2003 Under the 2002-2005 Extended Arrangement 1/
(In millions of dinars, unless otherwise noted; end of period)

	2002 December Est. end-02 Ex. Rates	2003 April	June	September	December
A. Quantitative performance criteria					
Floor on the net foreign assets of the NBS 2/ 3/	1,069	885	1,004	1,099	1,161
Ceiling on net domestic assets of the NBS 2/ 4/	1,185	9,744	5,385	3,385	1,185
Ceiling on net credit of the banking system to the consolidated general government 2/ 5/ 6/	-12,253	-762	1,702	-4,752	-11,707
Ceiling on contracting or guaranteeing by the public sector of new nonconcessional external debt with original maturity of more than one year 3/ 7/	0	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 3/ 8/	0	0	0	0	0
Ceiling on new guarantees and the assumption of bank or enterprise debt by the public sector 9/	0	0	0	0	0
Ceiling on outstanding external debt service arrears 3/ 10/	0	0	0	0	0
B. Indicative targets					
Ceiling on net credit of the banking system to					
consolidated general government of Serbia 2/ 5/ 11/	-10,172	858	3,628	-2,472	-10,172
consolidated general government of Montenegro 2/ 5/ 11/	-2,081	-1,620	-1,926	-2,280	-1,535
Ceiling on net domestic assets of the banking system 2/ 12/	53,468	61,460	63,233	62,231	64,332
Ceiling on change in the arrears of					
the federal government	0	0	0	0	0
the consolidated general government in Serbia	0	0	0	0	0
the consolidated general government in Montenegro	0	0	0	0	0
Ceiling on the wage bill of the 7 largest public enterprises, cumulative from beginning of year 13/	22,398	8,030	12,261	18,684	25,399

1/ Quantitative performance criteria and indicative targets are defined in Annex F and evaluated at end-December 2002 exchange rates for program purposes.

2/ These performance criteria will be adjusted by the amount that revised estimates differ from the preliminary estimates of the end-2002 outcome.

3/ In millions of U.S. dollars.

4/ Monitored on the basis of monthly averages as defined in Annex F. Subject to the same adjustment for excess or shortfall in combined budgetary external financing and privatization proceeds for the consolidated Serbian government as defined in 5/ except that the limit for upward adjustment is dinar 2500 million.

5/ 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 currency deposits), starting from January 1, 2003, and upward for any decrease. In addition, in the event of a shortfall in the sum of net foreign budgetary financing and privatization proceeds, the ceilings will be adjusted upward by 75 percent of the shortfall subject to the total adjustment limit of 5 billion dinar for Serbia and €10 million for Montenegro's consolidated government. The ceilings will be adjusted downward for the excess of combined net external budgetary financing and privatization proceeds relative to budgeted levels that are not used (1) to reduce the government external indebtedness by more than envisaged under the program, or (2) to cover investment and restructuring costs in consultation with the Fund in the context of program reviews.

6/ The consolidated general government comprises the Serbian republican and local governments, union level operations, the Montenegrin republican government, the Serbian and Montenegrin social security funds, and the Serbian special extrabudgetary programs.

7/ Excluding loans from the IMF, EBRD, EIB, EU, IBRD, or IFC as well as debt contracted in the context of debt restructuring agreements in the framework of the Paris Club and London Club. The public sector comprises the consolidated general government, the National Bank of Serbia, and the Central Bank of Montenegro.

8/ Excludes normal import-related credits.

9/ Excludes indebtedness arising from the fulfillment of existing government guarantees.

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

11/ Consolidated Montenegrin government includes all entities in Montenegro defined under 6/; the rest of entities under 6/ is included in the consolidated Serbian government.

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

13/ JP Elektroprivreda Srbije, JP Nafna Industrija Srbije, JP PTT Srbije, JP Jugoslovenski Aerotransport, JP Zelenicko Transportno Preduzece Srbije, JP Srbija Sume, and JP Srbija Vode. The ceiling will be adjusted downwards to prorate for spin-offs from these companies of activities through the creation of new companies.

Serbia and Montenegro: Extended Arrangement, March 2002-March 2005 Prior Actions, Structural Performance Criteria, and Structural Benchmarks, March 2002-December 2002

	Proposed implementation date EBS/02/73, April 25/2002	Status/ revised implementation date reported in EBS/02/139, August 2002	Current status
I. Prior Action for Board Consideration			
1. 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		Implemented	Implemented
II. Structural Performance Criteria			
1. Serbia: Increase electricity prices by 50 percent on average.	end-June 2002	Implemented	Implemented
2. Federation or Serbia: 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		Implemented
III. Structural Benchmarks			
A. Fiscal Sector			
1. Serbia: Establish a Large Taxpayers Unit in the Belgrade office.	end-June 2002	beginning-October 2002	Implemented
2. Serbia: Adopt the Law on Tax Administration Organization and the Law on Identification, Control and Payment of Public Revenue.	end-June 2002	end-September 2002 (Law on Tax Administration Organization yet to be adopted)	Implemented (Law on Tax Administration Organization, covering both areas, was adopted in November 2002; delay was caused by hiatus in Parliament's work).
3. Serbia: Establish a Treasury in the Ministry of Finance with basic core functions in cash and debt management.	end-September 2002	...	Implemented
4. Serbia: Create a unified taxpayer identification number.	end-December 2002	. .	Implemented
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	. .	Adoption delayed, expected to occur by end-April 2003.
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	Expected to be implemented in August 2002	Implemented in December 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	Implemented	Implemented
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 to establish a regulatory framework in line with international standards.	end- June 2002	Law on banks was amended; Law on NBY remains to be adopted	Expected to be adopted by the the Serbian parliament (under the new Constitution).
4. Federation: Publish IAS-based financial statements of the NBY	end-June 2002	Implemented	Implemented
5. Federation: Submit draft Law on Securities Market to Parliament.	end-June 2002	Implemented	Implemented
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	Implemented, except that a decision remains to be taken for Borska Banka	Mostly implemented
7. Federation: Amend the Accounting Law to adopt IAS as the permanent accounting framework of all financial institutions, including the NBY.	end-September 2002		Implemented in December 2002

Serbia and Montenegro: Extended Arrangement, March 2002-March 2005
Prior Actions, Structural Performance Criteria, and Structural Benchmarks, January-December 2003

	Implementation
I. Prior Actions for Board Consideration	
1. Serbia, Montenegro: Parliamentary approval of Serbian and Montenegrin budgets (including provisions for Union-level expenditures) for 2003, consistent with policy understandings in MEFP of April 1, 2003.	
II. Structural Performance Criteria	
1. Serbia: Effective July 1, 2003, increase weighted average electricity price for sales to end-users by at least 20 percent in dinar terms from the level prevailing at end-2002.	end-June 2003
III. Structural Benchmarks	
A. Fiscal Sector	
1. Montenegro: Adopt a pension law that shifts the indexation of pensions to a weighted average of changes in wages and prices (with the weight of wages not to exceed 50 percent) and raises the minimum retirement age by 5 years in a phased manner.	end-April 2003
2. Serbia, Montenegro: Reach agreement on timetable for harmonizing at the latest by end-2005 trade, customs, and indirect tax regimes.	end-April 2003
3. Montenegro: Begin reporting quarterly budgetary arrears data	end-May 2003
4. Serbia: Bring all line ministries and other direct budget users under the treasury single account.	end-June 2003
5. Serbia: Establish Large Taxpayers Units (LTUs) for Nis, Novi Sad and Kragujevac.	end-September 2003
6. Serbia: Establish and implement a centralized payroll system under the Central Accounting Division of the Treasury.	end-December 2003
B. Financial Sector	
1. Serbia: Adopt new National Bank of Serbia law to provide for a National Bank Supervisory Board.	end-December 2003
2. Serbia: Offer majority or controlling stakes to strategic investors in at least 3 of the banks affected by the July 2002 laws on Paris and London Club debt and frozen foreign currency deposits.	end-December 2003
C. Foreign trade	
1. Montenegro: Eliminate all export quotas	end-April 2003
D. Enterprise restructuring and privatization	
1. Serbia: Government to approve restructuring strategies for the 7 large state enterprises consistent with a significant improvement in their profitability through streamlining of operations and cost-cutting.	end-April 2003

Annex E. Serbia and Montenegro: 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) (S, M) Bring all extrabudgetary funds—notably the social funds—into the annual budgetary preparation and approval process.	2003–04	IMF/World Bank (S) EAR, USAID (M)	Serbian and Montenegrin MOF
	(b) Strengthen internal audit of budget	(1) (S, M) Set up an internal audit office and prepare a plan for annual audits.	2003	IMF/World Bank/ Bilateral Donors	Serbian and Montenegrin MoF
		(2) (S, M) Issue internal audit manuals and standards and complete internal audit.	2004		
	(c) Improve fiscal reporting	(1) (S, M) Establish a GFS-consistent fiscal reporting system from all levels of general government:	2002–2004		Serbian and Montenegrin MoF
		• Social funds	2003 (September)		
		• Local governments	2003 (December)		
		(2) Begin reporting from local governments to the Treasury.	2004		
1.2 Tax policy	(a) Improve the efficiency of the tax system by broadening the tax base and, as appropriate, reducing tax rates	(1) (S) Further reduce the financial transactions tax.	2003		Serbian MoF
		(2) (M) Eliminate most of the exemptions introduced in the six laws on direct and indirect taxes adopted in 2002.	2003–2005		Montenegrin MoF
		(3) (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 Extended Arrangement.

Annex E. Serbia and Montenegro: 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) (S, M) Introduce a VAT.			
		• Montenegro	2003 (April)		Montenegrin MoF
		• Serbia	2005 (January)		Serbian MoF
		(5) (S, M) *Reach agreement on a timetable for harmonizing at the latest by end-2005 the trade, customs, and indirect tax regimes.*	2003 (April)		Montenegrin and Serbian governments
1.3 Tax administration	(a) Modernize tax administration to improve collection and compliance while reducing compliance costs	(S) Establish LTUs outside Belgrade for			
		• *Novi Sad, Nis, Kragujevac*	*2003 (September)*		Serbian PRA
1.4 Public expenditure	(a) Strengthen government financial management and capacity for budget planning, preparation and execution	(1) (S, M) Reorganize MoF and strengthen capacity along functional lines corresponding to its mandate and responsibilities.	2002–2004		Serbian and Montenegrin MoF
		(2) (S, M) Develop fiscal and budget planning functions and build capacity for policy analysis.	2003 –2004		Serbian and Montenegrin MoF
		(3) Establish (M) and strengthen (S) debt management capacity.	2003 (April)		Serbian and Montenegrin MoF
		(4) (M) Begin reporting quarterly budgetary arrears data.	*2003 (May)*		Montenegrin MoF
		(5) (S) Bring all line ministries and other direct budget users under the treasury single account.	*2003 (June)*		Serbian and MoF
		(6) (S, M) Establish a system of commitment control, unify system of making payments, and strengthen control processes and procedures.	2003 (June)		Serbian and Montenegrin MoF

Annex E. Serbia and Montenegro: 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
		(8) (S) Establish and implement a centralized payroll system under the Central Accounting Division of the Treasury.	*2003 (December)*		Serbian MoF
	(b) Civil service reform	(S, M, U) Downsize public sector employment and streamline personnel costs.	2003 (December)	World Bank	Serbian and Montenegrin
2. Social Security					
2.1 Social Security Funds	(a) Improve expenditure management	Bring social funds' budget execution under the Treasury.	2003 (December)		Serbian MoF and Social Funds
2.2 Pensions	(a) Reform the pension system to improve long-term financial viability and facilitate a lowering of payroll taxes	(1) (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.)	2003 (April)	World Bank	Serbian and Montenegrin governments, and Ministry of Social Affairs in Serbia.
		(2) (S, M) Redesign and tighten eligibility requirements for disability pensions.	2003 (April)		Serbian and Montenegrin govts. and Ministry of Social Affairs
		(3) (M) Adopt a Pension Law that increases the minimum retirement age in a phased manner by 5 years, and shifts the indexation of pensions to a weighted average of changes in wages and prices (with the weight of wages not to exceed 50 percent).	*2003 (April)*		Montenegrin government
		(4) (S) Assess the need for further measures to strengthen the financial position of the pension fund.	2003–2004		Serbian MoF
		(5) (S) Merge the three pension funds into a single fund with an account under the Single Treasury	2003 (June)	World Bank	Serbian govt. & Ministry of Social

Annex E. Serbia and Montenegro: 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
		Account in line with the timetable under the World Bank's SOSAC.			Affairs
2.3 Health	(a) Rationalize and provide cost-effective public health services	(1) (S, M) Improve spending control and encourage efficiency in healthcare delivery by refining contracts for medical services to reduce spending on cost-ineffective treatments and create incentives for providers to reduce costs and improve collection of co-payments.	2003		Serbian and Montenegrin Health Fund
		(2) (S, M) Draft new law on pharmaceuticals to reduce overlap, clarify roles of the public health institutions, and to set the framework for a more efficient public health system.	(S) 2003 (April) (M) 2003	World Bank	Ministries of Health and Health Funds in Serbia and Montenegro
		(3) (S, M) Prepare draft of new laws on health insurance and healthcare provision that provide for enhanced accountability and governance in consultation with the World Bank.	2003	World Bank	Ministries of Health and Health Funds in Serbia and Montenegro
		(4) (S) Develop guidelines for more efficient levels of capacity and clear definitions of the roles of different levels in the healthcare delivery system.	2003 (September)		Serbian Ministry of Health & Health Fund
		(5) (S) Develop master plan for implementing these guidelines.	2003 (December)		Serbian Ministry of Health & Health Fund
3. Financial Sector					
3.1 Monetary instruments	(a) Improve monetary policymaking	(1) (M) Compile and begin publishing a consistent monetary survey table.	2003 (April)	IMF	CBM
		(2) (S) Facilitate interbank market development by automating settlement, deepening market liquidity, increasing transparency, and building an Electronic	2003 (June)	IMF	NBS

Annex E. Serbia and Montenegro: 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
		Interbank System (ESYSTEM) to integrate the functions of (i) carrying out monetary policy operations, (ii) registering interbank money market operations, and (iii) deposit and settlement accounts management.			
		(3) (S) Issue regulations governing interbank money market transactions, auction of treasury bills, and ESYSTEM operations.	2003	IMF	NBS
3.2 Central bank structure and organization	(a) Strengthen internal audit and accounting	(M) Prepare a consistent consolidated Central Bank of Montenegro balance sheet based on IAS incorporating all ZOP (internal and external) and Central Bank accounts.	2003 (April)	USAID	CBM
3.3 Banking supervision	(a) Ensure soundness of banking system	(1) (M) Transfer the database on existing offshore banks from MoF to CBM to enable effective monitoring and elimination of remaining offshore banking activities.	2003 (April)		CBM/Montenegrin MoF
		(2) (M) Adopt the Law on Anti Money-Laundering and issue supporting regulations.	2003 (April)	IMF/USAID	CBM/Montenegrin MoF
		(3) (S) Implement a comprehensive Supervisory Development Plan outlining medium- to long-term objectives, and legislative and institutional changes necessary to achieve these objectives.	2003 (May)	World Bank, USAID	NBS
		(4) (S) Develop consistent operational indicators on credit to the non-government sector, and a consistent consolidated banking system balance sheet.	2003 (June)		NBS banking supervision, research, and monetary depts.
		(5) (S) Adopt the new Law on the National Bank of Serbia to provide for a National Bank Supervisory	*2003 (December)*	IMF/WB	NBS

Annex E. Serbia and Montenegro: 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
		Board.			
3.4 Bank restructuring	(a) Establish a competitive banking system	(1) (S) The NBS and Government to put in place effective monitoring and control mechanisms to preserve the value of state-owned banks prior to their privatization.	2003 (March)	IMF/WB	NBS/BRA
		(2) (M) Adopt Public Debt Law to pave the way for banking nonperforming assets resolution.	2003 (April)	IMF/USAID	CBM/Montenegrin MoF
		(3) (S) Appoint privatization advisors for three banks affected by the July 2002 PLC Law and FFDC Law.	2003 (June)	IMF/WB	BRA/Serbian MoF
		(4) (S) Offer for sale three banks affected by the July 2002 PLC Law and FFCD Law.	*2003 (December)*	IMF/WB	BRA/Serbian MoF
3.5 Non-bank financial sector	(a) Developing financial markets	(1) (S) Adopt a Law on Secured Transactions and regulations on a Pledge Registry.	2003 (April)	World Bank, EBRD, USAID	Serbian MIER
		(2) (S) Adopt legislation to eliminate restrictions on leasing operations.	2003 (April)	World Bank	Serbian MIER
		(3) (S) Develop a Central Registry to centralize registration of traded securities.	2003 (April)		NBS/Serbian MoF
4. Private Sector Development					
4.1 Enterprise privatization	(a) Expedite privatization through tenders, auctions and sales of minority stakes of the state	(1) (S) Offer for sale 260 large and 2,700 small socially-owned companies and further reduce the state's existing minority share in enterprises.	2002-2006	World Bank	Serbian Ministry of Privatization/ Privatization Agency
		• Launch competitive investment tenders for the remaining groups of the World Bank pools.	2003 (April)		
		• Offer for sale a further 20 viable large socially-owned enterprises through international tenders.	2003 (December)		

Annex E. Serbia and Montenegro: 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
		• Offer for sale a further 800 small socially-owned enterprises through auctions.	2003 (December)		
		• Offer for sale a further 70 large and 1,000 small socially owned enterprises through tenders and auctions, respectively.	2004		
		• Offer for sale the remaining 70 large and 500 small socially owned enterprises through tenders and auctions, respectively.	2005-2006		
		(2) (M) Offer for sale majority shares in companies to strategic investors through international tenders	2002-2005	USAID	Montenegrin Privatization Council
		• Offer for sale shares in selected companies including the tobacco company and hotels.	2003		
4.2 Enterprise restructuring	(a) Create viable companies that can be privatized	(1) (S) Restructure 49 conglomerates (of which 40 are in the PA portfolio) prior to privatization under tender or auction procedures:	2002–2006	World Bank, EAR	Serbian Ministry of Privatization/ Privatization Agency
		• Sign contracts with financial advisors for 8 socially-owned conglomerates in the PA portfolio to design programs for restructuring and privatization.	2003 (May)		
		• Government adopts these restructuring/ privatization programs, and their implementation begins.	2003-04		
		• Following the reduction by 40,000 in employment supported by social programs in 2002, reduce employment in conglomerates under restructuring by a further 40,000.	2003 (December) *2003 (April)*		

Annex E. Serbia and Montenegro: 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
		• *(S) Government to approve restructuring strategies for the 7 large state enterprises consistent with a significant improvement in their profitability through streamlining of operations and cost-cutting.* • (S) Government will begin implementing the restructuring strategies for the 7 large state enterprises.	*2003 (June)*		
4.3 Legal and regulatory framework	(a) Strengthen creditor rights	(1) (S) Implement new bankruptcy law: • Adopt new law; • Establish Bankruptcy Agency to license individual administrators; • Establish agency to serve as trustee for socially owned enterprises under bankruptcy.	2003 2003 (April) 2003 (April) 2003 (May)	World Bank	Federal Ministry of Justice/ Serbian Ministry of Privatization
5. Sectoral Policies					
5.1 Energy sector	(a) Establish financial viability	*(1) (*S) Increase weighted average electricity price for sale to end-users to cost recovery levels by the middle of 2004: • *increase the price by at least 20 percent in dinar terms;* • increase it further to a cost-recovery level in consultation with the World Bank.	2002-2004 *2003 (June)* 2004 (June)	World Bank	Ministry of Energy and EPS
	(b) EPS restructuring	(1) Complete the accounting separation of key profit centers in EPS. (2) Strengthen management control over core activities to achieve effective cost control. (3) Spin off non-core activities in EPS.	2003 (June) 2003 (June) 2003 (December)		

Annex E. Serbia and Montenegro: 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
	(c) Create market-conforming regulatory framework	(S, M) Design and introduce a legal and institutional framework for an independent energy regulator.	2002–2003	World Bank	Serbian and Montenegrin Ministries of Energy
6. Trade Policy					
6.1 Merchandise trade	(a) Further liberalize foreign trade regime	(1) (S) Remove import quotas for steel products and export quotas on agricultural products, wood and raw hides: • Eliminate all import quotas.	2002–2004 2004 (December)	World Bank	Serbian Ministry of Trade
		(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 (April)* 2004 (December)		Montenegrin Ministry of Trade
7. Statistical issues					
7.1 Collections of statistics	Improve the statistical base for macroeconomic decision-making	(1) (S, M) Statistics will be reviewed in the context of IMF TA missions.	2002–2005	IMF	Federal, Serbian, and Montenegrin Statistical Offices

Notes:
S – Serbia; M – Montenegro; U - Union;
CBM – Central Bank of Montenegro;
EPS – Electricity company of Serbia;
IAS – International Accounting Standards;
LTU – Large Taxpayer Unit;
MoF – Ministry of Finance;
NBS – National Bank of Serbia;
PRA – Public Revenue Agency.

Union of Serbia and Montenegro: Technical Memorandum of Understanding

I. Introduction

1. This memorandum replaces the Technical Memorandum of Understanding attached to the Memorandum of Economic and Financial Policies of April 26, 2002. It sets out the understandings regarding the definitions of quantitative and structural performance criteria and benchmarks, as well as indicative targets, for the program supported by the Fund under an Extended Arrangement (EA), as well as the related reporting requirements. The key changes in this updated memorandum include a revised adjustor on net credit to government, and the incorporation of changes implied by the new Constitutional Charter.

2. To monitor developments under the program, the 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 October 31, 2002, except as noted below. Quantitative performance criteria and indicative targets for end-December 2002 as well as end-April, end-June, end-September and end-December 2003 are specified in Annexes A and B of the Memorandum of Economic and Financial Policies (MEFP).

3. For program purposes, the public sector consists of the consolidated general government (comprising union operations, Serbian state and local governments, the Montenegrin state government, the Serbian and Montenegrin social security funds, and the Serbian special budgetary programs), the National Bank of Serbia (NBS), and the Central Bank of Montenegro (CBM). 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 *2001 Manual on Government Financial Statistics*, and will ensure that these will be incorporated within the definition of consolidated general government.

II. Quantitative Criteria: Definitions and Reporting Standards

A. Floor for Net Foreign Assets of the NBS and Program Exchange Rates

4. **Definition.** Net foreign assets (NFA) of the NBS consist 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 NBS 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 NBS. In particular, excluded from foreign reserve assets are: frozen assets of the Union of Serbia and Montenegro (SM), undivided assets of the former Socialist Federal Republic of Yugoslavia (SFRY), long-term assets, NBS claims on resident banks and nonbanks, as well as subsidiaries or branches of SM commercial banks located abroad, any assets in nonconvertible currencies, encumbered reserve assets (e.g., pledged as collateral for foreign loans or through forward contracts), and precious metals other than gold. For program purposes, all euro and foreign currency-related assets will be evaluated at **program exchange rates**; for 2003, the program exchange rates are those that prevailed on December 31, 2002. In particular, US$1 = DIN 58.9848, €1 = DIN 61.5152, and SDR1 = US$1.3595. Monetary gold shall be valued at an accounting price of US$349.25 per ounce. On December 31, 2002 the NBS's foreign reserve assets as defined above amounted to US$2,280 million, including gold valued at US$114.2 million.

- For purposes of the program, **foreign reserve liabilities** shall be defined as any foreign currency-denominated short-term loan or deposit (with a maturity of up to and including one year), swaps (including any portion of the NBS gold that is collateralized), and forward liabilities of the NBS—to residents and nonresidents; IMF purchases; and loans contracted by the NBS from international capital markets, banks or other financial institutions located abroad, and foreign governments, irrespective of their maturity. Undivided foreign exchange liabilities of SFRY are excluded. On December 31, 2002, the NBS's foreign reserve liabilities, as defined above, to nonresidents were US$667 million and to residents were US$544 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 31, 2002. All changes in definition or in 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.

5. **Reporting.** Data on foreign reserve assets and foreign reserve liabilities of the NBS 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 NBS will provide the data at the indicated constant prices and exchange rates, as well as at current exchange rates. The NBS will report if any of the reported foreign reserve assets are illiquid or pledged, swapped, or encumbered.

6. **Adjustors.** For program purposes, the floor for net foreign assets will be adjusted upward pari passu to the extent that: (i) after December 31, 2002, the NBS 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 SM commercial banks abroad; and (ii) the restructuring of the banking sector by the Bank Restructuring Agency (BRA) involves a write-off of NBS foreign-exchange-denominated liabilities to resident banks. These performance criteria will be adjusted by the amount that revised estimates differ from the preliminary estimates of the end-2002 outcome.

B. Ceiling on Net Domestic Assets of the NBS

7. **Definition.** For purposes of the program, net domestic assets (NDA) of the NBS are 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 as specified above. The ceiling is established as the monthly average of each month with an end-month test date (i.e., the averages of April, June, September, and December, 2003, respectively). As of December 31, 2002, NDA of the NBS so defined were valued at DIN 1,185 million (Annex A). The monthly average of NDA for program purposes will be calculated as the difference of the monthly average of reserve money and monthly average of NFA. The monthly average of NFA will be adjusted so that the disbursements of World Bank program loans and EU macro-financial assistance are counted as if they occurred on the first day of the month in which they were effected.

8. **Adjustors**. The NBS's NDA ceiling is subject to the same adjustor for excess or shortfall in combined budgetary external financing and privatization proceeds for the consolidated Serbian government as defined in Section C, except that the limit for upward adjustment is DIN 2.5 billion.

9. **Reporting.** The ceilings will be monitored on the basis of daily data on the accounts of the NBS, reported 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 NBS within four business days of the end of each business week. To facilitate program monitoring, the NBS will provide daily its foreign reserves liabilities, as well as the amounts and dates of World Bank and EU macro-financial assistance disbursements at the current and the agreed constant exchange rates.

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

10. **Definition.** The banking system comprises the NBS, commercial banks in Serbia, the CBM, and commercial 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 other than frozen foreign currency deposit (FFCD) bonds (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 December 31, 2002 exchange rates. 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 2002, net credit of the banking system in Montenegro to the consolidated general government in Montenegro amounted to €-33.8 million (equivalent to DIN -2,067 million). At end-December 2002, net credit of the banking system to the consolidated general government so defined was DIN -7,438 million.

11. **Reporting.** The ceilings will be monitored using end-month data on the accounts of the banking system supplied to the European 1 Department of the Fund with a lag not to exceed three weeks.

12. **Adjustors.** For program purposes, the ceilings on net credit of the banking system to the consolidated general governments 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, 2003, and upward for any decrease. These performance criteria will be adjusted by the amount that revised estimates differ from the preliminary estimates of the end-2002 outcome. In addition, in the event of a shortfall in the sum of net foreign budgetary financing and privatization proceeds, the ceilings will be adjusted upward by 75 percent of the shortfall subject to the total adjustment limit of DIN 5 billion for Serbia's and €10 million for Montenegro's consolidated government. The ceilings will be adjusted downward for the excess of combined net external budgetary financing and privatization proceeds relative to budgeted levels that are not used (1) to reduce the government's external indebtedness by more than envisaged under the program, or (2) to cover investment and restructuring costs in consultation with the Fund in the context of reviews under the EA. Privatization receipts are defined to include all receipts, including those accruing to extrabudgetary funds. Net external budgetary financing is defined to include all budgetary grants and loans, less amortization (on a cash basis). The estimation of the shortfalls (excesses) in the sum of net foreign budgetary financing and privatization receipts will be based on the following projections (cumulative from the beginning of 2003):

Serbia (In billions of dinars)

	end-April	end-June	end-Sep.	end-Dec.
Foreign financing	0.2	7.6	14.8	16.6
Privatization proceeds	5.8	9.0	14.1	20.3

Montenegro (In € million)

	end-April	end-June	end-Sep.	end-Dec.
Foreign financing	15.0	35.0	37.8	40.7
Privatization proceeds	0.7	1.1	15.5	23.2

D. Ceiling on Change in Domestic Arrears

13. For program purposes, indicative targets will be set on the change in domestic arrears. Separate indicative targets will be set for the budget of the Union of Serbia and Montenegro,

the consolidated general government of Serbia, and the consolidated general government of Montenegro.

14. **Definition**

- For the purpose of establishing compliance with this indicative target, the union budget is defined to comprise all budgetary activities specified in the Constitutional Charter, including the SM army and the SM pension fund for retired military personnel. The consolidated general government of Serbia is defined to comprise all budgetary institutions financed from the Serbian state 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 state 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.

- 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 2002, the stock of arrears at the union level was estimated at DIN 0 billion; and the stock of arrears of the consolidated general government in Serbia was estimated at DIN 44.3 billion.

- € denominated claims on government will be converted at the program exchange rate; claims denominated in currencies other than the € will first be converted at their respective program exchange rates against the €. 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 2002.

15. **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 reporting agency at the union level, the Ministry of Finance of Serbia, and the Ministry of Finance of Montenegro.

E. Definition of Reserve Money

16. **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 NBS. 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 NBS. Reserves that banks are required to hold were set at 20 percent effective on April 11, 2002 of the base as defined in NBS Decision of March 28, 2002. As of March 1, 2003 the required reserve ratio was raised to 23 percent. Subsequent changes in the reserve requirement will be reflected in program definitions. 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 (DIN 174.1 million). Excess reserves include commercial bank's (1) balances in Giro accounts 620, 621, 623, and 625, (2) overnight deposit in account 205 at the NBS, (3) excess balances (with the shortfall in required reserves counted as negative excess) above required reserves on account 201 at the NBS, and (4) cash in vaults.

17. Data on reserve money will be monitored from the daily indicators data of the NBS, which shall be supplied to the European 1 Department of the Fund weekly by the NBS with a three-day lag. The end-month data is based on the NBS balance sheet, which is provided to the Fund with a lag of less than three weeks. On December 31, 2002, currency in circulation amounted to DIN 43,651 million, while required reserves amounted to DIN 15,843 million, and excess reserves to DIN 9,824 million. For program and projection purposes, monthly averages of reserve money and its components were used. On the assumption that the increase in required reserves would be met through a corresponding decline in excess reserves, the hypothetical December 2002 average required reserves associated with a 23 percent reserve requirement would have been DIN 17,690 million, while excess reserves would have been DIN 5,719 million. Data on effective reserve requirements and the deposit base used in reserve requirement calculations will be supplied to the European 1 Department on a ten-day basis with a lag of less than a week.

18. **Adjustors.** For program monitoring purposes, reserve money will be adjusted as follows. Should the standard reserve requirement increase (decrease) from the level prevailing on March 1, 2003, 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 NBS 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

19. **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.

20. **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 at the union level, by the 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

21. **Definitions.** The ceiling on contracting or guaranteeing of new nonconcessional external debt by the public sector with original maturity of more than one year 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 normal short-term import credits.

22. **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, details on debt service obligations, 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

23. A macroeconomic monitoring committee, composed of senior officials from the Union Government, Serbian and Montenegrin Ministries of Finance, the NBS, 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

24. 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

25. 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.

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

Public finance

27. Monthly data on public finance will require a consolidated budget report of the state governments and union level operations, transmitted within four weeks of the end of each month comprising:

- The revenue data by each major item, including that collected by the state and local governments, as well as the social funds;
- Details of the recurrent and capital expenditure of the union, state, and local governments, as well as the social funds; and
- Details of budget financing, both from domestic, and external sources, including total privatization receipts.

In addition, Montenegro will begin quarterly reporting of the stock of arrears of the consolidated general government in Montenegro from end-May 2003.

Monetary sector data

28. 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 reserves of the NBS at current and program exchange rates and gold prices, indicating amounts sold/bought at the auction, in foreign exchange offices and on the interbank market, inflows of foreign grants, inflows of foreign loans, and repayments of frozen foreign currency deposits.

- Daily movements in foreign exchange-denominated liabilities of the NBS to (i) non-residents; (ii) SM banks; and (iii) other SM residents.
- Daily movements in liquid foreign exchange assets of SM banks as reported by these banks to the NBS.
- Daily movements in reserve money, indicating currency in circulation, the basis upon which required reserves are calculated, required reserves, reserves held, and excess reserves.
- Outstanding stocks of Treasury bills, and auction details (rates, amounts per maturity and number of banks participating in the auction per maturity).
- Interbank foreign exchange rates and volume of transactions, including rates and volume of trading outside the fixing session.
- Ten-day report on public sector borrowing and lending from commercial banks and the NBS.
- Ten-day report on required reserves and the reserve base.

29. The balance sheet of the NBS 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 NBS securities held by banks and by non-banks, as available to the NBS, 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. Credit to government by the banking system is provided with detailed breakdowns on the union, state, and local governments.

30. The following data will be transmitted on a monthly basis:

- NBS foreign exchange reserves held in accounts abroad, foreign banknotes, and foreign securities as well as interest income on foreign assets.
- Individuals' foreign exchange savings in top ten banks.
- Grants and loans disbursement as well as debt amortization and interest payments.

External data

31. 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 of exports and imports, separating out 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
EXTERNAL RELATIONS DEPARTMENT

Press Release No. 03/51
FOR IMMEDIATE RELEASE
April 16, 2003

International Monetary Fund
Washington, D.C. 20431 USA

IMF Approves US$137 Million Credit Disbursement Under Extended Arrangement with Serbia and Montenegro

The Executive Board of the International Monetary Fund (IMF) today completed its first review of Serbia and Montenegro's economic performance under the Extended Arrangement. This will enable Serbia and Montenegro to draw SDR 100 million (about US$137 million) under the arrangement immediately.

The Extended Arrangement was approved on May 14, 2002 for a total of SDR 650 million (about US$889 million) to support Serbia and Montenegro's economic program in 2002-2005 (see Press Release No. 02/25). So far, Serbia and Montenegro has drawn SDR 100 million (about US$137 million) from the IMF.

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

"The IMF commends the authorities of Serbia and Montenegro for the impressive further progress in stabilization and reform achieved in 2002. Firm macroeconomic policy implementation contributed to rapid disinflation, a strengthening of foreign reserves, and a continued recovery in output and exports. Significant advances were also made in structural reform. Equally welcome is the renewed commitment to reform of the new government formed following Premier Djindjic's tragic assassination.

"Looking ahead, continued prudence and vigilance in policy implementation will remain essential to safeguard the authorities' inflation and external objectives, especially in light of macroeconomic uncertainties and the challenges remaining in the area of structural reform. On the macroeconomic front, there is a need for a tightening of monetary policy and further fiscal consolidation. On the structural front, continued progress will require strong resolve as reforms move to a more difficult phase. The authorities' demonstrated commitment to reform augurs well for achieving these objectives and laying the basis for durable growth, and merits continued support from the international community.

"Fiscal policy in 2003 will aim not only at containing the external imbalance, but will also continue to support restructuring and an appropriate social safety net. Owing to the unusual risks to the macroeconomic outlook and tax collections, the authorities intend to contain discretionary spending commitments below the program level until revenue prospects become clearer. Revenue efforts will focus on improving tax administration and broadening the tax base. Fiscal transparency and management should improve with the channeling of all privatization proceeds through the budget and the planned use of any excess privatization proceeds to reduce the government's net indebtedness.

"The planned tightening of monetary policy will help lower inflation further and safeguard foreign reserves. Exchange rate policy should be kept under close review in light of trade, price, and wage developments and conditions in the interbank foreign exchange market. In light of the rapid increase in bank credit to enterprises since mid-2002, prudential regulations should be enforced strictly to ensure that new lending remains sound. The IMF welcomes the further liberalization of the country's foreign exchange system and the authorities' acceptance of the obligations under Article VIII, Sections 2, 3, and 4 in 2002.

"The authorities intend to press ahead with structural reform. Attracting strategic investors for the envisaged privatization of the 16 nationalized banks, while ensuring their proper governance, will be key to building a healthy banking system. The recent streamlining of enterprise privatization procedures should help attract investor interest in financially weaker enterprises and maintain the pace of privatization.

"The formation of the state union of Serbia and Montenegro in early 2003 will enhance political stability and provide a unique window of opportunity for carrying forward the reform process. The envisaged normalization of economic relations between Serbia and Montenegro under the new constitutional framework—notably by harmonizing the trade, customs, and indirect tax regimes as they converge toward EU directives—should help improve economic efficiency in both states," Ms. Krueger said.

**Statement by Fritz Zurbrügg, Executive Director for Serbia and Montenegro and Srboljub Antic, Advisor to Executive Director
April 16, 2003**

Introduction

1. Our authorities of Serbia and Montenegro welcome the staff report, which presents a balanced and candid picture of the economic situation. They would like to express their gratitude to management and the Executive Board for their continuous support over the last two and half years. During the period of political change, this support has been crucial and has contributed to the smooth institutional transition.

2. The political process of creating the state union was completed successfully with the inauguration of the first government of Serbia and Montenegro in March 2003. With a new Montenegrin government in power since January 2003 and a new Serbian government, that was quickly formed after the assassination of Prime Minister Djindjic, a window of opportunity of at least two years has opened to continue to implement the necessary reforms. The formation of the state union was an important step. It eliminated a major political uncertainty, by taking into account the broader regional and political considerations, while at the same time recognizing the political and economic realities. Furthermore, the state union's responsibilities were streamlined to provide only essential services.

3. Macroeconomic policies have been firmly implemented. All quantitative performance criteria were observed. Moreover, the prior action for Board consideration of the first review under the Extended Arrangement has been implemented with the adoption of the revised Serbian budget on April 2, 2003. Some temporary delays in the adoption of reform legislation occurred, stemming mainly from the transformation process into the new state union and the presidential elections in both republics. However, these were of relatively minor significance and progress in implementing reforms in most areas has stayed well within expectations, mainly as a result of strong ownership and a continuous dialogue with staff. Our authorities stress that the formation of the new political and institutional setup provides the basis for an acceleration of all reforms. The membership in the Council of Europe and the prospects for a Stabilization and Association Agreement with the EU create additional opportunities for fast and lasting reforms.

4. Unfortunately, the assassination of the Serb Prime Minister has considerably increased the overall uncertainty—with significant negative effects on growth, investment and budget. However, the authorities are confident that a firm implementation of macroeconomic policies, together with an adequate support from the donor community and the IFI's will improve the situation substantially.

Macroeconomic Developments and Outlook

5. The macroeconomic performance in 2002 was promising. The inflation rate was well below the program target and real GDP is estimated to have grown between 3½ and

4 percent, broadly in line with the target. The service sector was the main source of growth and industrial production showed signs of recovery. Foreign reserves reached $2.3 billion at the end of 2002, due to buoyant private capital transfers. However, the fast growing domestic demand led to a larger current account deficit than projected.

6. In the short run, curbing domestic demand is the main task of macroeconomic policy. Consequently, the fiscal deficit target has been reduced to 4.5 percent to rein in the current account deficit. Additionally, excess bank lending will be curbed by a tightening of credit policy and a strengthening of banking supervision.

7. Looking forward, the authorities are fully aware of the many daunting tasks lying ahead. With a GDP that lies currently only at about 50 percent its 1990 level, achieving high permanent growth is the main challenge. Such growth will help to alleviate poverty and to secure a sustainable external position.

Fiscal Policy

8. Fiscal policy performance has been broadly in line with the Fund program. The fiscal stance will continue to provide the necessary resources for the large financing needs, particularly in the social area, while taking into account the need to contain external imbalances. The expenditure-to-GDP ratio is envisaged to decline by 1.8 percentage points to 45.1 percent in 2003. On the revenue side, the main focus will lie on improving tax administration and on bringing in a larger share of private sector activity into the formal economy. As a result, the overall fiscal deficit will be reduced by 0.5 percentage points to 4.5 percent of GDP in 2003, which will also help to slow down domestic demand.

9. The budget on the state union level for 2003, to be financed entirely by transfers from the republics, will be streamlined and in balance. The adequate comparison with the former budget shows that expenditures were significantly reduced by layoffs and lower defense spending (which will decline by 0.3 percentage points to 3.4 percent of GDP).

10. The Serbian budget tries to reconcile the need for supporting the recovery with the need to tame inflation, while ensuring the overall goal of fiscal sustainability. The recovery is supported by an increase in capital spending and a substantial reduction of the tax burden on labor and corporate investment. Subsidies and transfers are projected to decline due to significant reductions in the subsidies to public enterprises (by almost 1 percent of GDP). The government has already identified areas where cuts would be possible should revenues fall short of expectations.

11. A number of structural reforms, outlined in the Memorandum of Economic Policies, have been initiated to further improve revenue collection and expenditure management. The ZOP payment system was successfully abolished, allowing commercial banks to execute payments without the mandatory intermediation of any institution or agency. The problems in revenue collection in January 2003 were successfully solved. Treasury procedures have been further strengthened, and the objective is to have full coverage by end-June 2003. On

April 8, 2003, the treasury started issuing bonds, which should alleviate liquidity management. Technical preparations are underway for the introduction of the VAT in Serbia, the last key tax policy reform, by January 2005.

12. Montenegro's fiscal deficit was broadly in line with the program. A higher than budgeted net wage made cuts in discretionary spending necessary. The 2003 budget aims to underpin fiscal sustainability by containing non-interest current expenditure in relation to GDP. The slight increase in the planned budget deficit stems mainly from the contributions to the Union budget. To prevent the build-up of excessive budget deficits, the government has explicitly linked the implementation of the envisaged increase in public wages to a reduction in the number of public employees.

13. To improve revenues a VAT has been introduced on April 1, 2003. Furthermore, the harmonization of some indirect tax and import duties with Serbia will also improve revenue performance. Additionally, the treasury will enhance expenditure reporting, monitoring of the arrears and debt management. A new Pension Law is under preparation with objectives to increase the retirement age and shift the indexation scheme to a more appropriate model.

Monetary and Exchange Rate Policies

14. In 2002, impressive progress has been made in lowering inflation and strengthening foreign reserves. For 2003, monetary policy in Serbia will seek to curb excess bank lending and lower inflation, with reserve money growth driven entirely by increases in NFA. The auctions of the National Bank of Serbia (NBS) securities will continue in quantities that are consistent with the NDA target. The NBS will accept the resulting interest rates, thus fostering the importance of that monetary instrument. Excessive bank lending in the second half of 2002 and the widening of current account deficit have been tackled by an increase of the reserve requirement.

15. During 2003, the exchange rate policy in Serbia will continue to keep the right balance between disinflation and external objectives by supporting a gradual improvement in external competitiveness, while aiming at a continuation of the disinflation process. The stability of the exchange rate has had a decisive role in containing inflationary expectations. Lately, safeguarding the external position has gained more importance. Developments in trade, wages and on the foreign exchange market will be monitored closely with a view to allowing greater flexibility in exchange rate policy.

Privatization

16. In Serbia, privatization has gained momentum in last quarter of 2002 and a similar pace is expected to continue in 2003. Revenues from selling state owned enterprises were above expectations in 2002. For 2003 Serbian authorities expect US$550 million. The government is confident about the privatization revenue, as streamlining the auction process and lowering the period of guaranteed post-privatization employment have created better conditions for investors. In April a tender was launched for selling two tobacco factories,

giving a clear sign that the privatization process is continuing even in times of higher uncertainty. The selling of one mobile phone operator was postponed to next year, due to the weak conditions in this specific market.

17. In Montenegro, privatization has taken place through several channels, combining Mass Voucher Privatization (MVP) with selling stakes in enterprises through tenders and auctions. All MVP was properly executed in 2002, while tenders and auctions will proceed throughout 2003. The successful selling of an oil product distribution company in 2002 has improved the climate for privatization in 2003.

Conclusions

18. Serbia and Montenegro are at an important transition point. The outstanding tasks to reform the country are challenging. The uncertainty after the assassination of the Prime Minister of Serbia was quickly and successfully addressed, but the negative economic effects are likely to be significant. The support of the IFI's and additional donor support, together with prudent government policies, are needed to tackle the current challenges.