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Federal Republic of Yugoslavia: First Review Under the Stand-By Arrangement and Request for a Waiver; News Brief on the Executive Board Discussion; and Statement by Authorities of the Federal Republic of Yugoslavia

In the context of the First Review Under the Stand-By Arrangement and Request for a Waiver by the Federal Republic of Yugoslavia, the following documents have been released and are included in this package:

- the staff report for the First Review Under the Stand-By Arrangement and Request for a Waiver, prepared by a staff team of the IMF, following discussions that ended on **July 26, 2001,** with the officials of Federal Republic of Yugoslavia on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on September 5, 2001.** 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 News Brief summarizing the **views of the Executive Board as expressed during its September 19, 2001, discussion** of the staff report that completed the review.

- a statement by the authorities of the Federal Republic of Yugoslavia.

The documents listed below have been or will be separately released.
Letter of Intent by the authorities of the Federal Republic of Yugoslavia*
Memorandum of Economic and Financial Policies by the authorities of the Federal Republic of Yugoslavia*
Technical Memorandum of Understanding*

*May also be included in Staff Report.

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FEDERAL REPUBLIC OF YUGOSLAVIA

First Review Under the Stand-By Arrangement and Request for a Waiver

Prepared by the European I and Policy Development and Review Departments
(In consultation with other Departments)

Approved by Susan Schadler and Shigeo Kashiwagi

September 5, 2001

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I. Introduction

1. On June 11, 2001, the Executive Board approved a 10-month stand-by arrangement the Federal Republic of Yugoslavia (FRY) in the amount of SDR 200 million, or 43 percent of quota, to be made available in four purchases of SDR 50 million each (Appendix I). The first purchase was made upon Board approval of the arrangement, while the second purchase depends on observance of performance criteria as of end-June 2001 and completion of the first review under the arrangement.

2. **Discussions on the first review under the stand-by arrangement were held in Belgrade and Podgorica during July 11–26, 2001.**[1] In the attached letter to the Managing Director of September 4, 2001, and the accompanying Revised Memorandum on Economic and Financial Policies, the federal and republican authorities outline policies for the period ahead, proposing revised performance criteria, indicative targets and structural benchmarks for the remainder of the program period (Appendix IV). On this basis, the authorities request completion of the first review under the stand-by arrangement and a waiver for the nonobservance of a performance criterion.

3. **Upon approving the stand-by arrangement on June 11, Executive Directors praised the authorities' policy achievements, while cautioning that the task of reconstructing the economy would be extremely difficult.** Directors noted that the program provides for prudent macroeconomic policies coupled with bold structural reforms, a critical number of which were implemented upfront. However, they cautioned that the success of the overall effort will require that the root causes of the macroeconomic imbalances are addressed, by restructuring the banking and enterprise sectors, improving financial discipline in the economy, and restoring fiscal sustainability. They also stressed that, in FRY's exceptionally difficult circumstances, progress toward sustainable growth and external viability would require strong support from creditors in the form of concessional debt relief, and from donors in the form of appropriate commitments of assistance at the June donor conference.

4. **The World Bank has been closely involved in FRY's reconstruction efforts** (Appendix II). On May 8, 2001, the World Bank Board approved a plan to clear FRY's arrears to the Bank, the country's membership in the Bank, and its three-year (FY 2002–04) eligibility for IDA lending under hardened terms (shorter grace and maturity periods). World Bank lending operations are expected to start following the settlement of the arrears of US$1.7 billion to the Bank in the coming months, through the extension of a consolidation

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[1] The mission met: (a) at the federal level, Deputy Prime Minister Labus and National Bank of Yugoslavia (NBY) Governor Dinkic; (b) in Serbia, Finance Minister Djelic, Social Affairs Minister Matkovic, and Privatization Minister Vlahovic; and (c) in Montenegro, Finance Minister Ivanisevic and Chairman of the Central Bank Council Krgovic.

The staff team included Mr. Zervoudakis (head), Mr. Herderschee, Ms. Li, Ms. Ribakova (all EU1), Ms. Kong (FAD), Mr. Tadesse (PDR), and Ms. Chuidian (assistant, EU1). The team was assisted by Mr. Charap, the Fund's resident representative, and cooperated with an overlapping MAE mission (Mr. Alexander) and World Bank staff.

loan. Envisaged program lending of US$540 million (depending on policy performance) during FY 2002–04 would generate a positive net resource transfer to FRY. A total of up to US$200 million of IDA resources could be provided as credits to FRY in FY 2002, with up to US$160 million in support of fiscal management, private sector development and banking reform, and up to US$40 million in support of investment operations. The Bank strategy also provides for advisory activities, including a Public Expenditure Review. Meanwhile, the Bank has been involved in mobilizing external support for FRY and prepared an Economic Recovery and Transition Report (in collaboration with the Fund, the European Commission, and bilateral donors) that served as a basis for a Donor Conference on June 29 (see ¶12 below)

5. **The political situation has stabilized following Mr. Milosevic's extradition, while the status of Montenegro within FRY remains to be decided.** Following a government crisis in the aftermath of Mr. Milosevic's extradition to the International Crimes Tribunal for former Yugoslavia, a new federal government was formed on July 24 under a new Prime Minister, Mr. Pesic. Deputy Prime Minister Labus (with overall responsibility for foreign economic relations) retained his position. Meanwhile, negotiations have been initiated between the authorities in Belgrade and the pro-independence government in Podgorica on a new constitutional framework, which could be put to a referendum in Montenegro in early 2002.

6. **The quality of statistics is improving, with technical assistance (TA) from the Fund and others** (Appendix III). Since late 2000, progress has been made toward ensuring that the monetary, external and fiscal accounts broadly comply with internationally accepted norms. Nevertheless, considerable weaknesses remain in the aforementioned areas as well as the national accounts. The authorities have, therefore, requested that the Fund send a ROSC mission to undertake a comprehensive data quality assessment, as a basis for further TA.

II. Background

7. **Against the background of dire economic conditions, the authorities have embarked on a program of economic stabilization, reconstruction, and reform.** The FRY economy was devastated by ten years of regional conflicts, international isolation, and economic mismanagement. Upon coming to power late last year, the new authorities adopted a short-term program supported by the Fund under its policy on post-conflict emergency assistance. This program helped bring inflation under control and strengthened FRY's institutional capacity to implement an upper tranche program. This paved the way, in early 2001, for the formulation and adoption of a comprehensive program of stabilization and reform, which is supported by the Fund under the current stand-by arrangement.

8. **Economic activity remains weak, while progress has been made in lowering core inflation.**[2] The removal of international sanctions in late 2000 has yet to stimulate economic activity, probably because of capacity constraints after years of disinvestment and the

[2] All data from 1999 onwards—with the exception of external debt figures—refer to the territory of FRY excluding Kosovo.

tightening of macroeconomic policies, including the elimination of monetary financing of quasi-fiscal deficits. Thus, industrial output in 2001 H1 was slightly lower than in the corresponding period of the previous year. Positive output growth was recorded mainly in electricity/gas and light manufacturing industry (textiles, chemical products, rubber and plastics, and furniture), while output in heavy industry continued to contract. The lifting of price controls in October 2000 resulted in an acceleration of year-on-year inflation (retail prices) to 115 percent by December, eroding real wages. Large increases in administered prices and indirect taxes kept headline inflation at an annualized 48½ percent during January–July 2001, while core inflation is tentatively estimated at about 15 percent during the same period. Wages in 2001 H1 were broadly unchanged from a year ago in real terms, and remained relatively low in DM terms (about DM 150 per month).

9. **Foreign trade has recovered only modestly from its depressed levels.** Data for 2001 H1 point to increases of 3.2 percent and 9.1 percent in recorded exports and imports in U.S. dollar terms (15.7 percent and 22.3 percent, respectively, in euro terms), but this at least partly reflects a decline in the under-recording of foreign trade owing to the exchange rate unification of last October. Even with this increase, recorded real exports remained some 20 percent below their level in 1998.

10. **Confidence in the dinar is recovering, owing to tighter credit conditions, increases in foreign reserves, and the stabilization of exchange rate expectations.** Following the adoption of a managed float at the beginning of this year, the NBY has been a net purchaser from the foreign exchange market, while the exchange rate for the dinar has depreciated only very slightly against the DM (euro). This is explained by the decline in the NDA of the NBY, which was entirely due to fiscal overperformance (see next paragraph), and the recovery in real dinar money, which apparently reflects improved confidence in the currency. As of mid-August, gross official reserves amounted to about US$940 million (2 months of projected 2001 imports), US$420 million above their level at end-2000.[3] The recent liberalization of the import regime has exerted only modest downward pressures on the foreign exchange market.

11. **Overall budget performance improved in early 2001 but the underlying fiscal position remains precarious.** The consolidated general government in the whole of FRY recorded a cash *surplus*[4] of 0.4 percent of annual GDP in January–June 2001; by comparison, the program allowed for a cash *deficit* of 0.3 percent of GDP during the same period. The federal budget was in balance on a cash basis, although at the cost of accumulating some arrears on army wages and pensions. The Serbian consolidated general government registered a cash surplus of 0.6 percent of GDP, as revenue performance was broadly in line with expectations, while expenditure was cautiously kept low in line with available resources, by strictly prioritizing spending. By contrast, in the runup to critical elections in April, the Montenegrin consolidated government ran a cash deficit of 0.2 percent of FRY's

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[3] Of this increase, about US$200 million represents net NBY purchases from the foreign exchange market; the remainder is explained by the distribution of former Yugoslavia's gold and foreign exchange deposits held with the BIS as well as IMF purchases.

[4] After foreign grants, foreign loans, and privatization receipts.

GDP (3 percent of Montenegro's annual GDP) in 2001 H1, in addition to accumulating expenditure arrears.

12. **Donor and creditor support is being mobilized.** A Donor Conference for FRY—jointly organized by the European Commission and the World Bank—was held in Brussels on June 29. The conference was successful, generating pledges of about US$1.3 billion (13 percent of GDP), slightly more than targeted. However, associated disbursements during 2001 are estimated to be somewhat lower than expected earlier. Meanwhile, on May 16, the Paris Club creditors indicated their intention to: (a) provide nonconcessional debt relief to FRY consistent with the external financing requirements of the current stand-by arrangement; and (b) consider a successor Paris Club agreement in the context of the next IMF arrangement.[5] Thus, the Paris Club has not yet taken a decision on a possible debt reduction operation, as requested by the FRY authorities. Comparable treatment will be required from other bilateral and commercial creditors. The FRY authorities have initiated contacts with the London Club, and a first meeting with the banks' steering committee was held on June 26, 2001. In light of these efforts, the Fund is providing resources under its lending into arrears policy.

III. Policy Discussions

13. **The discussions in Serbia took place against the background of good policy implementation but also official concerns about rising social tensions.** All performance criteria pertaining to Serbia were observed as of end-June, as were—with a few exceptions—the structural benchmarks and indicative targets at end-June (see Box 1 on Program Implementation). The authorities were convinced that only strict implementation of the program could create the necessary conditions for sustainable growth. However, with output and real wages showing little if any recovery from their depressed levels of last year, the population's expectations of improved living standards were not being met. The authorities were therefore concerned that political support for reform would weaken, precisely when the extremely difficult task of bank and enterprise restructuring was to commence. They hoped therefore that timely external assistance would help alleviate the social costs of transition and that an early decision by Paris Club creditors on concessional debt relief would reduce uncertainties about external viability and encourage investment.

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[5] FRY's external debt—largely in arrears—is tentatively estimated at US$11.5 billion at end-2000, equivalent to about 142 percent of GDP (Table 3). About 22 percent of this was owed to multilaterals, 39 percent to Paris Club creditors, 20 percent to London Club creditors, and 9 percent to other creditors; the remainder (10 percent) was short-term debt.

Box 1. Program Implementation

Program implementation has been generally good, despite fiscal slippage in Montenegro (Annex A to Appendix IV). (Serbia accounts for about 93 percent of GDP, and 91 percent of total general government spending, in FRY.)

All seven *quantitative performance criteria* were met as of end-June 2001, with a single exception pertaining to Montenegro. Specifically, the NFA floor and the NDA ceiling were comfortably observed. The ceiling on bank credit to the government was also comfortably observed, notwithstanding a higher-than-targeted fiscal deficit in Montenegro. The four debt-related performance criteria were also observed, with the exception of the ceiling (set at zero under the program) on contracting or guaranteeing of new nonconcessional external debt with original maturity of more than a year by the public sector. The Montenegrin government extended a guarantee in the amount US$7.3 million to the Montenegrin Airlines (a state-owned company), with respect to a lease/purchase arrangement for a commercial aircraft. The authorities noted that Montenegrin Airlines is a viable entity and that they did not expect the guarantee to be exercised.

Out of six *structural benchmarks* for the period through end-June—in the fiscal, financial, and privatization sectors—two were not met. In Serbia, the adoption of a new drug list by the health fund was to have been adopted by end-June but was delayed to end-September, owing to changes in the fund's management. In Montenegro, an organic budget law was adopted by parliament on August 8, rather than by end-June as envisaged under the program, owing to delays in the formation of a government after the April elections.

Of the three *indicative targets,* two—relating to the NDA of the banking system and the wage bills of the largest state enterprises in Serbia—were met. The ceiling on the government expenditure arrears was missed, despite a good overall fiscal performance so far, reflecting conditions that are expected to be reversed in the remainder of the year.

14. **In Montenegro, the discussions focused on the means to address a large fiscal imbalance as well as transparency issues.** The authorities acknowledged that overspending in the runup to the April elections had led to a large fiscal deficit in 2001 H1. They also noted that difficulties in forming a new cabinet after the elections had contributed to delays in the formulation of corrective fiscal measures as well as the adoption of institutional legislation (monitored through a structural benchmark). The mission noted with concern the lack of transparency in the financing side of the republican budget, which the authorities attributed to weakness in accounting practices and undertook to correct by the time of the next (second) review under the stand-by arrangement (see ¶20 below).

15. **The output and external objectives of the original program remain well within reach, while challenges have emerged on the inflation front.** As regards *output* in FRY, it was agreed that the program target of 5 percent real GDP growth in 2001 was achievable, notwithstanding the weak performance of industry so far this year, after taking into account the recovery in agricultural output from last year's severe drought and the increased activity

in services. On the *external* front, the projection for the current account deficit was revised downwards to reflect higher net inflows of services and net transfers. The *inflation* target for Serbia was left unchanged—in light of the progress in lowering core inflation and in order to avoid a premature relaxation of the nominal targets of the program—even though both sides recognized that its achievement would be difficult. The inflation target in Montenegro (in terms of DM) was raised to 15 percent from 6½ percent, to take account of developments so far this year, which reflected administered price increases as well as the lagged effects of large wage increases until late last year.

Text Table 1. Key Macroeconomic Objectives and Policies, 2000–2001

	2000	2001	
		Original	Revised
	(Percentage change)		
Real GDP growth	5	5	5
Inflation (end period)	113.5	30–35	35
Of which: Montenegro	...	6.5	15
Current account deficit (before grants)			
US$ million	610	1,812	1,489
In percent of GDP	7.6	17.7	14.8
	(In percent of GDP)		
Fiscal deficit	0.9	6.1	4.0
Government credit from the banking system	0.2	0.6	0.8
	(In percent of year-beginning reserve money)		
NFA growth	148	8	20.5
NDA growth	-56.9	18.1	25.1
Reserve money growth	91.1	26.1	45.6

Sources: Yugoslav authorities; and Fund staff estimates.

16. **The key macroeconomic policy targets for the remainder of the year have been updated.** In the fiscal area, the target for the general government deficit in FRY was lowered by 2.1 percentage points to 4.0 percent of GDP in 2001, in light of expected shortfalls in foreign financing of projects and privatization receipts. This will be matched partly by lower spending and partly by higher foreign budgetary support and domestic borrowing (the latter would become available strictly for bank restructuring costs). In the monetary area, the targets for the NFA, reserve money, and—to a smaller extent—the NDA of the NBY have been raised to take into account the strengthening of the demand for dinars and to lock in some of the external overperformance.

A. Fiscal Policy

17. **The discussions highlighted the challenges for fiscal policy in the remainder of the year.** While fiscal policy so far in 2001 has been broadly in line with the program, the authorities and the mission agreed that the fiscal position would come under severe pressure in the remainder of the year, owing to a shortfall in expected privatization revenues in Serbia

and, in Montenegro, the need to reverse the policy slippage of the first half of the year. By contrast, the federal budget was expected to benefit from an improving revenue performance. Against this background, the discussions focused on identifying corrective measures to fill a large part of the financing gap in Serbia (with the remainder being covered by additional foreign and domestic financing) and to achieve the original fiscal deficit target in Montenegro.

Text Table 2. Consolidated General Government Fiscal Operations in 2000-2001 1/
(In percent of GDP) 2/

	2000	2001		
	Estimated	Program	Rev.Prog.	Difference
Total revenue	38.8	39.9	39.8	-0.1
Tax revenue	35.0	36.6	37.2	0.6
Nontax revenue	3.8	3.1	2.4	-0.7
Capital revenue	0.0	0.2	0.2	0.0
Total expenditure and net lending	39.7	46.0	43.8	-2.2
Purchases of goods and services	18.4	19.3	19.8	0.4
Of which: Wages and salaries	10.0	10.3	10.1	-0.3
Interest payment	0.6	1.0	0.4	-0.6
Subsidies	2.2	3.3	3.4	0.1
Transfers to households	15.1	17.8	17.2	-0.6
Capital expenditure	3.3	3.6	1.6	-2.0
Other	0.2	0.9	1.4	-0.4
Overall balance	-0.9	-6.1	-4.0	2.1
Financing	0.9	6.1	4.0	-2.1
Domestic financing	0.1	0.6	0.8	0.2
Foreign grants	0.8	1.2	1.2	0.0
Foreign debt financing	0.0	2.9	1.6	-1.3
Project financing	...	2.3	0.5	-1.8
Budgetary support	...	0.6	1.1	0.4
Privatization receipts	0.0	1.4	0.4	-1.0
Accumulation of expenditure arrears	2.1	0.0	0.0	0.0
Overall commitment balance	-3.0	-6.1	-4.0	2.1
Memorandum items:				
Overall cash balance of:				
Serbian general government	-0.2	-5.7	-3.5	2.1
Montenegro general government	-0.7	-0.4	-0.4	0.0
Overall cash balance of general government of Montenegro				
In percent of Montenegro GDP	-10.5	-6.1	-6.1	0.0

Sources: Ministries of Finance of FRY, Republic of Serbia, and Republic of Montenegro; and Fund staff estimates.

1/ Consolidated general government includes the federal, the republican and local governments, the social security funds, and the extrabudgetary programs. Local governments in Montenegro are, however, excluded.
2/ Expressed in terms of GDP of the FRY excluding Kosovo.

Federation

18. **The federal budget faces an improving outlook in the remainder of the year** (¶7).[6] According to revised estimates, which take into account higher revenue from sales taxes and import tariffs in line with recent developments and some expenditure savings in line with earlier policy commitments, the federal government should be able to achieve the fiscal target for the year, while eliminating the expenditure arrears incurred since the beginning of the year (Table 7B). In order to bring the execution of the defense budget fully under the control of the Minister of Defense, the government has transferred the Operational and Financial Service, which is in charge of the accounting and payment orders of the defense budget, from the General Staff Headquarters to the Ministry of Defense as of end-August.

Serbian government

19. **The fiscal discussions in Serbia focused on measures to offset an expected shortfall in privatization receipts** (¶8–11). Based on revised estimates, the Serbian budget faced a financing gap of about 1.3 percent of GDP in 2001, owing mainly to a downward revision of expected privatization receipts. The tax revenue target should be achievable for the year as a whole, with a shortfall in excises being offset by higher receipts from wage and sales taxes, while expenditure would be slightly higher on current policies. Larger than earlier envisaged foreign budgetary support (in the form of EU macrofinancial assistance) and, to a lesser extent, borrowing from the domestic banking system will help cover part of this gap.[7] For the remainder, the authorities have undertaken to implement expenditure cuts of 0.7 percent of GDP in 2001, mainly in the form of cuts in enterprise subsidies, social transfers, and net lending as well as containment of personnel cost increases.

Montenegrin government

20. **The fiscal discussions in Montenegro focused on measures to fill a budget financing gap as well as the need to reconcile the fiscal and monetary accounts** (¶12–13). Agreement was reached on the size of the fiscal financing gap (about 1.3 percent of Montenegrin GDP in 2001), and on sufficient expenditure cuts (affecting wage benefits, subsidies, capital, and maintenance spending) to close the gap and also create a contingency reserve of about ½ percent of GDP in light of uncertainties related to budget revenue and financing. The authorities noted that recently announced measures in the area of tax

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[6] Henceforth, unless otherwise noted, references to paragraphs pertain to the Revised Memorandum of Economic and Financial Policies (RMEFP, Appendix IV to this report).

[7] The additional domestic borrowing of 0.2 percent of GDP will be strictly limited to financing bank restructuring costs in excess of the existing budgetary allocation of 0.1 percent of GDP (the domestic borrowing ceiling will be adjusted downwards correspondingly if costs are lower than envisaged).

administration should help with the achievement of the revenue target. The mission indicated its concern about the lack of transparency of data on budget financing, which complicated an assessment of (a) compliance with the performance criterion on bank credit to the government and (b) the sustainability/financeability of the budget deficit. The authorities undertook to provide, by early September, improved data on the financing of the budget, which would be compiled with the assistance of a local auditor. In addition, they indicated that—were the data weaknesses to persist in the judgment of the staff—a reputable foreign accounting would be retained to audit the financing of the budget and prepare a report by mid-November, 2001. Fiscal transparency issues will be an important element of the discussions on the next review under the stand-by arrangement.

B. Wage and Price Policies

21. **The discussions confirmed the authorities' intention to contain wage growth and bring administered prices into line with economic costs.** Specifically, a strict wage policy in the federal and republican governments—consistent with keeping real wage bills constant—remains in effect. In the case of state-owned enterprises in Serbia, a wage freeze in effect since January will be relaxed somewhat, through an increase in wages by up to 10 percent in September, implying an increase in the indicative targets for end-September and end-December 2001 (Annex A to RMEFP); even after this increase, wages in these enterprises would decline in real terms in 2001 on the basis of the targeted rate of inflation. Regarding electricity prices, the Serbian authorities noted that the cumulative increase so far this year amounted to 120 percent, which was judged sufficient to cover most of the operational costs of the electricity company. In light of this, agreement was reached that the authorities' undertaking (monitored as a performance criterion) to raise electricity prices further by another 40 percent as of October 1 be replaced by a commitment to raise electricity prices by 15 percent on October 1 (to be monitored as a performance criterion) and to designate electricity pricing policy as an issue for discussion under the next (second) review under the stand-by arrangement.

C. Monetary and Exchange Rate Policies

22. **Credit and monetary policy targets were revised.** Specifically, to take into account the increased demand for the dinar and to lock in some of the external overperformance, the monetary program has been adjusted as shown in the text table below. In the event of higher than projected NFA, the NBY confirmed its intention to consult with the Fund staff on the implications for credit policy and to keep NDA below the program target, should it appear that the NFA overperformance does not reflect increased money demand.

Text Table 3. Monetary Indicators, 2000-2001

	2000	2001						
	Dec.	June		July	September		December	
		Prog.	Actual		Prog.	Rev. Prog.	Prog.	Rev.Prog.
	(Cumulative change as percent of reserve money at year-beginning)							
NFA	147.7	8.0	44.1	54.0	1.8	17.0	8.2	20.5
NDA	-56.6	-1.3	-18.0	-25.4	12.2	19.3	18.0	25.1
Reserve money	91.1	6.8	26.1	28.6	14.0	36.3	26.1	45.6
	(Cumulative percentage change from year-beginning)							
Currency in circulation	64.1	10.7	28.3	38.3	19.8	45.0	36.0	60.0
	(Cumulative change in millions of U.S. dollars from year-beginning; end-Dec. 2000 exchange rates)							
NFA 1/	...	25.2	138.5	169.7	5.2	53.4	25.2	64.4
Gross official reserves 2/	...	88.3	386.4	409.6	132.3	365.3	216.3	440.3
Memorandum item								
	(Cumulative change from year-beginning)							
Retail prices (end period)	113.5	21.7	23.1	26.0	26.4	28.0	35.0	35.0

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

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

23. **The discussions on exchange rate policy highlighted the potential risks from an effective pegging of the exchange rate of the dinar.** The staff shared the NBY's view that the current level of the exchange rate remained appropriate, in light of the continuing (albeit decelerating) accumulation of official reserves through purchases from the foreign exchange market and the historical levels of the real exchange rate. However, in light of the ongoing real appreciation of the dinar, and the fact that a worsening of external competitiveness would be reflected in the trade flows with a considerable lag, the mission advised a gradual and modest depreciation of the dinar, without pre-announcement, with a view to limiting the loss of cost competitiveness and avoiding exit problems associated with an effective pegging of the exchange rate. On their part, the monetary authorities were concerned about the effects on market confidence of even a gradual depreciation before reforms have taken hold and expectations have further stabilized. Nevertheless, they stood ready to depreciate the exchange rate in light of underlying developments in the NFA (i.e., adjusting for net autonomous inflows, which will be sizable in the remainder of the year). Owing to uncertainty about the external outlook and underlying position, exchange rate policy will be reviewed quarterly under the program.

24. **In consultation with MAE, the mission reached preliminary understandings on measures to reform monetary policy instruments.** The agreed measures—to be introduced by January 1, 2002, in line with progress in restructuring the banking system—include a streamlining of the required reserve system through a widening of the deposit base and a lowering of the required reserve ratio, and increasing reliance on open market operations in dinars and foreign exchange for the conduct of monetary policy (¶18).

D. Bank Restructuring

25. **The NBY noted that progress had been made in implementing a recently adopted bank restructuring strategy.**[8] Specifically, the NBY—with the assistance of a foreign accounting firm and bilateral donors—completed detailed diagnostic reports of some 28 banks, which had been earlier identified as problematic. On this basis, the NBY delicensed 7 small banks, placed 6 banks under enhanced NBY supervision, identified 11 banks as potential candidates for rehabilitation by the Bank Rehabilitation Agency (BRA), and declared 4 banks healthy (¶19). Importantly, one of the largest six banks was placed under enhanced NBY supervision as basically solvent but undercapitalized and another four large banks were found insolvent and placed under the Bank Rehabilitation Agency (BRA) for possible rehabilitation.

26. **In consultation with MAE and the World Bank, agreement was reached on the next steps in the implementation of the bank restructuring strategy.** The discussions focused in particular on the treatment of the large banks. The monetary authorities generally favored their rehabilitation—provided that fiscal resources could become available—on the grounds that they are "systemically" important, both as providers of banking services to the enterprise sector and as large employers. Fund and World Bank staff, however, took the view that, with the exception of possibly one or two large banks, all other insolvent banks probably should be liquidated for not being potentially viable. In the event, agreement was reached on an action plan that envisages, inter alia, decisions on the rehabilitation/resolution of the large banks by end-October, 2001, when the discussions for the second review under the stand-by arrangement are to take place (¶20). In particular, by mid-September, the NBY will recommend either liquidation or possible rehabilitation (through the BRA) of seven small banks that have been found to be insolvent. In addition, by mid-October, the BRA will develop rehabilitation/resolution plans for the four large banks under its control. On this basis, by end-October, the Board of Directors of the BRA will decide on whether these banks would be liquidated or rehabilitated. Pending further specification of bank restructuring measures, agreement was also reached on an additional budgetary allocation of 0.2 percent of GDP in 2001, to cover costs solely related to the winding down of operations of some banks (e.g., severance payments and payouts of deposit insurance payments, ¶22).

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[8] According to the bank restructuring strategy adopted by the authorities in line with Fund/World Bank recommendations (¶40 of the MEFP of May 25, 2001), bank rehabilitation will be undertaken only if it is expected to produce a viable bank with good prospects for privatization; and can be implemented with identifiable fiscal resources. Moreover, if this does not appear to be achievable based on performance during the first six months of a rehabilitation program, the banks should be closed and liquidated.

E. Enterprise Restructuring and Privatization

27. **The privatization program in Serbia—which is implemented with World Bank assistance—remains broadly on track.** A new privatization law was adopted by the Serbian parliament in June 2001 and by-laws and other regulations were adopted by mid-July, as envisaged under the program. On the basis of the new framework, the privatization of about 40 large socially owned enterprises, including three cement factories, has been initiated or will be initiated soon, in line with transparent procedures agreed with the World Bank (¶25). Progress toward the privatization of these enterprises is monitored through structural benchmarks. Privatization receipts of only 3 billion dinars (0.4 percent of GDP) now appear to be achievable by end-2001 (compared with an earlier estimate of 10 billion dinars), mainly because of a delay in the sale of a large cement company under the old privatization law that granted veto power to enterprise workers. However, the authorities expect substantially higher privatization proceeds by early 2002, when a large number of sales, under already initiated privatization projects, will be nearing completion. The privatization process for the remaining 4,000 socially owned enterprises has started as envisaged under the program, and actual sales are expected to accelerate in 2002–03. Meanwhile, important labor legislation—aiming to increase labor market flexibility and reduce the financial burden on enterprises—will be submitted to parliament in September (¶25).

28. **Montenegro's privatization program is underway, with support from bilateral donors** (¶26). In Montenegro, the authorities intend to rely on international tenders to attract strategic investors, including for the Montenegrin Telecom, while preserving minority shares for a mass voucher privatization program that is set to begin in September. A majority share will be sold in 15 large companies through international tender, and international investors will be offered a minority share in other companies which can be expanded to a majority interest. In addition, some 29 percent of the shares of 227 companies will be offered for sale through the mass privatization scheme.

IV. Staff Appraisal

29. **The authorities have implemented the Fund-supported program with impressive firmness and have moved quickly to adopt corrective measures as needed to ensure that it stays on track.** While this augurs well for the future, the tasks ahead will be extremely difficult, requiring continued perseverance from the authorities as well as strong support from donors and creditors.

30. **A lot has been accomplished in stabilization and structural reform within a short period.** Good progress has been made toward restoring macroeconomic stability and improving market confidence. This has been reflected in a sharp decline in core inflation, a strengthening of the foreign reserve position, and a gradual output recovery in line with program expectations. On the structural front, a market-oriented legal and regulatory framework has already been put in place to guide the transformation of the economy. In Serbia, a new privatization framework and a bank resolution strategy have recently been adopted, in line with Fund and World Bank recommendations. These important steps follow the streamlining of the tax system, and the almost complete liberalization of the exchange, trade, and price systems earlier this year. In Montenegro, political developments interfered

with the conduct of fiscal policy and fiscal transparency problems became evident, but the implications for the program were limited by the republic's small share in the FRY economy.

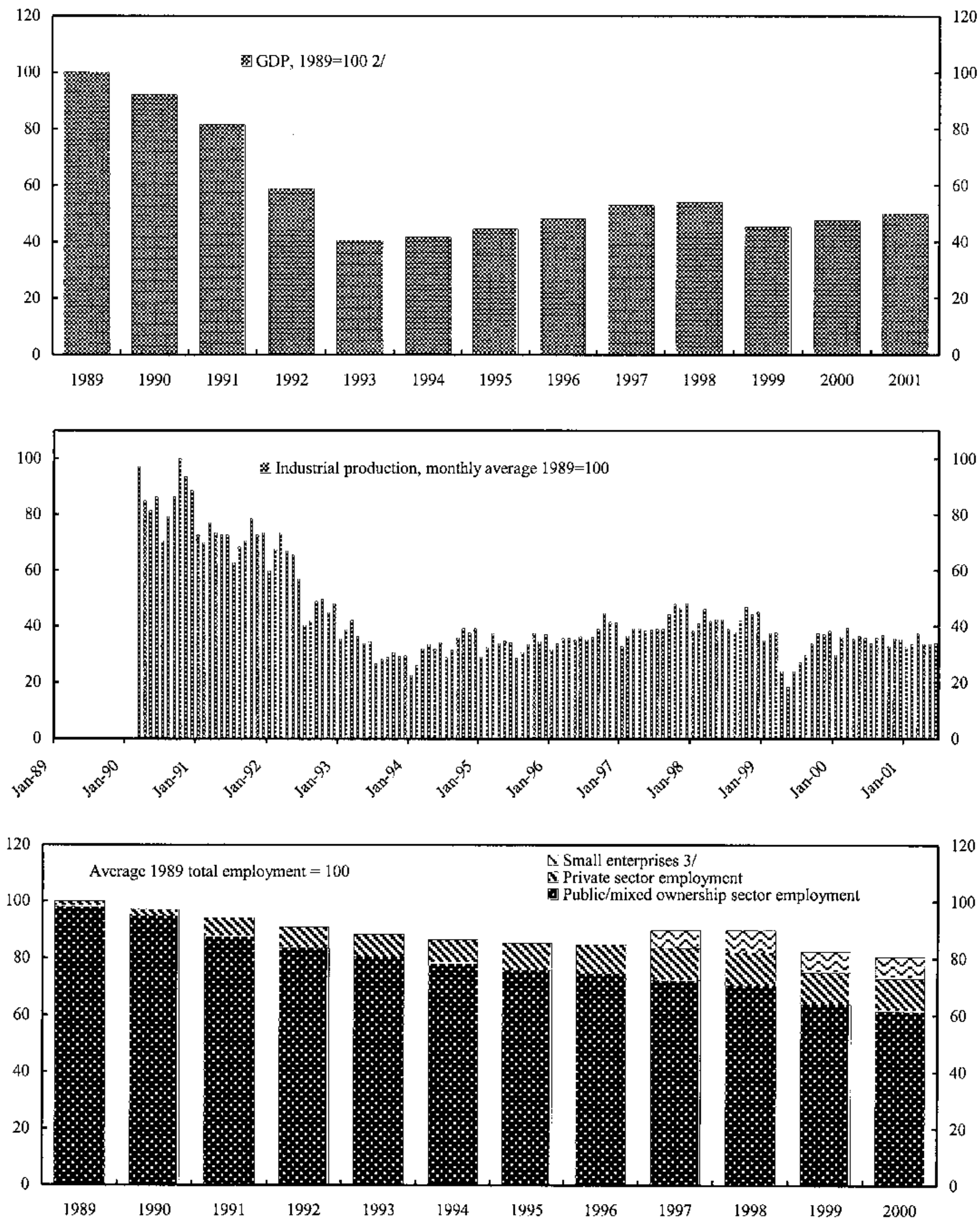
31. **Looking ahead, achievement of the fiscal objectives will be challenging, in both Serbia and Montenegro.** In light of considerable uncertainties surrounding budgetary revenue as well as financing, the authorities will need to prioritize expenditure commitments and limit spending in line with available resources, to avoid the incurrence of expenditure arrears or recourse to inflationary financing. In addition, the NBY will need to monitor closely developments in prices and the foreign exchange market, with a view to calibrating credit policy, in light of the uncertain outlook and structural shifts in the demand for money. In Montenegro, the authorities have undertaken to address fiscal transparency problems.

32. **Continued progress in structural reform is also important.** For sustainable growth, the underlying causes of the macroeconomic imbalances will need to be addressed, by restructuring the largely insolvent enterprise and banking sectors, improving financial discipline, and restoring fiscal sustainability. To this end, with privatization frameworks in place in both republics, the authorities should intensify their efforts to privatize state and socially owned enterprises, with the first results being visible by late 2001, while improving their operational efficiency through cost savings. Moreover, decisions on the rehabilitation/resolution of banks should be made expeditiously and on the basis of a realistic assessment of their potential viability and the fiscal constraints.

33. **FRY needs the continued support of donors and creditors.** Given its devastated economy and heavy external debt burden, FRY will need continued support from donors and creditors, as well as prudent policies, to achieve sustainable growth and external viability. While the June donor conference generated a large amount of pledges, donor assistance will have to remain at high levels over several years given FRY's reconstruction needs. Moreover, while FRY has benefited from a major reduction in debt servicing costs for the duration of the stand-by arrangement, its external prospects will remain highly uncertain—thus hampering investment and growth—until the external debt is restructured on concessional terms.

34. **The staff recommends completion of the first review and a waiver for the nonobservance of a performance criterion on external debt.** Under extremely difficult conditions, the FRY authorities have made good progress in stabilization and reform since late last year, through their firm implementation of prudent policies. Moreover, they have promptly adopted corrective measures as needed to keep the macroeconomic program on track and reaffirmed their policy commitments in the area of structural policies, as a basis for the completion of the first review. While program implementation in Montenegro has been a source of concern, owing to policy slippages and transparency problems in the fiscal area, the staff welcomes undertakings by the Montenegrin authorities to take corrective fiscal measures and to have the fiscal accounts properly audited.

Figure 1. Federal Republic of Yugoslavia: Selected Economic Activity Indicators, 1989-2001 1/



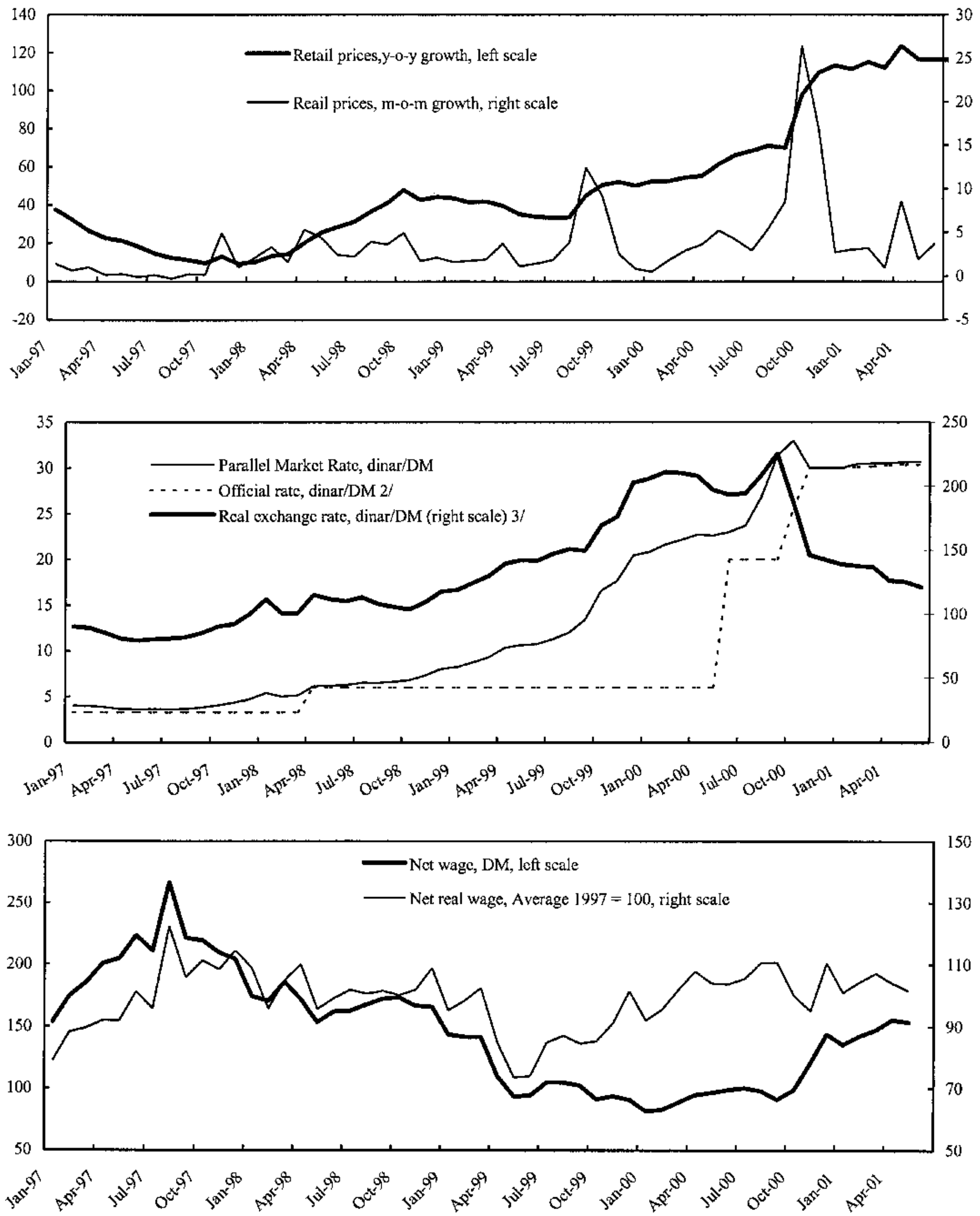
Sources: Federal Institute of Statistics and National Bank of Yugoslavia.

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

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

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

Figure 2. Federal Republic of Yugoslavia: Prices, Exchange Rates, and Wages
January 1997-June 2001 1/



Sources: Federal Institute of Statistics; National Bank of Yugoslavia; and Fund staff calculations.
1/ Data after February 1999 exclude Kosovo.
2/ 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.
3/ Real index obtained by applying the FRY retail price index and the German CPI to the average parallel market rate. Increase denotes depreciation.

Table 1. Federal Republic of Yugoslavia (Serbia/Montenegro): Selected Economic and Financial Indicators, 1996-2001 1/

	1996	1997	1998	1999	2000 Prel.	2001 Prog. Orig.	2001 Prog. Rev.
Real economy							
GDP, in billions of YUD	79.0	112.4	146.3	192.9	358.1	678.5	693.3
GDP, in millions of US dollars	14,455	16,556	13,889	10,155	8,071	10,231	10,045
Average net real wage, 1997 =100	82	100	102	88	103	103	104
Average net wage in DM, at gray market exchange rates	155	206	169	109	99	149	161
			(Percent change)				
Real GDP	7.8	10.1	1.9	-15.7	5.0	5.0	5.0
Industrial production	7.6	9.5	3.6	-22.5	10.9	0.0	0.0
Retail prices (annual average)	92.7	18.5	29.8	42.4	71.8	86-89	89.0
Retail prices (end of period)	...	...	...	49.9	113.5	30-35	35.0
Unemployment rate (in percent) 2/	25.8	25.8	25.1	26.5	27.3	...	...
			(Percent of GDP)				
General government finances 3/							
Revenue 4/	...	...	...	...	38.8	39.9	39.8
Expenditure	...	...	...	...	39.7	45.9	43.8
Of which : Budget for reconstruction and recovery	...	...	...	...	0.0	2.3	0.5
Cash balance	...	...	...	...	-0.9	-6.1	-4.0
Domestic financing	...	...	...	...	0.2	0.6	0.8
Foreign financing	...	...	...	...	0.0	2.9	1.6
Foreign grants	...	...	...	...	0.8	1.2	1.2
Privatization receipts	...	...	...	...	0.0	1.4	0.4
Commitment balance 5/	...	...	...	...	-3.0	-6.1	-4.0
			(Percent change)				
Money supply (end-of-period)							
M1 6/	...	...	...	47.3	85.1	36.0	60.2
M2 6/ 7/	...	...	...	67.6	61.4	20.4	29.3
Balance of payments			(In billions of U.S. dollars)				
Merchandise exports 8/	2.0	2.4	3.0	1.7	1.9	2.1	2.0
Merchandise imports	-4.1	-4.8	-4.8	-3.3	-3.7	-4.5	-4.5
Trade balance	-2.1	-2.4	-1.9	-1.6	-1.8	-2.4	-2.5
Current account balance, after grants 9/	-0.6	-1.6	-0.7	-0.8	-0.3	-1.2	-0.9
(In percent of GDP)	-4.1	-9.4	-5.0	-7.5	-4.2	-11.4	-9.3
Current account balance, before grants 9/	-0.6	-1.6	-0.7	-0.8	-0.6	-1.8	-1.5
(In percent of GDP)	-4.1	-9.4	-5.0	-7.5	-7.6	-17.7	-14.8
Foreign debt (year-end) 10/	...	...	...	...	11.5	12.5	12.2
Gross official reserves	...	...	...	0.3	0.5	0.7	0.9
(In months of imports of goods and services)	...	...	...	1.1	1.3	1.7	2.1

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

1/ With the exception of foreign debt, data for 1999-2001 exclude Kosovo. GDP excludes Kosovo throughout.

2/ Excludes workers on "forced holiday" (about 20-25 percent of the labor force in recent years).

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

4/ Excludes foreign grants.

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

6/ From 1999 onwards excludes Montenegro.

7/ Frozen foreign-currency deposits are excluded and other foreign-currency deposits are valued at parallel market rates until September 2000 and at YUD 30 per DM thereafter.

8/ From 1996 onwards, includes an estimate of unrecorded exports of about US$0.2 billion.

9/ In 2000-01, includes an estimate of unrecorded transfers of US$0.6 billion.

10/ Includes arrears on unpaid imports of fuel and gas.

Table 2. Federal Republic of Yugoslavia: Balance of Payments, 1997-2002
(in millions of U.S. dollars)

9/5/01 10:40

	1997	1998	1999	2000	2001		2002
				Revised	Program EBS/01/93	Revised Program	Proj.
Trade balance	**-2,352**	**-1,816**	**-1,619**	**-1,788**	**-2,441**	**-2,496**	**-2,631**
Exports f.o.b.	2,447	3,033	1,677	1,923	2,064	1,989	2,315
(percent growth)		23.9	-44.7	14.7	7.3	3.4	16.4
Recorded	2,368	2,858	1,498	1,723	1,964	1,889	2,315
Unrecorded	79	175	179	200	100	100	0
Imports f.o.b.	-4,799	-4,849	-3,296	-3,711	-4,506	-4,485	-4,946
(percent growth)		1.0	-32.0	-22.7	21.4	20.9	10.3
Services, net	**456**	**493**	**228**	**331**	**210**	**353**	**402**
Receipts	818	914	471	624	775	725	826
Expenditure	-362	-421	-243	-293	-565	-372	-424
Net factor income	**25**	**8**	**-41**	**-1**	**-470**	**-308**	**-727**
Of which: Net interest	25	8	-41	11	-470	-308	-727
Earnings	59	57	43	53	52	52	59
Payments 1/	-34	-49	-84	-42	-522	-360	-787
Unrequited private and official transfers, net	**310**	**655**	**668**	**1,119**	**1,440**	**1,513**	**1,204**
Private remittances, net	310	655	668	848	890	963	914
Inflows	662	1,033	948	1,132	1,190	1,397	1,466
Recorded	465	688	501	632	980	1,256	
Unrecorded	197	345	447	500	210	142	
Outflows	-352	-378	-280	-284	-300	-434	-553
Official grants	0	0	0	271	550	550	290
Current account balance, before grants	**-1,561**	**-660**	**-764**	**-610**	**-1,812**	**-1,489**	**-2,042**
(In percent of GDP)	-9.4	-4.8	-7.5	-7.6	-17.7	-14.8	-18.6
Foreign direct investment	740	113	112	25	160	120	300
Foreign loans	283	-10	-25	180	-98	-73	-49
Medium and long term	54	25	12	213	-98	-32	-90
Disbursements	128	50	29	227	70	70	82
Amortization 2/	-74	-25	-17	-14	-168	-102	-172
Short term, net	229	-35	-37	-33	0	-41	41
Other capital inflows	139	78	30	49	50	35	50
Capital account balance	**1,162**	**181**	**117**	**255**	**112**	**82**	**301**
Errors and omissions	179	278	410	267	290	290	290
Overall balance	**-220**	**-201**	**-237**	**183**	**-860**	**-567**	**-1,162**
Financing	**220**	**201**	**237**	**-183**	**-9,806**	**-9,701**	**-250**
Net foreign assets (increase, -)	18	115	111	-246	-217	-284	-250
Central Bank							
Gross foreign reserves 3/	18	115	111	-227	-217	-279	-250
Gross foreign liabilities	0	0	0	-19	0	0	0
Commercial banks, net					0	-5	0
Arrears (reduction, -) 4/	202	86	126	63	-9,589	-9,416	0
Financing gap, *to be filled by:*	...	...	...	...	10,666	10,268	1,412
Program and project assistance	...	...	...	...	821	722	1,100
World Bank adjustment lending	...	...	...	...	85	85	205
IMF	...	...	...	...	192	192	64
EBRD	...	...	...	...	10	30	100
EU	...	...	...	...	220	260	
Bilateral donor support	...	...	...	...	80	80	
Project assistance	...	...	...	...	234	75	310
Residual gap, *to be possibly filled by debt relief* 5/	...	...	...	...	9,845	9,546	312
Arrears	...	...	...	...	9,369	9,223	...
Current maturities	...	...	...	...	476	323	...
Memorandum items:							
Current account balance, after grants	-1,561	-660	-764	-339	-1,162	-939	-1,442
(In percent of GDP)	-9.4	-4.8	-7.5	-4.2	-11.4	-9.3	-13.1
Gross international reserves, USD mn (end period) 6/	...	...	289	516	733	933	1,212
in months of prospective imports of goods & services	...	...	0.9	1.3	1.6	2.1	2.5
Debt service, cash	108	74	101	56	215	140	846
(In percent of GDP)	0.7	0.5	1.0	0.7	2.1	1.4	7.7
Principal	74	25	17	14	11	11	153
Interest	34	49	84	42	204	129	693

Sources: National Bank of Yugoslavia and Fund staff estimates.

1/ Up to 2000, only interest paid is included.

2/ Up to 2000, only amortization paid is included.

3/ Reserve accumulation at fixed (Dec 2000) exchange rates and excluding US $161.5 mn on account of the distribution of BIS gold and foreign exchange in June 2001.

4/ For 2001 revised projection, the arrears stock is valued at US $9,380 million, compared to US $9,589 million in the original program.

5/ Compared to the original program, the following changes have been incorporated for the revised 2001 projection: a new lower debt stock of US $11,460 mn is used; bilateral and commercial debt as of end-2000 is assumed to be subject to debt treatment (on Houston terms, as in original program); and debt service to the World Bank is now envisaged to commence in early 2002, as per restructuring agreement. For 2002 projection, the assumed rescheduling on Houston terms would cover $113 million of the residual gap.

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

Table 3. Federal Republic of Yugoslavia: Stock of External Debt at end-December 2000
(In millions of U.S. dollars)

	Creditor	Total Debt	*Of which:* Arrears			
			Principal	Interest	Late Interest	Total Arrears
I.	Total stock of outstanding debt	11,460	5,436	1,519	2,462	9,416
	Of which : Medium and long-term debt	10,296	4,935	1,519	2,462	9,416
II.	Multilateral creditors	2,488	1,157	354	557	2,068
	IMF	152	0	0	0	0
	IBRD	1,781	1,004 1/	263	436	1,703
	Eurofima	126	0	0	0	0
	IFC	132	71	9	52	132
	EIB	257	54	74	65	193
	Other	40	28	8	4	40
III.	Official bilateral creditors	4,620	2,408	393	1,528	4,329
	Paris Club	4,424	2,372	393	1,528	4,293
	Pre-cutoff (1982) debt	3,420	1,880	304	1,206	3,390
	Previously rescheduled	2,386	1,299	269	818	2,386
	Previously not rescheduled	1,034	581	35	388	1,004
	Post-cutoff (1982) debt	1,004	492	89	322	903
	Other bilateral creditors (largely post-1992)	196	36	0	0	36
IV.	Commercial creditors	3,188	1,370	772	377	2,518
	London Club 2/	2,297	811	745	124	1,679
	Other commercial creditors: convertible currencies	682	350	27	253	630
	Other commercial creditors: non-convertible currencies	209	209	0	0	209
V.	Short-term debt	1,164	501	0	0	501
	Trade arrears related to oil and gas imports 3/	501	501	0	0	501
	Other short-term debt	663	0	0	0	0

Source: Data provided by the FRY authorities in July 2001; not yet fully reconciled with creditor data.

1/ Including exchange rate adjustments.

2/ Debt held by the NBY amounting to US$500 million has been excluded; but other debt held by Yugoslav-connected parties may be included.

3/ Non-guaranteed overdue obligations (trade credits) owed to oil and gas enterprises in Russia and China.

Table 4. Federal Republic of Yugoslavia: Net Foreign Assets--Actual and Program Floors, December 1999-December 2001

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

	1999	2000				2001								
	Dec.	Mar.	June	Sep.	Dec.	Mar.	Apr.	May	June		Sep.		Dec.	
									Prog.	Actual	Prog.	Rev. Prog.	Prog.	Rev. Prog.
Net foreign assets of the NBY 1/	163	125	238	239	364	457	471	535	389	525	369	440	389	451
Net foreign assets of the NBY for program purposes	-552	-567	-451	-406	-309	-231	-219	-155	-283 2/	-170	-303	-255 2/	-283	-244 2/
Gross foreign assets	293	255	369	368	516	608	623	687	605	741	649	720	733	795
Gold	139	134	141	135	125	126	126	126	...	127	...	...	...	...
Foreign currencies	100	93	108	145	240	178	194	242	...	236	...	...	...	...
Foreign exchange accounts abroad	55	29	120	88	151	404	303	319	...	378	...	...	...	...
Reserve-related liabilities (-)	130	130	131	129	152	152	152	152	216	216	280	280	344	344
Gross reserve liabilities for program purposes (-)	844	822	820	774	825	840	842	842	888	911	952	975	1,016	1,039
IMF	130	130	131	129	152	152	152	152	216	216	280	280	344	344
Other	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Adjustments for program purposes	714	693	689	645	672	688	690	690	672	695	672	695	672	695
Foreign currency liabilities to domestic banks	714	693	689	645	672	688	690	690	...	695	...	...	...	...
Loan from China deposited by Yugoslav bank	...	...	...	99	100	100	100	100	...	100	...	...	...	...
Forex deposits from commercial banks	...	...	...	63	61	66	57	57	...	57	...	...	...	...
Unpaid interest	...	...	...	68	70	70	70	70	...	70	...	...	...	...
Short-term loan from commercial banks	...	...	...	0	11	12	12	12	...	10	...	...	...	...
Minimum reserve and other deposits	...	...	...	96	105	115	126	126	...	133	...	...	...	...
Old obligations commercial banks	...	...	...	319	325	325	325	325	...	325	...	...	...	...
Foreign currency liabilities to nonbank non-government residents	0	0	0	0	0	0	0	0	...	0	...	...	...	...
Net foreign assets of commercial banks of Serbia	366	333	373	384	366	351	347	352	366	371	366	371	366	371

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

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

Table 5. Federal Republic of Yugoslavia: Balance Sheet of the National Bank of Yugoslavia, December 1999-December 2001 1/

(In millions of dinars; end of period)

	1999	2000				2001								
	Dec.	Mar.	June	Sep.	Dec.	Mar.	April	May	June		Sep.		Dec.	
								Prel.	Prog.	Actual	Prog.	Rev. Prog.	Prog.	Rev. Prog.
Net foreign assets	-22,549	-26,135	-21,231	-27,167	-19,501	-14,618	-13,859	-9,772	-17,879	-10,751	-19,142	-16,127 2/	-17,879	-15,433 2/
Net foreign assets in DM million	-1,074	-1,162	-923	-906	-650	-487	-219	-155	-596	-358	-638	-538	-596	-514
Gross foreign assets 3/	11,975	11,751	17,375	24,628	32,587	38,430	39,327	43,414	38,197	46,793	40,977	45,459	46,282	50,197
Gross reserve liabilities (-) 4/	-34,524	-37,886	-38,606	-51,795	-52,088	-53,048	-53,186	-53,186	-56,076	-57,544	-60,119	61,587	-64,161	65,629
Net domestic assets	32,016	36,085	32,085	41,389	39,347	34,525	34,828	32,294	39,064	35,770	41,766	43,185 5/	42,909	44,328 5/
Domestic credit	107,968	120,412	124,285	167,691	153,611	148,191	148,136	146,460	...	148,169	...	...	...	...
Net claims on government	5,096	6,415	6,344	8,781	5,480	1,880	1,940	454	...	3,181	...	...	...	...
Claims	6,713	8,083	8,675	11,162	11,424	11,433	11,516	11,415	...	11,433	...	...	...	...
Dinar credits	1,652	2,364	2,685	2,691	3,071	3,187	3,186	3,085	...	3,103	...	...	...	...
Foreign currency credits	5,060	5,720	5,990	8,472	8,353	8,246	8,330	8,330	...	8,330	...	...	...	...
Liabilities (-)	-1,617	-1,668	-2,331	-2,381	-5,944	-9,553	-9,576	-10,961	...	-8,252	...	...	...	...
Dinar liabilities	-547	-498	-1,145	-702	-1,462	-3,608	-4,163	-5,669	...	-3,591	...	...	...	...
Foreign currency liabilities	-1,070	-1,170	-1,186	-1,680	-4,482	-5,945	-5,413	-5,292	...	-4,661	...	...	...	...
Net claims on banks	100,214	111,013	115,110	154,894	144,932	143,171	143,231	143,122	...	142,085	...	...	...	...
Claims	100,677	111,488	115,404	155,964	145,603	144,423	144,518	145,036	...	144,293	...	...	...	...
Recourse to required reserves	866	859	1,023	1,521	1,174	882	1,074	1,541	...	1,017	...	...	...	...
Other dinar credits	4,120	3,357	3,224	3,322	3,364	3,401	3,368	3,344	...	3,346	...	...	...	...
Foreign currency credits	95,690	107,271	111,157	151,121	141,065	140,140	140,076	140,151	...	139,930	...	...	...	...
Foreign currency credits in DM million	4,557	4,768	4,833	5,037	4,702	4,671	4,669	4,672	...	4,664	...	...	...	...
Liabilities (-)	-463	-475	-294	-1,070	-671	-1,252	-1,287	-1,914	...	-2,208	...	...	...	...
of which: stock of NBY bills	0	0	0	0	-86	-343	-375	-998	...	-1,372	...	...	...	...
Net claims on the rest of the economy	2,658	2,984	2,832	4,016	3,199	3,140	2,965	2,884	...	2,903	...	...	...	...
Claims	2,785	3,095	3,106	4,178	3,660	3,559	3,564	3,685	...	3,702	...	...	...	...
Dinar credits	2,663	2,957	2,963	3,981	3,457	3,358	3,362	3,485	...	3,503	...	...	...	...
Foreign currency credits	123	137	143	197	203	201	202	200	...	199	...	...	...	...
Liabilities (-)	-127	-111	-274	-161	-461	-419	-599	-801	...	-799	...	...	...	...
Dinar deposits	-127	-111	-274	-161	-461	-419	-599	-801	...	-799	...	...	...	...
Other assets, net	-75,951	-84,327	-92,200	-126,302	-114,264	-113,666	-113,308	-114,166	...	-112,399	...	...	...	...
Reserve money	9,467	9,950	10,854	14,222	19,846	19,907	20,969	22,522	21,186	25,019	22,624	27,057	25,030	28,895
Currency in circulation	6,688	6,203	7,159	9,026	10,933	11,258	12,362	13,544	12,100	14,318	13,100	15,853	14,869	17,493
Reserve deposits	2,779	3,747	3,695	5,196	8,912	8,649	8,607	8,978	9,086	10,701	9,524	11,204	10,160	11,402
Required reserves held 6/	1,217	1,656	1,723	2,569	3,650	4,730	4,798	4,912	5,886	6,041	6,124	7,727	6,560	8,030
Shortfall in required reserves 6/	866	859	1,023	1,521	1,174	882	1,074	1,541	0	1,017	0	0	0	0
Excess reserves 7/	696	1,231	948	1,106	4,088	3,037	2,735	2,525	3,200	3,643	3,400	3,477	3,600	3,371
Memorandum items: (12-months growth rates, unless otherwise indicated)														
Reserve money, nominal 8/	26.0	28.0	27.9	66.9	109.6	99.7	109.9	131.2	95.6	127.3	59.1	90.7	26.1	45.6
Reserve money, real 8/	-15.9	-14.6	-20.1	5.2	-1.8	-9.6	-8.0	4.7	-11.6	-42.6	-17.5	-0.5	-4.8	14.6
Currency in circulation, nominal	32.3	23.8	30.6	57.5	63.5	81.5	92.6	129.1	69.0	96.0	45.1	75.6	36.0	60.0
Currency in circulation, real	-11.8	-17.4	-18.4	-0.7	-23.4	-17.9	-15.5	3.7	-23.5	-10.8	-24.7	-8.2	7.0	25.9
Currency in circulation, monthly average, nominal	...	46.5	28.4	50.6	41.5	76.6	87.1	99.3	...	88.3	...	...	...	...
Currency in circulation, monthly average, real	...	-2.2	-19.8	-5.0	-33.7	-18.8	-17.9	-9.7	...	-14.3	...	...	...	...
Required reserves, including shortfall, nominal 8/	2.7	12.7	33.1	130.4	131.6	50.9	55.3	66.7	48.9	78.6	49.7	88.9	36.0	66.5
Required reserves, including shortfall, real 8/	-31.5	-24.8	-16.8	45.3	8.5	-31.7	-31.9	-24.5	-3.0	16.9	-22.3	-1.2	7.0	31.0
Excess reserves, nominal	62.4	131.4	1.1	8.8	487.4	146.6	188.7	274.3	237.5	284.2	207.5	214.5	-11.9	-17.5
Excess reserves, real	8.4	54.5	-36.8	-31.4	175.1	11.6	26.6	69.5	52.8	74.8	59.5	64.4	-30.7	-35.1
Excess reserves as a share of quarterly GDP (percent)	1.18	1.87	1.27	1.27	3.04	2.00	2.2	2.2	1.9	2.2	1.91	2.0	1.88	1.8
Cash in circulation as share of quarterly GDP (percent)	11.37	9.41	9.60	10.40	8.14	7.41	10.8	10.8	7.0	8.6	7.38	8.9	7.75	9.1
Stock of NBY bills as share of reserve money (percent)	0.00	0.00	0.00	0.00	0.43	1.72	1.79	4.43	...	5.49	...	...	...	...

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

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

2/ Program floor.

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

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

5/ Program ceiling. It will be monitored as a monthly average as defined in the Technical Memorandum of Understanding.

6/ Reserves that banks are required to hold in NBY account 201 to satisfy the standard 24.5 percent reserve requirement.

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

8/ Figures in 2001are adjusted for lower reserve requirements and exemptions in early 2000.

Table 6. Monetary Survey of Serbia, December 1999 - December 2001

(In millions of dinars; end of period)

	1999	2000				2001								
	Dec.	Mar.	June	Sep.	Dec.	Mar.	Apr.	May	June		Sep.		Dec.	
									Program	Actual	Prog.	Rev. Prog.	Prog.	Rev. Prog.
Net Foreign Assets 1/	21,596	21,093	28,765	41,663	46,058	51,015	51,644	56,047	47,675	56,571	46,411	51,195	47,675	51,889
(NFA in DM m.)	1,028	937	1,251	1,389	1,535	1,701	1,721	1,868	1,589	1,886	1,547	1,706	1,589	1,730
Assets	26,921	27,068	34,916	50,300	55,681	60,601	61,246	65,648	61,303	70,215	64,083	68,881	69,389	73,618
NBY	11,975	11,751	17,375	24,628	32,587	38,430	39,327	43,414	38,197	46,793	40,977	45,459	46,282	50,197
Commercial banks	14,947	15,317	17,540	25,672	23,093	22,171	21,919	22,234	23,106	23,422	23,106	23,422	23,106	23,422
Liabilities (-) 2/	-5,325	-5,975	-6,151	-8,636	-9,623	-9,586	-9,601	-9,601	-13,628	-13,644	-17,671	-17,686	-21,714	-21,729
NBY	-5,325	-5,975	-6,151	-8,636	-9,623	-9,586	-9,601	-9,601	-13,628	-13,644	-17,671	-17,686	-21,714	-21,729
Net Domestic Assets	18,991	21,675	17,765	18,306	19,464	16,522	18,090	14,889	24,604	18,513 3/	28,226	29,198 3/	31,226	32,831 3/
Domestic credit	133,017	152,501	159,805	210,846	218,642	215,825	218,612	216,283	...	217,338	...	...	...	...
Net credit to government	6,869	7,627	6,962	10,066	5,917	1,788	1,440	-946	7,917	1,935 3/	9,917	11,336 3/	9,917	11,336 3/
Credit	10,521	11,645	12,363	15,347	15,367	14,710	14,752	14,538	...	15,056	...	...	...	...
Dinar credit	4,573	4,926	5,339	5,446	5,521	5,052	4,986	4,813	...	4,750	...	...	...	...
NBY	1,652	2,364	2,685	2,691	3,071	3,187	3,186	3,085	...	3,103	...	...	...	...
Commercial banks	2,921	2,562	2,654	2,756	2,450	1,865	1,800	1,728	...	1,647	...	...	...	...
Foreign currency credits	5,948	6,719	7,024	9,901	9,846	9,658	9,766	9,725	...	10,306	...	...	...	...
NBY	5,060	5,720	5,990	8,472	8,353	8,246	8,330	8,330	...	8,330	...	...	...	...
Commercial banks	887	999	1,034	1,429	1,493	1,412	1,436	1,395	...	1,976	...	...	...	...
Deposits	-3,652	-4,018	-5,402	-5,281	-9,450	-12,922	-13,312	-15,484	...	-13,121	...	...	...	...
Dinar credit	-2,448	-2,625	-3,854	-3,324	-4,745	-6,771	-7,492	-9,757	...	-8,271	...	...	...	...
NBY	-547	-498	-1,145	-702	-1,462	-3,608	-4,163	-5,669	...	-3,591	...	...	...	...
Commercial banks	-1,901	-2,127	-2,709	-2,622	-3,282	-3,163	-3,329	-4,088	...	-4,680	...	...	...	...
Foreign currency deposits	-1,204	-1,393	-1,548	-1,958	-4,705	-6,151	-5,820	-5,727	...	-4,850	...	...	...	...
NBY	-1,070	-1,170	-1,186	-1,680	-4,482	-5,976	-5,620	-5,549	...	-4,661	...	...	...	...
Commercial banks	-134	-223	-361	-278	-223	-175	-200	-178	...	-189	...	...	...	...
Credit to the non-government sector	126,148	144,874	152,844	200,780	212,725	214,037	217,172	217,230	...	215,403	...	...	...	...
Households	1,663	2,063	2,687	3,178	2,684	2,344	2,606	2,985	...	3,494	...	...	...	...
Non-profit and other sectors	3,662	7,130	7,037	8,184	24,409	24,828	25,446	25,734	...	26,280	...	...	...	...
Enterprises in dinar	20,719	23,118	25,334	28,674	31,189	34,468	35,696	38,044	...	37,593	...	...	...	...
Enterprises in foreign currency	100,104	112,563	117,786	160,744	154,444	152,397	153,424	150,466	...	148,036	...	...	...	...
Enterprises in foreign currency (DM million)	4,767	5,003	5,121	5,358	5,148	5,080	5,114	5,016	...	4,935	...	...	...	...
Other items, net.	-114,026	-130,826	-142,041	-192,539	-199,177	-199,303	-200,522	-201,395	...	-198,825	...	...	...	...
Broad Money (M2)	40,587	42,768	46,530	59,970	65,522	67,538	69,734	70,936	72,279	75,084	74,637	80,393	78,901	84,720
Dinar-denominated M2	18,229	19,277	21,054	25,752	32,588	35,244	37,037	39,075	38,521	43,543	40,591	48,236	44,319	51,497
M1	14,552	15,476	17,208	21,078	26,954	28,875	30,639	32,364	31,648	36,591	33,440	40,579	36,658	43,191
Currency outside banks	6,688	6,203	7,159	9,026	10,932	11,257	12,362	13,544	12,100	14,318	13,100	15,853	14,869	17,493
Demand deposit	7,864	9,273	10,049	12,051	16,022	17,618	18,277	18,820	19,548	22,273	20,340	24,726	21,789	25,697
Time and savings deposits	3,677	3,801	3,846	4,675	5,633	6,369	6,398	6,711	6,873	6,952	7,152	7,656	7,661	8,306
Foreign currency deposit (non-frozen)	22,358	23,491	25,476	34,218	32,935	32,294	32,697	31,861	33,758	31,541	34,046	32,157	34,581	33,224
Foreign currency deposit (not-frozen), (DM million)	1,065	1,044	1,108	1,141	1,098	1,076	1,090	1,062	1,125	1,051	1,135	1,072	1,153	1,107
Memorandum items:														
12-months growth rates (in percent)														
Broad Money (M2)	...	...	...	...	61.4	57.9	...	...	55.3	61.4	24.5	34.1	20.4	29.3
Dinar-denominated M2	...	...	...	...	78.8	82.8	...	...	83.0	106.8	57.6	87.3	36.0	58.0
M1	...	...	...	...	85.2	86.6	...	...	83.9	112.6	58.7	92.5	36.0	60.2
Currency outside banks	...	...	...	...	63.5	81.5	...	...	69.0	100.0	45.1	75.6	36.0	60.0
Velocity (M1)	12.9	15.0	16.0	15.1	13.4	15.4	15.4	15.4	16.6	14.4	18.2	15.0	18.9	16.0
Multiplier (M2/Reserve money)	4.3	4.3	4.3	4.2	3.3	3.4	3.3	3.1	3.4	3.0	3.3	3.0	3.2	2.9
Demand deposits/Required reserves	3.8	3.7	3.7	2.9	3.3	3.1	3.1	2.9	3.3	3.2	3.3	3.2	3.3	3.2
M1/Time and Saving Deposits	4.0	4.1	4.5	4.5	4.8	4.5	4.8	4.8	4.6	5.3	4.7	5.3	4.8	5.2
Foreign exchange deposit/Time deposit	6.1	6.2	6.6	7.3	5.8	5.1	5.1	4.7	4.9	4.5	4.8	4.2	4.5	4.0
Frozen foreign currency deposit (dinar million)	143,956	156,258	159,790	210,102	211,431	...	...	...	...	...	...	...	...	...
Frozen foreign currency deposit (DM million))	6,855	6,945	6,947	7,003	7,048	...	...	...	...	...	...	...	...	...

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

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

2/ Excluding frozen liabilities and liabilities that are likely to be rescheduled as part of Yugoslavia's negotiations with official creditors.

3/ Program ceiling.

Table 7A. Federal Republic of Yugoslavia: Consolidated General Government Fiscal Operations in 2000-2001

	Consolidated General Government Excluding Montenegro						Consolidated General Government Including Montenegro					
	2000	2001		2000	2001		2000	2001		2000	2001	
		Prog.	Rev. Prog.		Prog.	Rev. Prog.		Prog.	Rev. Prog.		Prog.	Rev. Prog.
	(Billion dinars)			(Percent of GDP) 2/			(Billion dinars)			(Percent of GDP) 2/		
Total revenue	128.8	250.8	251.7	35.6	36.5	36.4	140.2	274.3	275.2	38.8	39.9	39.8
Current revenue	128.8	250.3	251.2	35.6	36.4	36.3	140.2	273.2	274.0	38.8	39.7	39.7
Tax revenue	115.7	229.9	235.5	32.0	33.4	34.1	126.4	251.6	257.2	35.0	36.6	37.2
Personal income tax	12.4	25.5	27.3	3.4	3.7	4.0	12.7	26.2	28.1	3.5	3.8	4.1
Social security contributions	39.7	73.2	70.5	11.0	10.6	10.2	44.8	83.9	81.2	12.4	12.2	11.8
Corporate income tax	1.1	2.1	3.1	0.3	0.3	0.4	1.1	2.1	3.1	0.3	0.3	0.4
Retail sales tax	29.4	57.5	63.4	8.1	8.4	9.2	32.9	63.8	69.8	9.1	9.3	10.1
Excises	9.9	25.1	22.3	2.7	3.7	3.2	9.9	25.1	22.3	2.7	3.7	3.2
Taxes on international trade and operations	8.5	14.1	14.1	2.4	2.1	2.0	10.3	17.8	17.8	2.9	2.6	2.6
Other taxes	14.6	32.4	34.7	4.0	4.7	5.0	14.7	32.5	34.9	4.1	4.7	5.1
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
Nontax revenue	13.1	20.4	15.7	3.6	3.0	2.3	13.8	21.6	16.9	3.8	3.1	2.4
Capital revenue	0.0	0.5	0.5	0.0	0.1	0.1	0.0	1.1	1.1	0.0	0.2	0.2
Total expenditure and net lending	129.6	289.7	276.2	35.8	42.1	40.0	143.6	316.1	302.8	39.7	46.0	43.8
Current expenditure	118.6	261.4	258.5	32.8	38.0	37.4	131.2	284.8	282.2	36.3	41.4	40.8
Expenditure on goods and services	61.6	123.5	127.2	17.0	18.0	18.4	66.4	133.0	136.7	18.4	19.3	19.8
Wages and salaries	33.4	64.5	63.0	9.2	9.4	9.1	36.0	71.1	69.5	10.0	10.3	10.1
Other purchases of goods and services	28.2	59.0	64.2	7.8	8.6	9.3	30.4	62.0	67.2	8.4	9.0	9.7
Interest payment	2.2	6.7	2.9	0.6	1.0	0.4	2.2	6.7	2.9	0.6	1.0	0.4
Subsidies and other current transfers	54.8	131.1	128.4	15.1	19.1	18.6	62.5	145.0	142.5	17.3	21.1	20.6
Subsidies	7.1	21.8	22.7	2.0	3.2	3.3	8.1	22.5	23.6	2.2	3.3	3.4
Transfers to households	47.7	109.4	105.7	13.2	15.9	15.3	54.5	122.6	118.9	15.1	17.8	17.2
Capital expenditure	11.0	23.6	9.9	3.0	3.4	1.4	11.8	24.8	11.1	3.3	3.6	1.6
General reserves	0.0	3.0	7.8	0.0	0.4	1.1	0.3	4.3	9.0	0.1	0.6	1.3
Lending minus repayment	0.0	1.7	0.0	0.0	0.2	0.0	0.3	2.2	0.5	0.1	0.3	0.1
Net transfer to other levels of government	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.2	0.0	0.0	0.0	0.0
Overall balance	-0.8	-38.9	-24.5	-0.2	-5.7	-3.5	-3.4	-42.0	-27.6	-0.9	-6.1	-4.0
Foreign grants	0.1	5.2	5.2	0.0	0.8	0.8	2.8	8.1	8.1	0.8	1.2	1.2
Overall balance including grants	-0.7	-33.7	-19.3	-0.2	-4.9	-2.8	-0.6	-33.9	-19.5	-0.2	-4.9	-2.8
Statistical discrepancy	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing	0.7	33.7	19.3	0.2	4.9	2.8	0.6	33.9	19.5	0.2	4.9	2.8
Domestic financing	0.7	4.0	5.4	0.2	0.6	0.8	0.6	4.1	5.5	0.2	0.6	0.8
Bank financing	0.3	4.0	5.4	0.1	0.6	0.8	0.3	4.1	5.5	0.1	0.6	0.8
NBY	0.3	4.0	5.4	0.1	0.6	0.8	0.3	4.0	5.4	0.1	0.6	0.8
Commercial banks	0.0	0.0	0.0	0.0	0.0	0.0	-0.1	0.2	0.2	0.0	0.0	0.0
Non-bank financing	0.4	0.0	0.0	0.1	0.0	0.0	0.4	0.0	0.0	0.1	0.0	0.0
Foreign Financing	0.0	19.9	10.7	0.0	2.9	1.6	0.0	19.9	10.7	0.0	2.9	1.6
Privatization receipts	0.0	9.7	3.0	0.0	1.4	0.4	0.0	9.7	3.0	0.0	1.4	0.4
Accumulation of expenditure arrears	7.5	0.0	0.0	2.1	0.0	0.0	7.5	0.0	0.0	2.1	0.0	0.0
Overall commitment balance excluding foreign grants	-8.3	-38.9	-24.5	-2.3	-5.7	-3.5	-10.9	-42.0	-27.6	-3.0	-6.1	-4.0

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

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

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

Table 7B. Federal Republic of Yugoslavia: Federal Government Fiscal Operations, 1997-2001

(In percent of GDP) 1/

	1997	1998	1999	2000		2001			
				Budget	Actual	Budget	Prog.	Rev. Prog.	Prel. Jan. - Jun.
A Total revenue and grants (1+2)	6.6	6.1	7.0	8.1	7.5	7.6	6.7	6.6	2.7
1 Total revenue (1.1+1.2)	6.6	6.1	7.0	8.1	7.5	7.6	6.7	6.6	2.7
1.1 Current revenue (1.1.1+1.1.2)	6.6	6.1	7.0	8.1	7.5	7.6	6.7	6.6	2.7
1.1.1 Tax revenue (1.1.1.1+1.1.1.2+1.1.1.3)	5.3	5.2	5.7	7.1	6.7	6.3	5.8	5.7	2.6
1.1.1.1 Turnover (retail sales) tax	2.1	2.4	2.5	3.3	4.2	3.7	3.5	3.4	1.6
1.1.1.2 Taxes on international trade and operations	2.7	2.3	2.3	3.2	2.4	2.4	2.1	2.0	0.7
1.1.1.3 Other taxes	0.5	0.4	0.3	0.6	0.2	0.3	0.2	0.2	0.3
1.1.1.4 Extrabudgetary taxes	0.0	0.0	0.6	0.0	0.0	0.0	0.0	0.0	0.0
1.1.2 Nontax revenue	1.4	0.9	1.2	1.0	0.8	1.3	0.9	0.9	0.2
1.2 Capital revenue	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
2 Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
B Total expenditure and net lending (1+2)	6.6	6.1	7.0	8.1	7.5	7.6	6.5	6.6	2.7
1 Total expenditure (1.1+1.2)	6.6	6.1	7.0	8.1	7.4	7.4	6.2	6.4	2.6
1.1 Current expenditure (1.1.1+1.1.2)	6.6	6.1	7.0	8.1	7.4	7.3	6.1	6.4	2.6
1.1.1 Interest	0.0	0.0	0.0	0.2	0.1	0.1	0.1	0.1	0.0
1.1.2 Non-interest (1.1.2.1+1.1.2.2+1.1.2.3+1.1.2.4)	6.6	6.1	7.0	7.9	7.3	7.2	6.1	6.3	2.6
1.1.2.1 General Government Services	0.8	0.9	0.9	0.9	0.8	1.2	1.0	0.7	0.3
1.1.2.2 Defense	4.8	4.2	5.2	5.9	5.0	4.7	4.0	3.8	1.5
1.1.2.3 Social Insurance and Social Security Transfers	0.6	0.5	0.5	0.6	1.2	1.1	1.1	1.6	0.7
1.1.2.5 Other non-interest expenditure	0.4	0.4	0.4	0.5	0.3	0.1	0.0	0.2	0.1
1.2 Capital expenditure	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.0	0.0
2 Net lending	0.0	0.0	0.0	0.0	0.1	0.2	0.3	0.2	0.1
Overall budget balance (cash) (A-B)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing (1+2+3)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
1 Domestic financing (net) (1.1+1.2)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
1.1 Banking system (1.1.1+1.1.2)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
1.1.1 National Bank of Yugoslavia	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
1.1.2 Commercial banks	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
1.2 Nonbank	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
2 Foreign financing (net) (2.1-2.2)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
2.1 Disbursements	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
2.2 Amortization	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
3 Privatization receipts	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:									
Nominal GDP (billion Dinars)	112.3	154.6	188.0	279.4	361.6	604.0	687.5	691.1	691.1
Modified overall balance including newly accumulated arrears	...	...	...	...	-1.1	...	...	...	...

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

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

Table 7C. Serbia: Republican Government Fiscal Operations, 1997-2001
(In percent of GDP) 1/

	1997	1998	1999	2000		2001			
				Budget	Actual	Budget	Program	Rev. Prog.	Prel. Jan.-Jun.
A Total revenue and grants (1+2)	**12.3**	**10.9**	**9.4**	**10.4**	**13.7**	**16.3**	**15.8**	**16.1**	**6.8**
1 Total revenue (1.1+1.2)	12.3	10.9	9.4	10.4	13.6	15.7	15.3	15.6	6.8
1.1 Current revenue (1.1.1+1.1.2)	12.3	10.9	9.4	10.4	13.6	15.7	15.3	15.6	6.8
1.1.1 Tax revenue (1.1.1.1+...+1.1.1.6)	12.3	10.9	9.4	10.4	12.2	15.5	14.5	15.6	6.8
1.1.1.1 Personal income tax	6.4	4.8	3.7	4.2	3.4	3.7	3.6	3.7	1.6
1.1.1.2 Corporate income tax	0.3	0.3	0.5	0.6	0.3	0.3	0.3	0.4	0.2
1.1.1.3 Turnover (retail sales) tax	3.6	3.1	3.1	3.4	3.4	4.3	4.0	4.8	2.1
1.1.1.4 Excises	1.0	0.8	0.5	1.2	2.2	3.7	3.7	3.2	1.3
1.1.1.5 Property taxes	0.3	0.4	0.4	0.4	0.2	0.0	0.0	1.2	0.6
1.1.1.6 Other taxes	0.7	1.5	1.1	0.7	2.7	3.5	2.9	2.1	1.0
1.1.2 Nontax revenue	0.0	0.0	0.0	0.0	1.4	0.2	0.8	0.0	0.0
1.2 Capital revenue	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
2 Grants	0.0	0.0	0.0	0.0	0.0	0.6	0.6	0.5	0.0
of which grants for the budget for recovery and restructuring	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
B. Total expenditure and net lending (1+5)	**12.3**	**10.9**	**9.4**	**10.4**	**14.0**	**18.9**	**20.7**	**18.9**	**6.4**
1. Total expenditure (2+3+4)	12.3	10.9	9.4	10.4	14.0	18.9	20.7	18.9	6.4
2 Current expenditure (2.1+2.2+2.3)	12.0	10.8	8.9	10.1	12.2	17.0	17.3	16.8	6.2
2.1. Expenditure on goods and services (2.1.1+...+2.1.4)	9.8	9.1	8.0	8.3	6.7	7.6	7.8	7.3	5.0
2.1.1 Wages and salaries	4.5	3.6	3.8	3.9	3.7	4.0	4.0	3.6	1.5
2.1.2 Employer contribution	1.4	1.1	1.2	1.0	0.9	0.9	0.9	0.9	0.4
2.1.2.1 Contribution	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.7	0.3
2.1.2.2 Tax	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.1
2.1.3 Severance payments	0.0	0.0	0.0	0.0	0.0	0.2	0.2	0.1	0.0
2.1.4 Other purchases of goods and services	3.9	4.4	3.0	3.3	2.1	2.6	2.7	2.7	2.7
2.2. Interest payment	0.1	0.3	0.2	0.1	0.1	0.8	0.7	0.1	0.1
2.3. Subsidies and other current transfers	2.1	1.4	0.8	1.7	5.3	8.6	8.9	9.4	1.2
2.3.1 Subsidies	0.0	0.0	0.0	0.0	2.0	2.4	2.3	2.8	0.0
2.3.2 Transfers to households	2.0	1.3	0.8	1.3	1.4	3.2	3.1	2.8	0.3
of which repayment for frozen foreign currey deposit	0.0	0.0	0.0	0.0	0.0	0.8	0.7	0.6	0.3
2.3.3 Current transfers to other levels of government	0.1	0.1	0.0	0.3	1.9	3.0	3.4	3.8	0.9
Federal budget	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Republican budget	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Local Budgets	0.1	0.1	0.0	0.3	0.5	0.1	0.1	0.1	0.1
Pension Funds	0.0	0.0	0.0	0.0	1.4	2.4	2.5	2.6	0.7
Health Fund	0.0	0.0	0.0	0.0	0.0	0.3	0.3	0.6	0.1
Labor Market Fund	0.0	0.0	0.0	0.0	0.0	0.2	0.4	0.4	0.0
3. Capital expenditure	0.3	0.1	0.4	0.3	1.8	0.7	2.9	0.9	0.0
of which budget for recovery and reconstruction	0.0	0.0	0.0	0.0	0.0	0.0	2.3	0.5	0.0
4. General reserves	0.0	0.0	0.0	0.0	0.0	1.2	0.4	1.1	0.2
5. Lending minus repayment	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall budget balance (cash) (A-B)	**0.0**	**0.0**	**0.0**	**0.0**	**-0.3**	**-2.6**	**-4.9**	**-2.8**	**0.4**
Core balance 2/	0.0	0.0	0.0	0.0	-0.3	-2.6	-2.6	-2.3	0.4
Balance of the budget for recovery and reconstruction 3/	0.0	0.0	0.0	0.0	0.0	0.0	-2.3	-0.5	0.0
Statistical Discrepancy	0.0	0.5	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Financing (1+2+3+4)	0.0	0.5	0.2	0.0	0.3	2.6	4.9	2.8	-0.4
1 Domestic financing (net) (1.1+1.2)	0.0	0.5	0.2	0.0	0.3	0.6	0.6	0.8	-0.4
1.1 Banking system (1.1.1+1.1.2)	0.0	0.5	0.2	0.0	0.2	0.6	0.6	0.8	-0.4
1.1.1 National Bank of Yugoslavia	0.0	0.1	0.2	0.0	0.2	0.6	0.6	0.8	-0.2
1.1.2 Commercial banks	0.0	0.3	0.0	0.0	0.0	0.0	0.0	0.0	-0.2
1.2 Nonbank	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0
2 Foreign financing (net) (2.1-2.2)	0.0	0.0	0.0	0.0	0.0	0.6	2.9	1.6	0.0
2.1 Disbursements	0.0	0.0	0.0	0.0	0.0	0.6	2.9	1.6	0.0
2.2 Amortization	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
3 Privatization receipts	0.0	0.0	0.0	0.0	0.0	1.4	1.4	0.4	0.0
Memorandum items:									
Nominal GDP (billion Dinars)	112.3	154.6	188.0	279.4	361.6	685.0	687.5	691.1	691.1

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

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

Table 7D. Montenegro: Republican Government Fiscal Operations, 2000-2001
(In percent of GDP)

	2000	2001			
		Budget	Jan-Dec Rev.Prog.	Jan-Mar Prelim	Jan-June Prelim
A Total revenue and grants (1+2)	**37.2**	**28.6**	**28.7**	**6.2**	**12.1**
1 Total revenue (1.1+1.2)	28.8	24.8	24.8	5.7	11.0
1.1 Current revenue (1.1.1+1.1.2)	28.8	24.8	24.8	5.7	11.0
1.1.1 Tax revenue (1.1.1.1+1.1.1.2+1.1.1.3+1.1.1.4)	23.4	21.3	21.6	4.6	9.4
1.1.1.1 Personal income	6.8	6.9	6.9	1.5	3.1
1.1.1.2 Turnover (retail sales) tax	4.8	6.9	7.0	1.2	2.7
1.1.1.3 Excises	7.4	4.2	3.9	0.7	1.7
1.1.1.4 Other taxes	4.4	3.2	3.7	1.2	1.9
1.1.2 Nontax revenue	5.4	3.5	3.2	1.1	1.6
1.2 Capital revenue	0.0	0.0	0.0	0.0	0.0
2 Grants	8.3	3.8	3.9	0.4	1.1
B Total expenditure and net lending (1+2)	**37.0**	**28.6**	**28.3**	**7.6**	**14.7**
1 Total expenditure (1.1+1.2)	37.0	28.2	28.0	7.7	14.5
1.1 Current expenditure (1.1.1+1.1.2)	32.4	26.0	26.4	7.0	13.3
1.1.1 Interest	0.2	0.1	0.2	0.0	0.0
1.1.2 Non-interest (1.1.2.1+1.1.2.2+1.1.2.3+1.1.2.4)	32.2	25.9	26.2	7.0	13.2
1.1.2.1 wages and salaries	15.6	14.7	13.8	2.6	5.2
1.1.2.2 goods and services	0.0	4.9	4.8	1.7	3.1
1.1.2.3 Social Insurance and Social Security Transfers	3.9	3.9	5.2	1.8	3.2
1.1.2.4 Other non-interest expenditure	12.8	1.0	1.1	0.3	0.8
1.2 Capital expenditure	4.6	2.3	1.6	0.7	1.2
2 Net lending	0.0	0.3	0.3	-0.1	0.3
C Net transfer to other levels of government (1+3-2-4)	**0.1**	**0.0**	**0.0**	**0.0**	**0.0**
1 Transfers to lower levels of government	0.1	0.0	0.0	0.0	0.0
2 Transfers from lower levels of government	0.0	0.0	0.0	0.0	0.0
3 Transfers to extra-budgetary social security funds	0.0	0.0	0.0	0.0	0.0
4 Transfers from extra-budgetary funds	0.0	0.0	0.0	0.0	0.0
Overall budget balance excluding grants (cash) (A-B-C-2)	**-8.3**	**-3.8**	**-3.5**	**-1.9**	**-3.8**
Overall budget balance (cash) (A-B-C)	0.0	0.0	0.4	-1.4	-2.7
Financing (1+2+3)	0.0	0.0	0.0	1.4	2.7
1 Domestic financing (net) (1.1+1.2)	0.0	0.0	0.0	1.4	2.7
1.1 Banking system (1.1.1+1.1.2)	0.0	0.0	0.0	1.4	2.7
1.1.1 National Bank of Yugoslavia	0.0	0.0	0.0	0.0	0.0
1.1.2 Commercial banks	0.0	0.0	0.0	1.4	2.7
1.2 Nonbank	0.0	0.0	0.0	0.0	0.0
2 Foreign financing (net) (2.1-2.2)	0.0	0.0	0.0	0.0	0.0
2.1 Disbursements	0.0	0.0	0.0	0.0	0.0
2.2 Amortization	0.0	0.0	0.0	0.0	0.0
3 Privatization receipts	0.0	0.0	0.0	0.0	0.0
Memorandum items:					
Nominal GDP (million DM)	1300.0	1570.0	1570.0	1570.0	1570.0

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

Table 8. Federal Republic of Yugoslavia: Indicators of External Vulnerability 1998-2001 1/
(In percent of GDP, unless otherwise indicated)

	1998	1999	2000 Est.	2001 Rev. prog.
Financial indicators				
Public sector debt	...	...	180.1	161.0
Broad money (percent change, 12-month basis)	69.4	67.6	61.4	28.6
Private sector credit (percent change, 12 month basis)	...	128.4	68.6	...
Weighted interest rates (percent per month, December) 2/	7.0	3.9	6.8	...
Retail prices (percent per annum, e.o.p.)	...	49.9	113.5	35
External Indicators				
Exports (percent change, 12-month basis in US$)	24.0	-44.7	14.7	3.4
Imports (percent change, 12-month basis in US$)	1.0	-32.0	14.4	20.9
Terms of Trade (percent change, 12 month basis)	-2.6	-4.4	0.0	1.0
Current account balance, before grants	-4.8	-7.5	-8.3	-14.8
Current account balance after grants and FDI	-3.9	-6.4	-4.6	-8.2
Errors and omissions	2.0	4.0	3.6	2.9
Gross official reserves (in US$ millions)	326	293	516	933
(in months of imports GS of the following year)	1.1	0.9	1.3	2.1
Central Bank short-term foreign liabilities (in US$ millions) 3/	0	0	0	0
Gross reserves of the banking system (in US$ millions)	774	659	882	1,280
(in months of imports GS of the following year)	2.6	1.9	2.2	2.9
Short term foreign liabilities of the commercial banks (in US$)	...	...	663	663
Foreign currency liabilities of the commercial banks (in US $)	...	...	4,345	4,371
Official reserves/Broad money (M2) (percent)	18	30	50	60
Official reserves/Narrow money (M0) (percent)	59	126	164	174
Total short term external debt by original maturity (in US$ millions)	...	...	1,164	1,164
Total short term external debt by remaining maturity (in US$ millions)	...	...	1,365	1,417
Total short term external debt to reserves by original maturity (in percent)	...	...	225.6	124.8
Total short term external debt to total debt by original maturity (in percent)	...	...	10.2	9.5
Total short term external debt to total debts by remaining maturity (in percent)	...	...	11.9	11.6
Total short term external debt to reserves by remaining maturity (in percent)	...	...	132.0	91.0
Total external debt (in US$ millions)	...	...	11,460	12,226
Of which : Public and Publicly guaranteed debt 4/	...	...	10,296	11,062
Total external debt (in percent of exports of G&S)	...	...	449.9	450.5
External interest payments, cash basis (in percent of exports of G&S)	...	...	1.6	4.8
External amortization payments, cash basis (in percent of exports of G&S)	...	...	0.0	0.4
Exchange rate, official (per DM, end of period)	6	6	30	...
Exchange rate, parallel (per DM, end of period)	8	21	30	...
REER (annual average, February-December 1994 = 100) 5/	91.7	66.9	51.4	80.0

Sources: Yugoslav authorities; and Fund staff estimates.

1/ All stocks are measured end-of-period.
2/ Weighted interest rates on commercial paper, bank bills, and certificates of deposit.
3/ Excluding IMF.
4/ Assuming all long- and medium-term external bank debt to official creditors is government guaranteed.
5/ Increase denotes Appreciation.

Table 9. Federal Republic of Yugoslavia: External Financing Requirements and Sources, 1998-2001
(In millions of U.S. dollars)

	1998	1999	2000	2001 Rev. prog.
1. Gross financing requirements	-720	-818	-1,074	-11,287
External current account deficit (excluding official transfers)	-660	-764	-671	-1,489
Debt amortization	-60	-54	-47	-102
Medium- and long-term debt	-25	-17	-14	-102
Public sector	...	...	...	-41
Multilateral 1/	...	...	...	-33
Bonds and notes	...	...	...	0
Other	...	...	...	-8
Commercial banks and corporate private sector	...	...	...	-61
Short-term debt 2/	-35	-37	-33	0
Repayment of arrears	0	0	0	-9,416
Gross reserve accumulation	0	0	-227	-279
IMF repurchases and repayments	0	0	-129	0
2. Available financing	720	818	1,074	1,019
Official grants	0	0	271	550
Foreign direct investment (net)	113	112	25	120
Debt financing from private creditors	78	30	49	-6
Medium and long-term financing	78	30	49	0
To public sector	0	0	0	0
Of which : Balance of payments financing 3/	0	0	0	0
To commercial banks	26	19	8	0
To corporate private sector	52	11	41	0
Short-term financing and other capital inflows	0	0	0	-6
Official creditors	50	29	227	70
Multilateral 1/	...	...	...	...
Of which : Balance of payments financing	...	...	...	...
Bilateral	...	...	...	...
To public sector	...	...	...	...
Of which : Balance of payments financing	...	...	...	...
To private sector	...	...	...	...
IMF (for 2001, presented as part of exceptional financing)	0	0	150	0
Accumulation of arrears (exceptional)	86	126	62	0
Other flows 4/	393	521	290	285
3. Financing gap	0	0	0	10,268
Program and project assistance	0	0	0	722
World Bank	0	0	0	85
IMF	0	0	0	192
EBRD	0	0	0	30
EU	0	0	0	260
Other bilateral support	0	0	0	80
Project assistance				75
Debt relief	0	0	0	9,546
4. Residual Financing Gap	...	...	...	0

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

1/ Including IMF for 2001.

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

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

4/ Includes errors and ommissions and change in net foreign assets of commercial banks.

Table 10. Federal Republic of Yugoslavia: Indicators of Capacity to Repay the Fund, 2000-2007

	2000	2001	2002	2003	2004	2005	2006	2007
		Projections 1/						
Fund repurchases and charges 2/								
In millions of SDRs	...	7.3	15.4	16.3	92.7	163.2	85.9	8.1
In millions of U.S. dollars	...	9.4	19.3	20.4	116.5	205.5	108.3	10.2
In percent of exports of goods and NFS	...	0.3	0.6	0.6	2.8	4.3	2.0	0.2
In percent of debt service	...	2.0	2.0	2.0	9.7	12.8	5.8	0.5
In percent of quota	...	1.6	3.3	3.5	19.8	34.9	18.4	1.7
In percent of gross official reserves	...	1.0	1.6	1.4	6.8	10.4	4.8	0.4
Fund credit outstanding								
In millions of SDRs	116.9	266.9	316.9	316.9	239.7	87.5	6.3	0.0
In millions of U.S. dollars	154.2	344.8	396.8	397.4	301.3	110.2	7.9	0.0
In percent of quota	25.0	57.1	67.8	67.8	51.3	18.7	1.3	0.0
In percent of GDP	1.9	3.4	3.6	3.2	2.2	0.8	0.1	0.0
In percent of gross official reserves	29.9	37.0	33.5	27.7	17.6	5.6	0.3	0.0
Memorandum items:								
Exports of goods and NFS (millions of US$)	2,547	2,714	3,142	3,637	4,211	4,832	5,472	6,024
Debt service (millions of US$)	56	463	959	1,046	1,201	1,602	1,852	2,039
Quota (millions of SDRs)	468	468	468	468	468	468	468	468
Quota (millions of US$)	617	604	586	586	588	589	590	590
Gross official reserves (millions of US$)	516	933	1,183	1,433	1,708	1,983	2,278	2,480
GDP (millions of US$)	8,071	10,045	10,974	12,238	13,472	14,530	15,663	16,821
U.S. dollar per SDR	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3

Sources: Yugoslav authorities and Fund staff estimates.

1/ As of August, 2001.
2/ Arrears to the Fund of SDR 101 million were cleared on December 20, 2000.

Table 11. Federal Republic of Yugoslavia: Schedule of Purchases
Under the Stand-By Arrangement

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

1/ The quota is SDR 467.7 million.

Federal Republic of Yugoslavia: Fund Relations
As of June 30, 2001

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

II. **General Resources Account:**	SDR Million	%Quota
Quota	467.70	100.0
Fund Holdings of Currency	634.64	135.0

III. **SDR Department:**	SDR Million	%Allocation
Net cumulative allocation	56.66	100.0
Holdings	11.02	19.4

IV. **Outstanding Purchases and Loans:**	SDR Million	%Quota
First Credit Tranche	116.9	25.0
Stand-by arrangement	50.0	10.7

V. **Financial Arrangements:**

Type	Approval Date	Expiration Date	Amount Approved	Amount Drawn
Emergency Post Conflict Assistance	12/20/00	...	SDR 116.9 million	SDR 116.9 million
SBA	6/11/01	3/31/02	SDR 200.0 million	SDR 50.0 million

VI. **Projected Obligations to Fund:**[1] (SDR Million; based on existing use of resources and present holdings of SDRs):

	Overdue	Forthcoming				
	03/31/2001	2001	2002	2003	2004	2005
Principal					58.5	58.5
Charges/Interest		5.5	7.2	7.2	6.4	3.8
Total		5.5	7.2	7.2	64.9	62.3

VII. **Safeguards Assessments:**

Under the Fund's safeguards assessment policy, the National Bank of Yugoslavia is subject to a full Stage One safeguards assessment with respect to the Stand-By Arrangement approved on June 11, 2001, which is scheduled to expire on March 3, 2002.

A Stage One safeguards assessment of the National Bank of Yugoslavia is underway.

[1] The projection of charges and interest assumes that overdue principal at the report date (if any) will remain outstanding, but forthcoming obligations will be settled on time.

VIII. **Exchange Arrangement**

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

IX. **Last Article IV Consultation**

No consultation discussions have yet been held with FRY.
The authorities have requested a ROSC Data Module mission.

X. **Technical Assistance**

Department	**Timing**	**Purpose**
FAD	February 2001	Tax policy and administration
FAD	March 2001	Public expenditure management
FAD	April 2001	Tax administration
MAE	November 2000	Diagnostic mission
MAE	December 2000	Diagnostic mission: Monetary policy instruments Bank supervision Payments system Foreign exchange operations and reserves management Development of money and securities markets
MAE	February 2001	Banking supervision and restructuring
MAE	April 2001	Diagnostic mission: Bank restructuring Monetary and foreign exchange dev.
MAE	July 2001	Banking supervision and restructuring.
STA	February 2001	Money and banking statistics

XI. **Resident Representative**

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

Federal Republic of Yugoslavia: Relations with the World Bank Group

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

2. The conditions for FRY's membership were that it would: (i) become a member of the IMF; (ii) accept the Bank's Articles of Agreement and the terms and conditions of subscription to the shares of Bank capital to which it succeeds; (iii) make local currency payments as necessary with respect to shares to which it succeeds; (iv) enter into final agreement with the Bank on the loans of the SFRY it assumes; and (v) eliminate or agree with the Bank on a plan to eliminate the arrears in the servicing of the Bank loans it has assumed.[1]

3. As of December 31, 2000, the stock of arrears of the FRY to the IBRD amounted to US$1.7 billion. The plan for arrears resolution agreed to as a condition of membership provides for the exceptional consolidation of FRY's arrears into a new package of IBRD loans. As part of the membership package the Bank's Board of Directors approved temporary exceptional IDA eligibility for FRY, allowing up to US$540 million in new IDA loans over the next three years, once arrears have actually been cleared. The consolidation package resolving arrears is expected to be finalized in the second half of 2001.

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

5. In the context of the membership package the Bank's Board of Directors also endorsed a Transitional Support Strategy (TSS) that provides the framework for World Bank assistance to FRY in FY02. A total of up to US$200 million in IDA resources could be

[1] These same conditions were also met by the other successor states of the SFRY (Bosnia and Herzegovina, Croatia, the former Yugoslav Republic of Macedonia and Slovenia) prior to membership in the World Bank.

provided as credits to FRY in FY02, with up to US$160 million as quick-disbursing assistance in support of priority reforms in the areas of fiscal management, private sector development and banking reform. Up to US$40 million would also be provided in support of investment operations in FY02. In addition, the strategy provides for advisory activities including a Public Expenditure Review, household survey work preparatory to a Poverty Assessment (and to the government's planned Interim Poverty Reduction Strategy Paper), and a Private Sector Development Strategy (in conjunction with the IFC and EBRD).

Federal Republic of Yugoslavia: Statistical Issues

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

A. Real Sector

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

3. National accounts on a material basis are compiled annually with approximately a half-year delay. National accounts in accordance with the *SNA* methodology have been compiled regularly and with increasing elaboration since 1994, but with substantial delays; the latest available data refer to 1998. The *SNA* methodology appears to be adequately implemented at present, but the source data—enterprise income statements—suffer from serious deficiencies due to nonstandard accounting rules and misreporting. The three major sources of distortion in the estimates of production are incomplete coverage, use of official exchange rates for the recording of all transactions when in the past most transactions were carried out at gray market rates, and overstatement of stock accumulation due to valuation inaccuracies. Price statistics are compiled on a number of price baskets, notably the retail price index, cost of living index, industrial producers' price index and others. While frequency and methodology of observation appear adequate, weighting, data storage, and dissemination could be improved.

B. Balance of Payments

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

of payments statistics suffer from substantial underrecording owing to the large proportion of foreign exchange transactions carried outside official channels and underreporting of external trade. During 2001, the NBY expended commendable efforts to improve its estimation of actual flows based on existing data.

C. Government Finance

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

D. Monetary Accounts

6. Monetary statistics are prepared by the NBY based on the Yugoslav chart of accounts that deviates substantially from international standards. Considerable effort has been devoted by the Fund, during four EU1 missions during 2000–01 and one STA mission in 2001, in preparing monetary statistics that approximate Fund standards. The STA mission reviewed procedures for collecting and compiling monetary statistics. The mission concluded that, while a good institutional base existed for monetary data collection and compilation, major enhancements were needed to ensure closer conformity with internationally accepted practices. The mission initiated preparatory work to facilitate implementation of the framework for monetary statistics recommended in the *Money and Financial Statistics Manual (MFSM)* and made specific recommendations in a number of areas, including as regards the sectorization and classification of existing accounts. Further technical assistance in this area is required. Future improvements in the quality of monetary statistics will be largely contingent upon the implementation of a new chart of accounts for financial institutions reflecting modern accounting standards. As Montenegro no longer reports monetary data to the NBY, and because it has adopted the DM as legal tender, it is in the process of establishing its own monetary statistical database with technical assistance from USAID.

Federal Republic of Yugoslavia: Core Statistical Indicators
(As of August 24, 2001)

	Exchange rates	Inter-national Reserves	Central Bank Balance Sheet	Reserve Money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Government Balance	Gross Social Product	External Debt/ Debt Service
Date of Latest Observation	Aug. 20, 2001	Aug. 3, 2001	July 30, 2001	Aug. 14, 2001	July 30, 2001	June 1, 2001	July 31, 2001	June 30, 2001	June 30, 2001	June 30, 2001	Dec. 31, 1999	May 31, 2001
Date Received	Aug. 21, 2001	Aug. 8, 2001	Aug. 20, 2001	Aug. 16, 2001	Aug. 20, 2001	July 20, 2001	Aug. 6, 2001	July, 2001	July, 2001	July 15, 2001		July, 2001
Frequency of Data	Daily	Daily	Monthly	Daily	Monthly	Daily	Monthly	Monthly	Monthly	Monthly	Annually	Monthly
Frequency of Reporting	Weekly	Weekly	Monthly	Weekly	Monthly	Weekly	Monthly	Monthly	Monthly	Monthly	Annually	Monthly
Source of Update	NBY	NBY	NBY	NBY	NBY	NBY	FBS	FBS	FBS	Ministries of Finance of the FRY, Serbia, and Montenegro	FBS	NBY
Mode of Reporting	Report to the Fund	Report to the Fund	Report to the Fund	Report to the Fund	Report to the Fund	Report to the Fund	Website	Website	Website	Report to the Fund	Website	NBY
Confidentiality	Public	Confi-Dential	Confi-dential	Confi-dential	Confi-dential	Public	Public	Public	Public	Public	Public	Confiden-tial
Frequency of Publication	Daily	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Annually	Annually	Monthly

September 4, 2001

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

Dear Mr. Köhler:

The implementation of policies under our stabilization and reform program for 2001, which is supported by a stand-by arrangement approved on June 11, has been firm, setting the basis for continued reforms and a sustained improvement in the living standards of our citizens. The attached Revised Memorandum of Economic and Financial Policies—which updates and supplements the Memorandum attached to our letter of May 25, 2001—describes our economic objectives and policies for the remainder of this year. On this basis, we request: (a) a waiver for the nonobservance of a performance criterion on new non-concessional external debt for end-June; and (b) completion of the first review under the stand-by arrangement.

We believe that the policies and measures described in the attached memorandum are sufficient to achieve the program objectives, but we stand ready to take additional measures and seek new understandings with the Fund, if necessary, to keep the program on track. We will remain in close consultation with the Fund in accordance with the Fund's policies on such consultations, and will provide the Fund with all information that it requests to assess the implementation of the program. The program will be reviewed by the Fund by November 15, 2001, and February 15, 2002. The next review will be the occasion for reaching understandings on bank restructuring, the basic parameters of fiscal policy for 2002, and electricity pricing policy.

Yours sincerely,

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

Mladjan Dinkic
Governor
National Bank of Yugoslavia

Bozidar Djelic
Minister of Finance
Republic of Serbia

Miroslav Ivanisevic
Minister of Finance
Republic of Montenegro

FEDERAL REPUBLIC OF YUGOSLAVIA

REVISED MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

I. Introduction

1. This memorandum updates and supplements the Memorandum of Economic and Financial Policies (MEFP) attached to the Letter of Intent of May 25, 2001. It reports on economic performance and policy implementation so far under the Fund-supported program for 2001 and updates as needed the economic objectives and policy agenda under the program for the remainder of this year. Annex A to this memorandum describes the quantitative performance criteria and indicative limits for the remainder of the program; Annex B lists the prior actions and preconditions for consideration of the review by the IMF Executive Board, and the structural performance criteria and benchmarks for the remainder of the program; and Annex C defines the performance criteria and indicative targets and describes the reporting arrangements.

II. Background

2. **Policies under the program have been firmly implemented, thereby creating the necessary conditions for continued reforms and improved living standards.** Fiscal and monetary policies have been on track for FRY as a whole, despite a higher than envisaged fiscal deficit in Montenegro. In Serbia, a major fiscal reform has been put in place, involving the streamlining of a complex tax system and the integration of a large number of extrabudgetary programs into the budget; the extremely restrictive foreign exchange and trade systems have been almost completely liberalized; a bank resolution strategy has been formulated and its implementation has begun, with support from the Fund, the World Bank, and bilateral donors; and a new privatization framework has been adopted, in cooperation with the World Bank, setting the basis for accelerated privatization with transparent procedures. In Montenegro, where significant institutional reforms have been adopted over the past several years with assistance from bilateral donors, further progress has been made in bank restructuring and privatization

3. **Donor and creditor support is key for FRY's success in reform.** At the Donor Conference that was held on June 29 in Brussels, US$1.3 billion was pledged, slightly more than originally envisaged. The timely disbursement of these funds—especially in the form of budgetary support in the third quarter of this year—is crucial, given the need to cushion the social costs of the rapid transformation of large sectors of the economy. Moreover, the external outlook will remain highly uncertain pending a restructuring of debt obligations to official bilateral and commercial creditors on concessional terms.

III. Economic Objectives and Policies for the Remainder of 2001

4. **The original macroeconomic objectives of the program remain broadly appropriate.** Recent output developments are in line with the program target of 5 percent *real GDP growth* in 2001, after taking into account the recovery in agricultural output from

last years' severe drought and the increased activity in transportation and other services (tourism in Montenegro); moreover, some strengthening of industrial output and exports in the second half of the year is likely, in lagged response to the removal of the sanctions. As regards *inflation* in Serbia, the upper end of the target range of 30–35 percent still appears achievable in light of the progress so far in lowering core inflation, albeit with difficulty owing to further adjustments in administered prices. The inflation rate in Montenegro is likely to reach about 15 percent in 2001 (expressed in DM terms), against a program target of 6½ percent, reflecting the larger than expected effects of administered price increases and the lagged effects of the rapid rise in wages through late last year; since then, wages have stabilized. Developments in the *external accounts* so far this year point to a somewhat higher than programmed accumulation of foreign reserves, as increased net inflows of services and private transfers are projected to offset a shortfall in net capital inflows. The allocation of gold and foreign exchange reserves of former SFRY held with BIS has further added to NBY's gross foreign exchange reserves, which are now expected to reach about US$1.0 billion by end-2001 (around 2 months of projected imports of goods and services), US$0.2 billion more than originally targeted.

5. **The key policy targets under the program—with only minor adjustments—remain appropriate as well as achievable.** In the fiscal area, government borrowing from the banking system will be limited to the equivalent of no more than 0.8 percent of FRY's GDP in 2001, or up to 0.2 percent of GDP more than originally programmed, to accommodate spending on bank restructuring costs in excess of the existing budgetary allocation. This will be achieved through containment and prioritization of spending as well as intensified revenue efforts at all levels of government. In the area of monetary policy, the original NDA targets will be adjusted to reflect the possibility of higher government borrowing to finance bank restructuring-related spending, while the targets for reserve money and NFA will be raised to take into account the strengthening of the demand for the dinar and the associated external overperformance so far. Moreover, structural reform will continue. In Serbia, the authorities intend to proceed with the implementation of a bank restructuring strategy and accelerate the privatization process on the basis of a new privatization framework. In Montenegro, besides addressing severe fiscal problems, the authorities intend to make progress in bank restructuring and privatization.

A. Fiscal Policy

6. **Fiscal policy has been broadly in line with the program so far, notwithstanding a higher than targeted fiscal deficit in Montenegro.** The consolidated general government in the whole of FRY recorded a cash surplus (after foreign grants, foreign borrowing and privatization receipts) of 0.4 percent of annual GDP in January–June 2001; by comparison, the program allowed for a cash deficit of 0.3 percent of GDP during the same period. The federal government maintained a cash balance, although at the cost of accumulating some arrears; the Serbian consolidated government registered a cash surplus of 0.6 percent of GDP; while the Montenegrin consolidated government incurred a cash deficit of 0.2 percent of FRY's GDP (3 percent of Montenegro's annual GDP), in addition to accumulating further arrears. Based on the revised fiscal program, the FRY consolidated general government deficit in 2001 (before grants, foreign borrowing and privatization proceeds) is projected to

amount to 4.0 percent of GDP, of which 0.8 percent will be financed by domestic borrowing, 0.4 percent by privatization proceeds, 1.2 percent by foreign grants, and 1.6 percent by foreign borrowing. This compares with an overall deficit of 6.1 percent under the original program. The difference is explained by a shortfall in expected foreign-financed project spending and expenditure cuts in response to a shortfall in expected privatization receipts.

Federation

7. **Most measures envisaged under the program have been implemented**. Salaries have been frozen at the January level for the federal administration and at last October's level for the army, while wage payments in the whole federal government will be limited from 13 to 12 months salaries. Nevertheless, new arrears of about 1.2 billion dinars were accumulated during the first half of this year, owing to lower than budgeted customs duties and nontax revenue. However, with the adoption of the new tariff schedule—which involved an effective increase in tariff rates—and improved sales tax collection in June, the revenue performance is expected to improve to the budgeted level by year-end. To ensure that the fiscal stance is in line with the program, the authorities will also keep general services of the federal administration at their current level of spending (savings of 2 billion dinars) and reduce the administrative and procurement cost of the army (0.5 billion dinars). With a view to introducing civilian control of defense spending, the Operational and Financial Service, which is in charge of the accounting and payment orders for defense budget, will be transferred from the General Staff Headquarters to the Ministry of Defense by August 31, 2001. This will bring the execution of the defense budget directly under the control of the Minister of Defense, thereby enhancing fiscal transparency and efficiency.

Serbia

8. **Given expected spending pressures and a likely shortfall in privatization receipts, revised fiscal estimates point to a sizable fiscal gap in 2001.** The cautious execution of the budget in Serbia generated a moderate cash surplus in the first half of 2001. Revenue performance was broadly in line with expectations, while expenditure was kept low in line with available resources, by strictly prioritizing spending. For the year as a whole, the budget target for revenue should be achievable, with a shortfall in excises being offset by overperformance with regard to income and sales taxes. Without corrective measures, expenditure is projected to reach 135½ billion dinars in 2001, 3 billion dinars more than budgeted, owing to pressures for increased spending in the remainder of the year. This reflects additional burdens stemming from higher than initially envisaged transfers to the social security funds (by 4.3 billion dinars, see ¶10), unanticipated lending to the electricity company for major maintenance operations (2 billion dinars) and to the commodity reserve for wheat harvest purchases (3.6 billion dinars), and additional spending on bank restructuring (of up to 1.4 billion dinars, or 0.2 percent of GDP in 2001, as explained in ¶21), which will be partly offset by previous overestimation of other expenditure items (other net lending, personnel expenditures, and lower interest payments, jointly amounting 9.4 billion dinars). Taking also into account a downward revision of expected privatization revenue (by 7 billion dinars, to 3 billion dinars) and assuming external financing as budgeted, the Serbian budget is faced with a financing gap of about 9 billion dinars (1.3 percent of GDP) in 2001.

(In addition, based on commitments at the June 29 Donor Conference, about US$50 million of project-related spending, mostly for reconstruction, is expected to take place in 2001; this compares with an original program estimate of US$230 million. Since this portion of spending is completely contingent on disbursement of foreign aid, there is no impact on the financing gap.)

9. **Significant additional foreign financing will be required to close the fiscal gap even after the adoption of corrective measures.** The Serbian authorities have identified corrective fiscal measures that are estimated to yield 5 billion dinars (0.7 percent of GDP) in 2001: transfers and subsidies to enterprises and households will be postponed until more financing becomes available (4.0 billion dinars), personnel cost increases will be contained (0.8 billion dinars,) and material costs will be reduced (0.3 billion dinars). In addition, since more than 70 percent of the general reserve has been committed, a set of contingency measures of 3 billion dinars has been identified for adoption in the event of delays in privatization revenue or other unfavorable developments. The remainder is expected to be covered by higher foreign financing (2.6 billion dinars or 0.4 percent of GDP) and increased borrowing from the domestic banking system (1.4 billion dinars or 0.2 percent of GDP).

10. **The social security funds are expected to require higher transfers from the budget than originally envisaged.** The funds have so far managed to keep spending in line with revenues without incurring new arrears, but the tax measures adopted in June (introduction of the gross wage system and lowering of contribution rates) are now expected to lead to even greater loss of revenue from contributions than originally envisaged. The health care fund, which saw its drug procurement cost rise after the introduction of the unified sales tax of 20 percent, will therefore be allocated an extra transfer of 2.3 billion dinars to avoid a severe reduction in the level of services, and the pension fund will receive an additional transfer of about 2 billion dinars. The labor market fund should be able to clear some arrears accumulated earlier his year and operate according to its budget, on the basis of the originally budgeted transfer.

11. **Further progress in fiscal reforms is envisaged for the remainder of the program period.** While wide-ranging reforms have been successfully implemented in the fiscal area so far this year, the structural benchmark for end-June—that envisages the adoption by the health fund of a drug list consistent with WHO guidelines—was missed, owing to management changes at the fund. A commission is working to finalize such a list by end-September, 2001. Meanwhile, progress in public expenditure management has been steady but somewhat slower than originally envisaged. A draft Organic Budget Law is being prepared with the help of donors and should be adopted by year-end. In light of staff and other capacity constraints, progress in establishing a Treasury and consolidating the government accounts would be facilitated by enhanced technical assistance.

Montenegro

12. **The government has adopted corrective measures to redress a difficult fiscal situation.** A significant expenditure overrun in the Montenegrin budget—owing to higher than envisaged spending on subsidies and lending to enterprises—resulted in a larger than targeted budget deficit in the first half of 2001. At the same time, the budget transfers to the

social security funds were lower than planned, leading to further arrears accumulation at both the health and labor funds. Based on revised revenue and expenditure estimates, and the latest projection of foreign grants (DM 92 million), the consolidated general government of Montenegro is estimated to have a financing gap of about DM 20 million in 2001. With a view to covering this gap and ensuring that the original program target of a balanced budget (after foreign grants) is achievable without further accumulation of arrears, the government has decided to: reduce hot meal allowances (DM 4.5 million), spending on contractual services (DM 5.2 million), facility maintenance and capital expenditure (DM 12 million), and subsidies to the enterprises after the food price liberalization in August (DM 4.9 million). The Government of Montenegro has also launched an offensive against the gray economy, involving: the requirement of immediate registration by all traders and for all taxable goods to avoid stiff penalties; enhanced monitoring of noncustoms border points by Montenegrin police; a duty-drawback scheme for goods in transit to Kosovo; the installation of cash registers in all 7,500 shops by November (4,500 by end-August); and the introduction and enforcement of excise stamps. Together these measures will fill the gap, while creating a contingency reserve of about DM 7 million, to allow for a possible shortfall in foreign financing. In addition, the Montenegrin authorities, in coordination with the authorities in Belgrade, intend to work toward harmonizing Montenegro's customs tariff schedule with that of Serbia, with a view to both raising revenue for the budget and removing obstacles to trade between the two republics.

13. **Notwithstanding progress in fiscal reform, a structural benchmark for end-June was missed.** Specifically, although the government has already approved a draft Organic Budget Law, political developments prevented its timely consideration by the parliament. In the event, the law was approved by parliament on August 8. An interim Treasury will be set up later this year and new drafts of tax codes will be discussed in the government in the next few months. In addition, with a view to addressing weaknesses in data on the financing of the budget, which have complicated the monitoring of fiscal developments under the program, the Ministry of Finance, with the assistance of a local auditing firm, will prepare detailed data on the financing of the budget by early September. Moreover, if the data continue to be of weak quality for program monitoring in the judgment of the Fund staff, the Ministry of Finance intends to retain a reputable foreign accounting firm to audit the financing of the budget and prepare a report by mid-November 2001. Related fiscal transparency issues will be an important element of the discussions on the next review under the stand-by arrangement.

B. External Debt Management

14. **To minimize fiscal as well as balance of payments pressures stemming from the servicing of new external loans, the federal and republican authorities remain committed to limiting the recourse to non-concessional external borrowing.** In this respect, a guarantee extended for US$7.3 million of non-concessional borrowing by Montenegrin Airlines is not expected to be exercised given the company's favorable business prospects. Nonetheless, the use of such guarantees will be eschewed in the future. In addition, the Serbian government intends to borrow up to the equivalent of US$50 million, under relatively favorable terms, for the rehabilitation of the ailing energy sector. The

projects—comprising investments and reparation works in the lignite mills and power stations—should achieve improvements in the power supply in the short run, thus having an immediate positive impact on the living conditions of the population. This financing operation, alongside continuing efforts to raise electricity prices and reduce operational costs, is expected to place the company on a viable commercial footing.

C. Wage and Price Policies

15. **The federal and republican authorities remain committed to preventing excessive wage growth and adjusting administered prices to reflect economic costs.** A strict wage policy in the government sector—consistent with keeping real wages unchanged in real terms from last year—has been and will continue to be firmly implemented. In state enterprises in Serbia, a wage freeze introduced in January has been strictly observed, and the indicative ceiling on the wage bill of the 8 largest state companies for end-June was met. Wage increases in state enterprises in the remainder of the year will be limited to 10 percent, to be implemented not earlier than September, implying an upward revision of the indicative target for the wage bills in those companies at end-September and end-December 2001. These wage increases will be conditioned on progress in reducing operational costs and improving profitability. Meanwhile, the electricity price in Serbia was more than doubled through adjustments in April and June, and will be raised further by 15 percent on October 1, 2001; in addition, the prices of gasoline, pharmaceuticals, tobacco and alcohol were adjusted in July and the price of bread was raised in August. In Montenegro, electricity and telecommunication prices were raised in April and June, respectively, and food prices were raised in August.

D. Monetary and Exchange Rate Policy

16. **The NBY has revised the financial program targets, to take into account a strengthening of the demand for the dinar and to lock in some of the external performance.** Following the adoption of a managed float at the beginning of this year, the exchange rate for the dinar has remained broadly stable against the euro, while the NBY has continued to accumulate NFA through net purchases from the foreign exchange market. This is explained by the larger-than-programmed decline in the NDA of the NBY, owing to fiscal overperformance, and the stronger-than-targeted growth in currency in circulation, which reflects improved confidence in the currency. With a view to supporting an output recovery while safeguarding the progress in reducing inflation, the NBY has raised the target for reserve money growth to 46 percent during 2001 (from 26 percent under the original program) and the target for NDA growth to the equivalent of 25 percent of end-2000 reserve money (from 18 percent under the original program). The target for NFA (excluding the effects of distribution of former SFRY foreign assets) has been accordingly raised by US$39 million for end-2001. In the event of higher-than-projected NFA, the NBY 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 the NDA below the program ceiling.

17. **The NBY will gear exchange rate policy to protecting external competitiveness and avoiding the emergence of 'exit' problems.** The current level of the exchange rate remains appropriate, as indicated by the continued accumulation of official reserves through purchases from the market and the fact that the real exchange rate is still somewhat depreciated in relation to historical levels. However, in light of the continuing real appreciation of the dinar, and the fact that a worsening of external competitiveness is reflected in current account flows with a considerable lag, the NBY will manage exchange rate policy with a view to limiting the loss of cost competitiveness and avoiding exit problems associated with an effective pegging of the exchange rate. Owing to uncertainty about the external outlook and underlying position, exchange rate policy will continue to be reviewed quarterly under the program.

18. **In line with progress in restructuring the banking system, the NBY is putting in place a plan to reform monetary policy instruments.** In particular, the NBY intends to (a) abolish the supplementary reserve requirements in the form of compulsory purchases of securities issued by the NBY and the electricity company by not renewing the expiring securities in the coming months; and (b) establish a unified required reserve ratio for dinar and foreign currency deposits that is significantly lower than 24.5 percent by January 1, 2002, in consultation with the Fund staff. As progress is being made toward cleaning up the banking system and a more efficient money market develops, the NBY will increasingly rely on open market operations in dinars and foreign exchange for the conduct of monetary policy.

E. Bank Restructuring

19. **Consistent with policy commitments in the MEFP of May 25, 2001, significant first steps have been taken toward cleaning up and restructuring the banking system in Serbia**. Based on detailed diagnostic reports—undertaken by the NBY with the assistance of foreign donors—of 28 banks that had been classified as insolvent on the basis of an earlier NBY survey, these banks have been re-categorized as healthy (A), needing enhanced supervision (B), insolvent with some systemic importance or potential economic value (C), and insolvent in need of liquidation (D). A bank restructuring strategy was completed by mid-May 2001, and the banking system was intervened on June 15. Of the 28 banks, 7 banks that were found to be category D were delicensed and had procedures for their liquidation initiated; 11 banks (including 5 of the largest banks) were identified as category C, for consideration for possible treatment by the BRA. Of the remaining banks, 6 banks, including one of the largest banks, were considered to be category B and were placed under intensified NBY supervision, and another 4 banks were considered to be category A and not in need of further action. NBY subsequently sent 4 of the largest banks (Beobanka, Beogradska Banka, Investbanka, and Yugobanka, classified as category C) to the BRA for possible rehabilitation. These banks now operate under new management and control by the BRA.

20. **Some key steps in the bank restructuring process are envisaged for the coming months.** Specifically, by September 15, the NBY will (a) refine, in close coordination with the BRA and in consultation with Fund and World Bank staff, its pricing matrix to be used to estimate the total costs and fiscal needs for bank restructuring, and (b) recommend either

immediate liquidation or possible rehabilitation (through the BRA) of the remaining 7 (of the 11) banks that were found to be category C banks. Moreover, the BRA will (a) by September 15, establish the potential validity of private nonguaranteed claims (including off-balance sheet items) on banks under its control, and (b) by October 15, develop rehabilitation/resolution plans for the 4 large banks under its control. These plans should include (a) monthly cash flows and operational losses during the rehabilitation period with a view to assessing progress toward achieving core profitability; (b) future business strategies; (c) the fiscal costs of restructuring, which will critically depend on progress in securing creditor haircuts, and (d) a recommendation on whether the bank should be rehabilitated or closed. On this basis, by end-October, the Board of Directors of the BRA, will recommend to the NBY, under Articles 7 and 22(a) of the law governing its operations, whether the banks should be subjected to a rehabilitation plan or liquidated. Bank rehabilitation will be undertaken only if it is expected to produce a viable bank with good prospects for privatization; and can be implemented with identifiable fiscal resources. If this does not appear to be achievable based on performance during the first six months of a rehabilitation program, the banks will be closed and liquidated. Moreover, the activities of banks under rehabilitation will be strictly controlled by the BRA, in accordance with ¶39 of the MEFP of May 25, 2001, with a view to containing further losses and limiting fiscal costs. Progress in bank restructuring will be the subject of the next review under the stand-by arrangement.

21. **Further changes in the legal and institutional framework are envisaged to restructure and strengthen the banking system.** The federal parliament is expected to approve, by end-September 2001, changes in the Law on the Financial Rehabilitation, Bankruptcy, and Liquidation of Banks to allow BRA to perform the functions of a bank liquidator. A revised deposit insurance scheme, designed to strengthen confidence in a restructured banking system, is another priority. To reduce moral hazard and enhance the credibility benefits from its adoption, such a scheme will be introduced once the solvency of the banking system has been restored through the closure of insolvent banks and the restoration of profitability in banks that have undergone restructuring.

22. **The social and economic costs of bank resolution will be considerable.** With a view to alleviating the social hardship associated with bank restructuring within tight fiscal constraints, the authorities will establish a social program to support and retrain bank employees who become redundant as a result of the restructuring or closure of banks. On the assumption that 5,000 workers will qualify for such assistance and retraining, the budgetary cost in 2001 is estimated at 600 million dinars. The payout of deposit insurance to household depositors in cases where banks have been (or will be) closed is expected to cost another 500 million dinars. These costs, along with BRA's operational expenses, are expected to be covered by an existing allocation of 600 million dinars in the Serbian budget as well as by additional budgetary allocations of up to 1.4 billion dinars; the ceilings on the NDA of the NBY and bank credit to the FRY consolidated general government have been adjusted upwards by up to that amount, with a view to accommodating such spending to the extent that it exceeds the existing budgetary allocation. The fiscal costs of restructuring will be the subject of the next review under the current stand-by arrangement.

23. **The NBY is strengthening bank supervision, with assistance from bilateral donors.** A review of prudential regulations has been completed and, by end-December 2001, revisions to Articles 26 and 27 of the Law on Banks are expected to be approved by the parliament, to empower the NBY to issue regulations on bank supervision in line with the international practice. Implementing regulations are being drafted and are to become effective on January 1, 2002, covering, among other things, capital adequacy, loan classification and provisioning, internal control and audit, risk management, credit concentration, and investment in fixed assets as well as other banks and enterprises' capital. The NBY is also working with donors to strengthen the regulatory framework and capacity regarding on-site supervisions. Furthermore, regulations on on-site supervisions are under review and training courses are planned for the coming months.

24. **The Central Bank of Montenegro (CBM) is making progress in restructuring the banking system and enhancing bank supervision.** The largest commercial bank, Montenegro Banka, has been placed under an administrator and will be privatized or liquidated with no government capital injection; documents to invite investors will be ready by end-September, 2001. Diagnostic reports for the remaining 11 commercial banks in Montenegro will be prepared by end-August with assistance from bilateral donors, and decisions on their resolution (liquidation, rehabilitation, mergers, no action) will be made by end-September 2001. New CBM regulations on bank rehabilitation, bankruptcy, and liquidation are being prepared and will be adopted by end-September 2001. With assistance from bilateral donors, a new regulation, to be based on the Accounting Law, will introduce international accounting standards for banks by end-2001. Decisions on minimum capital requirements, credit concentration, asset classification, and bank licensing have come into force as of May 9, 2001. The reform of the Clearing and Settlement Bureau (ZOP) is continuing as envisaged under the program.

F. Private Sector Development

25. **In Serbia, privatization is to proceed expeditiously on the basis of a new transparent framework.** A new privatization law was adopted in June 2001, and by-laws and other regulations were put in place by mid-July as envisaged in the MEFP of May 25, 2001. On the basis of the new framework, the privatization of about 40 large socially owned enterprises, including three cement factories, has been initiated or will be initiated soon. With World Bank assistance, expressions of interest have been solicited for financial advisors for 16 enterprises grouped in four pools of 3–5 companies, with 11 companies grouped in 3 pools to follow in the coming weeks. It is envisaged that at least four (of the seven) contracts with investment advisors should be signed by end-October 2001, and at least one pool of enterprises should be offered for sale by end-December 2001. It now appears that privatization revenue of only 3 billion dinars will be achievable by end-2001 (compared with an earlier estimate of 10 billion dinars), mainly because of a delay in the sale of a large cement company under the old privatization law. The privatization process for the remaining 4,000 socially owned enterprises has been initiated as envisaged in the MEFP of May 25, and is expected to accelerate in 2002–03. A new bankruptcy law will be drafted with assistance from the World Bank, to strengthen creditor rights.

26. **Labor market reforms will improve the business environment in Serbia.** Amendments to the law on Employment that were adopted in April (a) harmonized benefits with the redefined wage for tax purposes and (b) reduced the amount and duration of the minimum statutory benefits for employment termination and unemployment. A draft new law on Labor Relations—to be considered by Parliament in September—is envisaged to (a) increase labor market flexibility, as only companies employing over 50 and retrenching more than 10 percent of their staff will be required to submit a justification, (b) reduce minimum severance payments from 6–12 months to 2–5 months, (c) allow for negotiations of collective agreements by any organization representing over 15 percent of total staff, (d) reduce maternity benefits from 5 years to 1 year, and (e) reduce the minimum annual leave days to 18.

27. **Privatization is an important element of Montenegro's structural reforms.** A mass privatization program will provide vouchers to some 95 percent of the population which will be distributed this September. These vouchers can be used to obtain shares in companies or they can be used to buy shares in 4–6 licensed privately-managed privatization funds that will use these vouchers to buy shares. This year some 29 percent of the shares of 227 companies will be offered for sale through the mass privatization scheme. In addition, a majority share will be sold in 15 large companies through international tender, and international investors will be offered a minority share in other companies which can be expanded to a majority interest. Expressions of interest for the telecom company have been received and may yield results early next year, and a first hotel is expected to be sold this year to a Slovenian investor.

G. Statistics

28. The FRY authorities intend to request an assessment by an IMF mission of FRY's compliance with international statistical standards. The report, which is to be issued to the IMF Board, will identify areas of potential improvement, including through Technical assistance from multilateral institutions and bilateral donors.

Federal Republic of Yugoslavia: Quantitative Performance Criteria and Indicative Limits Under the 2001-2002 Stand-By Arrangement 1/
(In millions of dinars, unless otherwise noted)

	2000	2001						
	End-Dec.	End-Mar.	End-June		End-Sep. Target		End-Dec. Target	
	Actual		Target	Actual	Original	Revised	Original	Revised
A. Quantitative performance criteria								
Floor on the net foreign assets of the NBY 2/	-308	-231	-283	-170	-303	-255	-283	-244
Ceiling on net domestic assets of the NBY 3/	39,315	34,526	39,064	35,770	41,766	43,185	42,909	44,328
Ceiling on net credit of the banking system to the consolidated general government 4/ 5/	3,373	294	5,373	531	7,373	8,792	7,373	8,792
Ceiling on contracting or guaranteeing of new nonconcessional external debt with original maturity of more than one year by the public sector 2/ 6/	...	0.0	0.0	7.3	0.0	57.3	0.0	57.3
Ceiling on new external debt owed by the consolidated general government or guaranteed by the public sector with an original maturity of up to and including one year 2/ 7/	...	0	0	0	0	0	0	0
Ceiling on new guarantees and the assumption of enterprise debt to banks by the public sector 8/	...	0	0	0	0	0	0	0
Ceiling on outstanding external debt service arrears 2/ 9/	...	0	0	0	0	0	0	0
B. Indicative targets								
Ceiling on net domestic assets of the banking system 10/	19,433	15,720	24,604	18,513	28,226	29,198	31,226	32,831
Ceiling on change in the arrears of								
the federal government	...	0	0	1,200	0	0	0	0
the consolidated general government in Serbia	...	0	0	700	0	0	0	0
the consolidated general government in Montenegro	...	0	0	...	0	0	0	0
Ceiling on the wage bill of the 8 largest public enterprises, cumulative from beginning of year 11/	9,992	4,318	8,756	8,609 2/	13,207	13,355	17,658	18,251

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

2/ In millions of U.S. dollars.

3/ The revised targets for September and December will be monitored based on monthly averages as defined in Annex C.

4/ For program purposes, the ceilings on net credit of the banking system to the consolidated general government will be adjusted downward by the cumulative increase in the stock of government debt held by the nonbank public, starting from January 1, 2001, and upward for any decrease.

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 EBRD, EIB, IBRD, or IFC. The public sector comprises the consolidated general government and the National Bank of Yugoslavia. The increase of $50 million for end-Sept. and end Dec. ceilings represents anticipated borrowing by the Serbian governments under relatively favorable terms to rehabilitate the ailing energy sector.

7/ Excluding normal import-related credits.

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

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

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

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

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

Federal Republic of Yugoslavia: Stand-By Arrangement, May 2001-March 2002
Prior Actions, Structural Performance Criteria, and Structural Benchmarks

	Implementation Date Reported in EBS/01/982	Status/Revised Implementation Date
I. Prior Action for Board Consideration		
1. (Federation) Transfer of the Operational and Financial Unit, which is in charge of the accounting and payment orders for defense budget, from the General staff Headquarters to the Ministry of Defense	...	implemented at end-August
II. Structural Performance Criteria		
1. (Serbia) Increase in average electricity tariff (weighted by consumption) by at least 40 percent.	October 1, 2001	no longer in effect (see immediately below; in addition, electricity pricing policy has become a subject for the second review under the arrangement)
2. (Serbia) Increase in average electricity tariff (weighted by consumption) by 15 percent.	...	October 1, 2001
III. Structural Benchmarks		
A. Fiscal Sector		
1. (Serbia) Redesign of the co-payment system in the health care sector, with a view to generating additional revenue of YUD 0.8-1.0 billion on an annual basis.	end-May 2001	implemented
2. (Montenegro) Adoption of an organic budget system law to standardize budget classification and implementation of a centralized treasury system.	end-June 2001	implemented on August 8, 2001
3. (Serbia) Issuance of decree revising the list of drugs offered to the general public population in state pharmacies, to bring expenditure on drugs in line with financial resources available to the health care system.	end-June 2001	end-September 2001
4. (Serbia) Improvement of cash management and fiscal reporting by eliminating primary budget managers' expenditure accounts and own accounts of direct spending units (637 accounts and their 850 subaccounts) and by creating ledger accounts within account 630.	end-September 2001	end-September 2001
5. (Montenegro) De-linking of the statutory minimum wage from public sector pay and social benefits levels through legislation.	end-September 2001	end-December 2001
6. (Serbia) Establishment of a Central Accounting Division in the Treasury Department of the Ministry of Finance and Economy.	end-December 2001	end-December 2001
7. (Serbia) Establishment of a new system of commitment control based in the Treasury's Central Accounting Division.	end-December 2001	end-December 2001
8. (Serbia) Set up of a Large Taxpayer Office in Belgrade.	end-December 2001	end-December 2001
B. Financial Sector		
1. (Federation and NBY) Adoption of a strategy for bank restructuring, in consultation with the Fund and the World Bank.	May 15, 2001	implemented
2. (Federation and NBY) Intervention of the largest, insolvent, banks in Serbia.	end-June 2001	implemented
3. (Federation and NBY) The NBY will (a) refine, in close coordination with the BRA and in consultation with Fund and World Bank staff, its pricing matrix to be used to estimate the total costs and fiscal needs for bank restructuring, and (b) recommend either liquidation or possible rehabilitation (through the BRA) of the remaining 7 (of the 11) banks that were found to be category C banks.	...	September 15, 2001

Federal Republic of Yugoslavia: Stand-By Arrangement, May 2001-March 2002
Prior Actions, Structural Performance Criteria, and Structural Benchmarks

	Implementation Date Reported in EBS/01/982	Status/Revised Implementation Date
4. (Federation) Approval by Parliament of the amendments to Law on the Financial Rehabilitation, Bankruptcy and Liquidation of Banks, allowing BRA to act as a bankruptcy liquidator.	...	end-September, 2001
5. (Montenegro) The CBM will decide on the resolution (liquidation, rehabilitation, mergers, no action) of all banks.	...	end-September, 2001
6. (Federation) The BRA will develop rehabilitation/resolution plans for the 4 large banks under its control. The plans will include (a) monthly cash flows and operational losses during the rehabilitation period with a view to assessing progress toward achieving core profitability; (b) future business strategies; (c) the fiscal costs of restructuring, which will critically depend on progress in securing creditor haircuts, and (d) a recommendation on whether the bank should be rehabilitated or closed.	...	October 15, 2001
7. (Federation) The Board of Directors of the BRA, will decide, under Articles 7 and 22(a) of the Act governing its operations, whether the banks should be subjected to a rehabilitation plan or liquidated. Bank rehabilitation will be undertaken only if it is expected to produce a viable bank with good prospects for privatization; and can be implemented with identifiable fiscal resources. If this does not appear to be achievable based on performance during the first six months of a rehabilitation program, the banks will be closed and liquidated.	...	end-October,2001
C. Private Sector Development		
1. (Serbia) Parliamentary approval of privatization legislation in Serbia, designed in cooperation with the World Bank, to:	end-June 2001	implemented
(a) attract investment capital by offering at least 70 percent of enterprise shares to investors and no privilege to company management, management, workers, or any other agents regarding purchase of these shares;		
(b) create, through dominant ownership, a clear ownership structure conducive to efficient resource allocation and good enterprise management;		
(c) facilitate failed enterprise liquidation/work-outs prior to privatization, among other things by authorizing the Privatization Agency to require an enterprise to enter workout/liquidation;		
(d) establish transparent and efficient privatization procedures.		
Legislation to include Law on Privatization, Law on Shares, Law on Agency for Privatization, Ordinance on Privatization Program, Ordinance on Public Tender, Ordinance on Auctions, Ordinance on Business Valuation, and Ordinance on Appraisers.		
2. (Serbia) Conclusion of at least four contracts for the privatization of pools of companies (of 3-5 enterprises each) with investment banks hired through competitive international tenders (out of a total of seven pools for which international advisors will be solicited this year).	end-October 2001	end-October 2001
3. (Serbia) Offer of at least one pool of companies consisting of 3-5 enterprises for sale observing well defined, internationally accepted tender rules.	end-December 2001	end-December 2001

Federal Republic of Yugoslavia: Technical Memorandum of Understanding

I. Introduction

1. This memorandum sets out the understandings between the Yugoslav authorities and staff of the International Monetary Fund (IMF) regarding the definitions of quantitative and structural performance criteria and benchmarks, as well as indicative targets, for the stand-by arrangement (SBA) approved on June 11, 2001, as well as the related reporting requirements. To monitor developments under the program, the Yugoslav authorities will provide the data listed in each section below to the European 1 Department of the Fund, in accordance with the indicated timing. The quantitative performance criteria and indicative targets will be monitored on the basis of the methodological classification of monetary and financial data that was in place on December 31, 2000, except as noted below. For program purposes, the public sector consists of the consolidated general government (comprising the federal, Serbian Republican and local governments, the Montenegrin Republican government, the Serbian and Montenegrin social security funds, and the Serbian special budgetary programs) and the National Bank of Yugoslavia (NBY). The authorities will inform the Fund staff of any new funds or special extrabudgetary programs that may be created during the program period to carry out operations of a fiscal nature as defined in the IMF's *Manual on Government Financial Statistics,* and will ensure that these will be incorporated within the definition of consolidated general government. Quantitative performance criteria and indicative targets for end-September and end-December 2001 are specified in Annex A of the Amended Memorandum of Economic and Financial Policies (MEFP).

II. Quantitative Criteria: Definitions and Reporting Standards

A. Floor for Net Foreign Assets of the NBY

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

- For purposes of the program, **foreign reserve assets** shall be defined as monetary gold, holdings of SDRs, the reserve position in the IMF, and NBY holdings of foreign exchange in convertible currencies. The assets should be under the effective control of, and readily available to, the NBY. Accordingly, excluded from foreign reserve assets are: frozen assets of the Federal Republic of Yugoslavia (FRY), undivided assets of the Socialist Federal Republic of Yugoslavia (SFRY), long-term assets, NBY claims on resident banks and nonbanks, as well as Yugoslav commercial banks located abroad, any assets in nonconvertible currencies, encumbered reserve assets pledged as collateral for foreign loans, reserve assets pledged through forward contracts, and precious metals other than gold. Monetary gold shall be valued at an accounting price of US$272.60 per ounce, and SDRs at SDR1 = US$1.3029. On December 31, 2000 the NBY's foreign reserve assets as defined above amounted to US$516 million, including gold valued at US$125 million.

- For purposes of the program, **foreign reserve liabilities** shall be defined as any short-term loan or deposit (with a maturity of up to and including one year), swaps (including any portion of the NBY gold that is collateralized), and forward liabilities of the NBY—in convertible currencies to residents and nonresidents; IMF purchases; and loans contracted by the NBY after December 31, 2000 from international capital markets, foreign banks or other financial institutions, and foreign governments (with the exception of bridge financing for clearance of arrears to the EIB), irrespective of their maturity. On December 31, 2000, the NBY's foreign reserve liabilities, as defined above, to nonresidents were US$152 million and to residents were US$672 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, 2000. All changes of definition or valuation of assets or liabilities, as well as details of operations concerning sales, purchases or swap operations with respect to gold shall be communicated to the Fund staff within one week of the operation.

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

4. **Adjusters**. For program purposes the reported net foreign assets will be adjusted downward pari passu to the extent that: (i) since January 1, 2001, the NBY has recovered frozen assets of the FRY, assets of the SFRY, long-term assets, and foreign-exchange-denominated claims on resident banks and nonbanks, as well as Yugoslav commercial banks abroad; and (ii) the restructuring of the banking sector by the Bank Restructuring Agency (BRA) involves a decline in NBY foreign-exchange-denominated liabilities to resident banks.

B. Ceiling on Net Domestic Assets of the NBY

5. **Definition.** For purposes of the program, net domestic assets (NDA) of the NBY are monitored on a monthly average basis and defined as the difference between reserve money (as defined in section E) and net foreign assets (as defined in section A), with the latter being converted from U.S. dollars into dinars at the program accounting exchange rate of US$1 = YUD 63.1659, which was the rate prevailing on December 31, 2000 and the exchange rates of the US$ *vis-a-vis* other currencies prevailing on that day. As of December 31, 2000, the domestic assets of the NBY so defined were valued at YUD 39,315 (Annex A). The monthly average of NDA is calculated as the difference of the monthly average of reserve money and monthly average of NFA. The monthly average of NFA for the program purpose will be adjusted so that the disbursements of World Bank program loans and EU macro-financial

assistance in excess of funds needed to clear arrears to the EIB are counted as if they occur on the first day of the month.

6. **Adjustor**. The ceilings will be revised downwards by the amount that government expenditure on bank restructuring falls short of YUD1,987 million, but the adjustment is not to exceed YUD1387 million.

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

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

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

- For program purposes, **net credit of the banking system to the consolidated general government** is defined as all claims (i.e., credits, securities, and other claims in both dinar and foreign currencies) of the banking system on the consolidated general government less all deposits of the consolidated general government with the banking system, including foreign currency deposits. Foreign currency deposits and foreign-currency denominated credits to the general government will be reported at the end-December 2000 exchange rates. Any holdings of government securities by commercial banks mandated by the NBY against reserve requirements above the actual amounts held at end-December 2000 (YUD 174 million) will be included in the credit of the banking system to the consolidated general government. Before undertaking any changes to reserve requirements, the NBY will consult with the Fund staff. (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 2000, net credit of the banking system in Montenegro to the consolidated general government in Montenegro amounted to [minus DM 84.8 million.])

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

10. **Adjusters.** For program purposes, the ceilings on net credit of the banking system to the consolidated general government will be adjusted downward by the cumulative increase in the stock of government debt held by the nonbank public (other than that related to the frozen foreign currency deposits), starting from January 1, 2001, and upward for any decrease. In addition, the ceilings will be revised downwards by the amount that government

expenditure on bank restructuring falls short of YUD1,987 million, with the adjustment not to exceed YUD1,387 million. Furthermore, the ceilings will be adjusted to the extent that the credit of the banking system in Montenegro to the consolidated general government at end-December 2000 is revised from the currently-reported level of minus DM 84.8 million.

D. Ceiling on Change in Arrears

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

12. **Definition**

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

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

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

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

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

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

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

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

- At end-December 2000, the stock of arrears of the Federal government was estimated at YUD 7.063 billion; and the stock of arrears of the consolidated general government in Serbia was estimated at YUD 32.522 billion.

- DM denominated claims on government will be converted at the exchange rate of DM 1 = YUD 30; claims denominated in currencies other than the DM will first be converted at their respective exchange rates against the DM prevailing on December 31, 2000. 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 2000.

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

E. Definition of Reserve Money

14. **Definition.** Reserve money is defined as the sum of currency in circulation (NBY Bulletin, September 2000, Table 3A, column 8) and reserves banks are required to hold under the standard reserve requirement, plus excess reserves of the commercial banks at the NBY. Shortfalls in reserves that banks are required to hold, will be included in required reserves (and therefore in reserve money), as well as in bank borrowing from the NBY. Reserves that banks are required to hold under the standard reserve requirement are currently set at 24.5 percent of the base as defined in the NBY Decision of September 24, 1999. Reserves that banks hold at the NBY to satisfy other additional or special reserve requirements will not be included as part of the amounts necessary to satisfy the standard reserve requirement. The amounts that banks are permitted to hold in securities to satisfy the statutory reserve requirement will be limited to the amount that banks were holding as of December 31, 2000 (YUD 174.1 million). Excess reserves include commercial bank balances in Giro accounts 620, 621, 623, and 625 with the NBY and cash in commercial bank vaults.

15. Data on reserve money will be monitored from the daily indicators data of the NBY, which shall be supplied to the European 1 Department of the Fund weekly by the NBY with a three-day lag. On December 31, 2000, currency in circulation amounted to YUD 10,933 million while required reserves amounted to YUD 4,824.0 million, and excess reserves to YUD 4,088 million. Data on effective reserve requirements and the deposit base used in reserve requirement calculations will be supplied to the European 1 Department within two days of the 11^{th}, 18^{th}, and 28^{th} day of each month.

16. **Adjusters.** For program monitoring purposes, reserve money will be adjusted as follows: Should the standard reserve requirement increase (decrease) from the level prevailing on December 31, 2000, the ceiling on net domestic assets would be increased (decreased) by an amount equivalent to the change in the standard reserve requirement ratio multiplied by the programmed deposit base used in the calculation of required reserves. Before making any such changes, the NBY will consult with Fund staff. Required reserves of banks placed under BRA administration or liquidation will remain part of reserve money for program purposes.

F. Ceiling on External Debt-Service Arrears

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

accumulated at any time under the arrangement on public sector or public sector guaranteed debts.

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

G. Ceilings on External Debt

19. **Definitions.** First, with regard to the ceiling on contracting or guaranteeing of new nonconcessional external debt by the public sector with original maturity of more than one year: This performance criterion applies not only to debt as defined in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt adopted on August 24, 2000 (Decision No. 12274-(00/85), see attachment to this Annex) but also to commitments contracted or guaranteed for which value has not been received. Excluded from this performance criterion are loans from, or other indebtedness to, the EBRD, the EIB, the IBRD, the IMF, and the IFC. Concessionality will be based on a currency-specific discount rate based on the ten-year average of the OECD's commercial interest reference rate (CIRR) for loans or leases with maturities greater than 15 years and on the six-month average CIRR for loans and leases maturing in less than 15 years. Under this definition of concessionality, only debt with a grant element equivalent to 35 percent or more will be excluded from the debt limit. Second, with regard to the ceiling on new external debt with original maturity of up to and including one year owed by the consolidated general government or guaranteed by the public sector : The term "debt" has the meaning set forth in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt adopted on August 24, 2000 (Decision No. 12274-(00/85). Excluded from this performance criterion are short-term import credits.

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

III. Other Reporting Requirement for Program Monitoring

A. Macroeconomic Monitoring Committee

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

B. Developments on Structural Performance Criteria and Benchmarks

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

C. Data Reporting

Production and prices

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

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

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

Public finance

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

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

Monetary sector data

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

- Daily movements in gross foreign exchange reserves of the NBY at current exchange rates, indicating amounts sold/bought at the auction, purchases through ZOP, purchases on the interbank market, inflows of foreign grants, inflows of foreign loans, and repayments of frozen currency deposits.
- Daily movements in foreign exchange denominated liabilities of the NBY to (i) non-residents; (ii) Yugoslav banks; and (iii) Yugoslav residents.

- Daily movements in liquid foreign exchange assets of Yugoslav banks as reported by these banks to the NBY.

- Daily movements in reserve money, indicating currency in circulation, the basis upon which required reserves are calculated, required reserves, reserves held, and excess reserves.

- Treasury bill auction details (rates, amounts per maturity and number of banks participating in the auction per maturity); and

- Interbank foreign exchange rates and volume of transactions.

- Public sector borrowing and lending from commercial banks and the NBY.

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

External data

28. The data below will be transmitted as follows:

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

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

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

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

Point No. 9

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

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

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

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

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

INTERNATIONAL MONETARY FUND

NEWS BRIEF

FOR IMMEDIATE RELEASE

News Brief No. 01/91
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September 19, 2001

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

IMF Approves US$65 Million Tranche Under Stand-By Credit to Federal Republic of Yugoslavia

The Executive Board of the International Monetary Fund (IMF) today completed the first review of the Federal Republic of Yugoslavia's economic program supported by a stand-by credit. The completion of the review will enable the FRY to draw another SDR 50 million (about US$65 million) from the IMF immediately.

The stand-by credit of a total of SDR 200 million (about US$259 million) was approved on June 11, 2001, and will expire March 31, 2002 (see Press Release No. 01/31).

Following the Executive Board discussion, Shigemitsu Sugisaki, Deputy Managing Director and Acting Chairman, said:

"The FRY authorities have made good progress in stabilization and reform since late last year under difficult conditions, through the firm implementation of prudent policies. However, the tasks ahead are extremely challenging, requiring continued perseverance and clear ownership of the program by the authorities as well as strong support from donors and creditors.

"Prudent macroeconomic policies have reduced inflation pressures and strengthened foreign exchange reserves, while supporting a recovery of output. On the structural front, the tax system was streamlined , and the exchange, trade, and price systems were almost completely liberalized earlier this year. With the recent adoption of a new privatization framework and the formulation of a bank resolution strategy, an appropriate legal and regulatory framework have been put in place to guide the market transformation of the economy. Problems in fiscal policy implementation and transparency are a source of concern in Montenegro, but the implications for the program are considered limited given the republic's small share in the FRY economy.

"Achievement of the fiscal objectives will be challenging, in both Serbia and Montenegro, owing to pressures for increased spending and uncertainties surrounding budgetary revenue and financing. This highlights the need for the authorities to prioritize expenditure commitments and limit spending in line with available resources, with a view to avoiding expenditure arrears and recourse to inflationary financing.

"It would be important for the central bank to monitor closely developments in the foreign exchange market and to calibrate exchange rate policy, with a view to limiting the loss of external competitiveness.

"On the structural side, the authorities appropriately intend to intensify their efforts to privatize state and socially owned enterprises, while improving their operational efficiency through cost savings. It would also be important to decide expeditiously on the resolution of banks, based on a realistic assessment of their potential viability and taking into account the severe fiscal constraints.

"Given the devastation and heavy external indebtedness of its economy, FRY will need continued support from donors and creditors, to achieve sustainable growth and external viability. In particular, FRY's external prospects will remain highly uncertain—thus hampering investment and growth—until the external debt is restructured on concessional terms," Mr. Sugisaki said.

Statement by Roberto F. Cippà, Executive Director and Srboljub Antic, Advisor to Executive Director for the Federal Republic of Yugoslavia
September 19, 2001

The situation in the FRY remains very difficult. Despite strong policy performance, economic activity continues to be weak. Industrial output is still stagnating, despite the removal of international sanctions at the end of 2000, and foreign trade is only slowly recovering. Headline inflation in the first semester of 2001 was running at an annualized rate slightly below 50 percent, while its core component was estimated at 15 percent. Economic reforms are being introduced in a fragile political and institutional environment, with pending final decisions about the shape and the organization of the federal state. Nevertheless, the authorities are taking all necessary, difficult, and sometimes unpopular steps, with strong determination to introduce economic and political reforms and achieve ambitious goals. Our authorities are well aware that this effort needs the support of the international community, especially in regard to reducing the foreign debt burden. They are very grateful to the international financial organizations, in particular the Fund, which have quickly reacted to the challenge, and through various forms of financial support and extremely valuable advise have underpinned the Yugoslav endeavor.

Our authorities are in broad agreement with staff assessment of the situation and broadly share their recommendations. As noted by staff, the implementation of the program has proceeded quite successfully. Six out of seven performance criteria and most of the structural benchmarks and indicative targets have been met. Our authorities would like to request a waiver for the non observance of the performance criterion related to the contracting or guaranteeing of new non concessional external debt.

Fiscal policy has been broadly in line with the program so far, despite a higher than projected fiscal deficit in Montenegro. The consolidated general government for the FRY recorded a cash surplus of 0.4 percent of annual GDP in January-June 2001, 0.7 percentage points better than targeted. Also, at the federation level, most measures envisaged under the program have been implemented, including a freeze of salaries for the federal administration and the army. The Federal budget was broadly balanced on a cash basis, though the accumulation of some arrears could not be avoided following lower than budgeted custom duties and nontax revenues. However, the revenue performance should be redressed, and the arrears cleared, following the adoption of the new tariff schedule and improvements in tax administration.

Serbian fiscal performance was satisfactory until now. A strict prioritization of expenditures together with a good revenue performance led to a cash surplus of 0.6 percent of GDP in the first half of 2001. However, for the rest of the year, pressure on the expenditure side will rise, stemming mainly from higher transfers to the social security funds, unanticipated lending to the electricity company as well as additional spending on bank restructuring. Together with sharply lower than expected privatization revenues, this will likely lead to a sizeable fiscal gap for 2001, in the order of 1.3 percent of GDP. Corrective measures are being considered by the authorities, including cuts of transfers and subsidies to enterprises and families. However, these measures will probably not be enough to fill the gap necessitating additional foreign financing and, to a lesser extent, increased borrowing from domestic banks.

The situation in Montenegro was less satisfactory. In the runup to the April elections higher than envisaged spending on subsidies and lending to enterprises led to a deficit of 0.2 percent of the FRY GDP, together with some expenditure arrears to the health and labor funds. The government of Montenegro is committed to stick to the original program target of a balanced budget, and a range of corrective measures are contemplated not only to fill the expected gap, but also to create a contingency reserve to allow for a possible shortfall in foreign financing.

Since the beginning of the year, the dinar has remained relatively stable vis-à-vis the euro and the National Bank of Yugoslavia (NBY) has steadily increased its foreign reserves. The strength of the dinar, reflecting improved confidence in the currency, led the NBY, in agreement with staff, to revise the financial program targets. The NBY believes that the current level of the exchange rate remains broadly appropriate and serves the purpose of fighting inflation. However, in light of the continuing real appreciation of the dinar, and the fact that a worsening of external competitiveness is reflected in current account flows with a considerable lag, the NBY will manage exchange rate policy with a view to limiting the loss of cost competitiveness and avoiding exit problems associated with an effective pegging of the exchange rate.

The intense efforts to stabilize the FRY economy have been accompanied by a steady progress in implementing structural reforms. As stressed by the staff, in the relatively short time since the restoration of democracy in the FRY the new authorities have already managed to establish a market-oriented legal and regulatory framework. The more recent additions to this framework include the comprehensive tax reform, the new privatization law and the far-reaching trade and foreign exchange liberalization in Serbia as well as the new organic budget law in Montenegro. The labor market flexibility and the overall business environment should be further enhanced by the new law on labor relations, which is currently being drafted in Serbia.

Banking sector reform, enterprise restructuring and private sector development remain among the top priorities of the FRY authorities. Bank restructuring in Serbia proceeds on the basis of the comprehensive strategy adopted in June in accordance with the recommendations of the Bank and Fund staffs. The 28 "problem" banks have been divided into four groups and seven of these banks have already had their licenses revoked. Another eleven banks had been identified as candidates for rehabilitation by the Bank Restructuring Agency (BRA). The powers of this Agency will be further augmented by the proposed changes in the Law on the Financial Rehabilitation, Bankruptcy and Liquidation of Banks. The proposals for the rehabilitation, or liquidation, of four large banks with "systemic" importance will be adopted by mid-October. Even though our authorities have indicated some preference for keeping these four banks "alive", they also remain fully committed to the general principle that rehabilitation should be limited to banks which can be expected to regain relatively soon a viable position and for which adequate fiscal resources can be identified. Progress in banking sector restructuring is also being made in Montenegro, where the process of privatizing the largest commercial bank is expected to be initiated by end-

September. The decisions on the resolution of the remaining 11 commercial banks should also be made by the end of this month based on the results of the recently conducted diagnostic studies.

The new privatization framework adopted by Serbia in June 2001 is expected to contribute to a significant acceleration of privatization later this year and in 2002-2003. For large enterprises the main objective is to establish a clearly defined ownership by selling, through competitive tenders, the majority stakes to strategic investors. Preparations for selling about 40 large socially owned companies are already well under way and the process of privatizing the remaining 4000 enterprises has been initiated. In Montenegro, the authorities have opted for a mass privatization scheme with vouchers to be distributed to the vast majority of the population. In addition to that the majority shares in 15 large enterprises and minority shares in some other companies will be offered to foreign investors through international tenders.

Our authorities fully share staff's assessment that sustainable growth and a viable external position cannot be achieved in the FRY without continued support from foreign creditors and donors. The successful conclusion of the June donor meeting, with pledges amounting to $1.28 billion, was a welcome indication of an emerging partnership between the international community and the FRY in addressing the very substantial economic recovery and transition needs. Our authorities count on a swift disbursement of the committed funds which are urgently needed both to cover the financing gaps in the Serbian and Montenegrin budgets in 2001 and to finance a large number of priority projects in such areas as energy sector, transport and urban infrastructure, water supply and aid for refugees and displaced people. The FRY authorities highly appreciate also the continued financial support and technical assistance provided by the Fund and they look forward to the forthcoming resumption of the World Bank/IDA financing.

However, as stressed by the staff, in view of the extremely heavy external debt burden the medium-term viability of the FRY's external position cannot be assured without a concessional restructuring of the FRY's foreign obligations. The debt servicing costs would remain very substantial even after the provision of debt relief on Naples terms. The unresolved debt problem can be seen as a major impediment to the FRY's reform effort and as very serious constraint to foreign investment. It may also negatively affect the implementation of the ambitious privatization program. Our authorities would like to stress that an undue delay in providing the debt relief may result in losing the reform momentum and increased risk of growing social tensions. Solving the debt problem is also an indispensable condition for starting the process of reestablishing the FRY's access to the international capital market. All this means that both the scope and the timing of the debt relief are of crucial importance for the continuation of the FRY's reform effort and for the prospects of achieving a sustainable economic growth.