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Serbia and Montenegro: Second Review Under the Extended Arrangement and Requests for Waiver and Modification of Performance Criteria, and for Extension of Repurchase Expectations—Staff Report; Staff Statement; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Serbia and Montenegro

In the context of the second review under the Extended Arrangement and requests for waiver and modification of performance criteria, and for extension of repurchase expectations, the following documents have been released and are included in this package:

- the staff report for the first review under the Extended Arrangement, prepared by a staff team of the IMF, following discussions that ended on **May 29, 2003,** with the officials of Serbia and Montenegro on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on July 14, 2003**. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a Press Release summarizing the **views of the Executive Board as expressed during its July 30, 2003 discussion** of the staff report that completed the review.

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

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

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

*May also be included in Staff Report

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

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SERBIA AND MONTENEGRO

Second Review Under the Extended Arrangement and Requests for Waiver and Modification of Performance Criteria, and for Extension of Repurchase Expectations

Prepared by the European I and Policy Development and Review Departments

Approved by Carlo Cottarelli and G. Russell Kincaid

July 14, 2003

The discussions for the second review under the Extended Arrangement (EA) were held in Belgrade and Podgorica during May 14–29, 2003.

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

The SM delegation was headed by National Bank of Serbia (NBS) Governor Dinkic and included: (a) at the union level, International Economic Relations Minister Lukovac; (b) in Serbia, Finance Minister Djelic, International Economic Relations Minister Pitic, Energy and Mines Minister Udovicki, and Privatization and Economy Minister Vlahovic; and (c) in Montenegro, Finance Minister Ivanisevic and Chairman of the Central Bank Council Krgovic. The mission also met with Serbian Premier Zivkovic.

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

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Appendices

I. Introduction

1. On April 16, 2003, the Executive Board completed the first review (and the second and third financing reviews) under the extended arrangement for SM approved in May 2002 (Appendix I).[1] SM has made four purchases under the arrangement. The fifth purchase is conditional on the observance of end-June 2003 performance criteria and completion of the second review (and the fourth financing review). The sixth purchase—available after August 14, 2003—is conditional on completion of the fifth financing review.

2. In the attached letter of July 11, 2003, and the accompanying Memorandum on Economic and Financial Policies, the authorities outline policies for the period through end-2003 (Appendix VI). On this basis, they request (a) waiver of end-June 2003 performance criteria (PC) pertaining to NFA and an electricity price increase;[2] (b) modification of the end-September and end-December 2003 PCs relating to NDA and NFA; (c) completion of the second program review and the fourth and fifth financing reviews; and (d) rephasing of the sixth purchase to July 28, 2003.

3. **The World Bank is involved closely in SM's reform efforts** (Appendix II). Contingent upon policy performance, the Bank envisages concessional lending of up to \$540 million for FY 2002–04 (mostly in adjustment loans). Of this amount, \$397 million has already been approved, in support of fiscal consolidation, private and financial sector development, and social sector reforms. An interim Poverty Reduction Strategy Paper (PRSP) was considered by the Boards of the Fund and the Bank last August, and a full PRSP is expected to be completed around October 2003.

4. **Progress has been made toward political stability but tensions persist.** Following Serbian Premier Djindjic's assassination in mid-March, Mr. Zivkovic (his successor) moved quickly to restore confidence by renewing the government's commitment to reform and taking strong measures against organized crime and political extremists under a six-week state of emergency. Notwithstanding internal tensions, the unity of the multi-party governing coalition was preserved. Meanwhile, cooperation between Serbia and Montenegro improved following adoption of a new constitution last February, as indicated by a recent agreement on a plan to harmonize trade, customs and indirect tax regimes—a precondition for negotiations

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[1] The extended arrangement was for SDR 650 million (139 percent of quota), available in 13 purchases of SDR 50 million each.

[2] Based on preliminary information, other end-June PCs were observed. Updated information as needed will be provided to the Executive Directors prior to the Board meeting to discuss this report.

on a Stabilization and Association Agreement with the EU.[3] Tensions remain, however, owing in part to pro-independence sentiment in both republics.

II. Background

5. **As described in EBS/03/41 (4/2/03), economic performance in 2002 was generally favorable with good policy implementation, but considerable risks remain.** Annual inflation declined by two-thirds to 14 percent by year-end, foreign reserves nearly doubled, and real GDP and exports continued to grow, albeit from low levels (Tables 1–2, Figures 1–4). However, the current account deficit (before grants) reached 13 percent of GDP in 2002, 1 percentage point above the program target, reflecting the larger-than-expected impact on domestic demand of the fiscal stimulus and rapid growth in bank lending, and the continued real appreciation of the dinar. The fiscal deficit rose to 4½ percent of GDP in 2002, compared with a program target of 5.3 percent.[4] Remonetization—boosted by the euro conversion process—facilitated a surge in bank credit to the economy.

6. **In early 2003, inflation declined further while growth was moderate.** (The 2003 macroeconomic program is summarized in Text Table 1.) Twelve-month retail inflation fell further to 13½ percent in May, in line with the 9–11 percent end-year target.[5] Based on recent developments, the 3½–4½ percent growth target in 2003 appears achievable, albeit subject to downside risks especially in light of conflicting signals from different indicators. While rising exports and tax revenue point to moderate growth, official data imply that gross industrial output declined by 3 percent in January–April 2003 compared with the same period in 2002. This may be explained by the fact that the official data do not cover private activity adequately and also reflect output losses in inefficient enterprises due to the hardening of budget constraints over the past two years.

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[3] The new constitution provides for common defense and foreign policies; acknowledges the existence of different monetary, exchange, customs, and tax regimes (consistent with a free trade area); and envisages harmonization of the economic systems of the two states with that of the EU. Serbia continues to use the dinar, while Montenegro uses the euro as its sole legal tender. Member states maintain customs controls to safeguard their customs and tax collections and finance all union-level expenditures through transfers to the union budget, proportional to their share in total GDP (Montenegro accounts for about 7 percent of SM's economy). After three years, each state may choose to gain independence following a referendum.

[4] Following a revision of cash privatization proceeds, the fiscal deficit is estimated to be 0.5 percent of GDP lower than in EBS/03/41, essentially eliminating the earlier discrepancy between above- and below-the-line items.

[5] This takes into account that administered price increases in the remainder of 2003 will be lower than in the corresponding period of 2002.

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

	2001	2002		2003		2004	2005
	Actual	Prog.	Prel. Est.	Prog.	Rev. Proj.	Prog.	Prog.
				(Percentage change)			
Real GDP Growth	5.5	4.0	4.0	3½–4½	3½–4½	4.0	4.5
Inflation (end period)	39.0	20.0	14.2	9–11	9–11	7.0	5.0
Of which : Montenegro	24.0	12.0	9.4	8.0	9.0	5.0	4.0
				(In percent of GDP)			
Domestic investment	13.5	15.4	16.1	16.6	16.6	17.8	19.5
Domestic savings	-8.6	-6.4	-7.0	-3.5	-3.9	-2.0	1.3
National savings	8.0	7.2	7.2	8.3	8.4	9.1	12.1
Current account deficit (before grants)				(In billions of US$)			
US$ billion	1.1	1.6	2.0	2.2	2.3	2.2	2.0
In percent of GDP 1/	9.7	12.0	12.8	11.0	10.9	10.2	8.9
Excluding net interest payments (percent of GDP) 1/	9.0	9.8	11.7	8.9	9.2	7.9	6.3
Gross official reserves	1.2	1.6	2.3	2.7	2.9	3.2	3.6
In months of projected imports	2.4	3.0	3.2	3.8	3.7	3.8	4.0
				(In percent of GDP)			
Fiscal Deficit 1/	1.4	5.3	4.5	4.5	4.5	4.3	3.9
Government credit from the banking system	0.7	0.5	-0.5	0.0	0.0	0.5	0.8
				(In percent of year-beginning reserve money)			
NFA growth	86.8	24.6	52.4	12.8	6.9	...	...
NDA growth	2.3	11.9	-4.2	0.0	4.3	...	...
Reserve money growth	89.1	36.5	48.1	12.8	11.3	...	...

Sources: SM authorities; and IMF staff estimates.

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

7. **The current account deficit showed some improvement in early 2003, reflecting a narrowing of the trade deficit.** *Import* volume growth decelerated sharply to 11½ percent in January–April 2003, year-on-year (from 33 percent in 2002 Q4), apparently reflecting the lack of fiscal stimulus (after a large increase in the fiscal deficit in 2002), credit growth deceleration, and the real depreciation.[6] *Exports* grew by 9 percent (slightly lower than in 2002 Q4) but remained low by historical standards, reflecting in part economic restructuring and still limited access to networks abroad (Figure 3). The current account deficit in January–April amounted to $0.7 billion, broadly in line with the program target.

8. **Lower net capital inflows, together with weak fiscal-monetary policy coordination, placed monetary policy under pressure.** The capital account worsened in 2003 Q1, reflecting mainly (a) the lagged effects of a peak in the trade deficit in late 2002 coupled with a repurchase of Serbian Telecom shares from the Italian Telecom, (b) delays in foreign assistance, (c) a decline in confidence owing in part to the Serbian Premier's

[6] The dinar depreciated by 7 percent against the euro during January-May 2003, appreciated by 2 percent during June and, by early July, returned to about its end-May level; this compares with an inflation rate of 3.7 percent during January–June 2003.

assassination, and (d) an initial boost in commercial bank liquidity from a large accumulation of government deposits after the domestic payments reform in January (see Box 1 on the domestic payments reform).[7] These developments contributed to an almost $300 million decline in banking system NFA and to nongovernment deposit withdrawals from commercial banks during January–March 2003, while bank credit to non-government continued to grow, albeit at a lower rate than in 2002.[8] In the resulting conditions of tight bank liquidity, the end-April ceiling on NDA was exceeded, as government bank deposits could not be transferred to the NBS nor could NBS tighten credit through other means without unduly squeezing the banking system.[9] Despite the large increase in NDA, reserve money declined in real terms in early 2003, apparently reflecting the weakening of confidence, thereby reversing partially a large increase over the past two years. With enhanced fiscal-monetary policy coordination and a more flexible exchange rate policy geared to improving competitiveness, NDA was brought back on track in May while condition in the foreign exchange market improved.[10]

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[7]The liquidity impact of these government deposits was partially sterilized by a temporary increase in the reserve requirement ratio from 20 percent to 23 percent in March. The ratio was gradually brought back to 20 percent by May and further lowered to 18 percent in July in tandem with a shift of government deposits from commercial banks to the NBS.

[8] Credit to nongovernment grew at an annualized rate of 30 percent during January–April 2003, compared with 50 percent in 2002. About 25 percent of the new lending was for the Telecom repurchase, 20 percent to households, 25 percent to private enterprises, and 30 percent to socially owned and state enterprises.

[9] The end-April NDA ceiling would have been probably exceeded only marginally if it had been set on the basis of revised data for January–March 2003.

[10] The NBS sold $210 million in the interbank foreign exchange market on a net basis in January–March (largely corresponding to NFA overperformance in 2002) before turning into a net purchaser of $70 million in April–June, 2003.

Box 1. Domestic Payments Reform in Serbia

The reform of Serbia's domestic payments system in January 2003 was a major step in market reform. But its implementation—albeit generally successful—complicated initially fiscal and monetary policy implementation.

- Until January 2003, the Accounting and Payment Operations Office (ZOP) (a) had a statutory monopoly on payments on behalf of banks and their clients, and (b) performed fiscal functions (such as assessment and collection of wage-based taxes, expenditure execution, and fiscal reporting). Its monitoring capabilities underpinned the control of enterprises and banks in the socialist regime.

- With a view to fostering financial sector development, the authorities—with TA from the Fund—replaced the ZOP by a market-oriented system in January 2003: (a) ZOP's interbank payment functions were replaced by a settlement system and a clearing center within the central bank; (b) retail payments moved to commercial banks, which now carry out payments and settlements among themselves and on behalf of their clients; and (c) fiscal functions were transferred to agencies under the Finance Ministry.

- Owing to initial difficulties in the tax collection and cash management systems, government revenue accumulated in commercial banks, raising government bank deposits from SRD 16 million at end-2002 to SRD 24 billion (29 percent of total dinar deposits) at end-February 2003. This facilitated nongovernment deposit withdrawals and foreign exchange outflows in response to a decline in confidence. The resulting tightening of bank liquidity constrained the withdrawal of the government deposits and forced the government to contain spending below programmed levels and, to a lesser extent, borrow from the NBS. Meanwhile, disruptions in monetary statistics led to an underestimation of reserve money in 2003 Q1, which served as a basis for setting NDA program ceilings, by 4 percent.

9. **Fiscal policy was cautiously implemented in early 2003.** The overall fiscal deficit was 0.5 percent of annual GDP in January–April 2003, below the 1.4 percent program target, reflecting mainly spending restraint in response to financing shortfalls:

- In Serbia, the government lowered spending below budget allocations by the equivalent of 0.6 percent of annual GDP owing to delays in foreign assistance and limited access to domestic bank financing.[11] Revenue was in line with the program,

[11] The ceiling on government credit from the banking system was comfortably observed as the government could not run down its illiquid deposits with commercial banks; and, in light of the breach of the NDA ceiling, could not borrow more from the NBS.

having recovered from an expected weak performance in January due to the domestic payments reform. In addition, unprogrammed surpluses were recorded by local governments and other indirect budget users (0.3 percent of GDP).

- In Montenegro, a revenue shortfall of 0.9 percent of its annual GDP—attributable mainly to reform-related pressures on tax administration—together with limited financing, led to a containment of expenditure and some arrears accumulation. The consolidated deficit was 0.8 percent of Montenegro's annual GDP compared with a target of 1.1 percent.

10. **Structural reforms have fallen behind program expectations but the delays are being addressed.** Owing largely to disruptions in government activity in Serbia after Premier Djindjic's assassination and the holding of presidential elections in Montenegro, only three of six structural benchmarks through early July have been implemented, but the rest are expected to be implemented by end-July 2003 (Annex B to the MEFP). Notably, agreement on a timetable to harmonize the trade, customs, and indirect tax regimes of the two republics was reached in early July. Moreover, good progress has been made in other areas, especially privatization (with another €193 million of sales in January–May 2003), pension reform in Serbia (redefinition of the benefit formula and tightening of disability benefits), tax reform in Montenegro (adoption of a single-rate VAT on April 1), and the adoption of legislation improving the business environment (on leasing, concessions, secured transactions, and construction).

III. Policy Discussions

11. **The discussions highlighted the need for prudent policies and strengthening of structural reform.** In light of recent developments, the key objectives of the program (inflation, growth, and the current account deficit) appear to be achievable, albeit with downside risks to growth. With the current account deficit still large, however, the external position remains vulnerable to shocks, as demonstrated by developments in early 2003. Accordingly, while the current stance of macro policies appears broadly appropriate, these policies need to be under constant review in light of developments in the external accounts. Moreover, enduring growth will require further improvement in external competitiveness, progress in restructuring the banking and enterprise sectors, and an improved business environment. The authorities noted that delays in reform were being addressed, while the crackdown on organized crime should improve the business environment (¶7).[12] In Montenegro, the discussions focused in particular on the need for wage restraint and productivity improvement to address the effects of the euro appreciation.

[12] Henceforth, references to paragraphs pertain to the MEFP in Appendix VI.

12. **Against this background, the authorities confirmed the fiscal deficit targets for 2003 and revised the monetary program to reflect lower-than-programmed capital inflows.** The fiscal deficit will be kept to 4.5 percent of GDP in 2003 as originally programmed. While the downward revision of the 2002 fiscal outturn by ½ percentage point now implies an unchanged fiscal deficit in 2003, the authorities and the mission agreed that—given indications of weakness in domestic demand, declining inflation, and an improved trade account in early 2003—fiscal tightening no longer appeared warranted.[13] In light of a decline in projected capital inflows owing to a deterioration in market sentiment and of subdued inflation so far, the NFA and NDA targets for the remainder of the year were relaxed so as to support growth without jeopardizing the inflation target. Accordingly, the authorities request waiver of the PC on NFA for end-June and modification of the PCs on NDA and NFA for end-September and end-December 2003.[14] Compared with the original program, credit policy will be tighter in the second half of the year after having been looser in the first half, while fiscal policy will be more relaxed after having been tighter than programmed in the first half of the year. Exchange rate policy will support competitiveness and remain subject to review in light of trade, wage, and price developments.

13. **In the remainder of 2003, structural reforms will focus on tax administration and expenditure management, banking supervision and resolution, and privatization.** Key measures include the implementation of a treasury single account, the strengthening of banking supervision, the adoption of a resolution plan for the largest Serbian bank, further enterprise privatization, and the adoption of a modern bankruptcy law.

14. **The public sector and external debt sustainability outlook remains broadly unchanged from EBS/03/41 (Appendices IV and V).** Under the baseline scenario, debt ratios are expected to decline steadily albeit from very high levels, while debt service ratios would increase until 2009—reflecting the end of the grace period on restructured debt—and decline gradually afterwards. The differences with the April projections—mainly somewhat higher external debt-to-GDP and debt service-to-GDP ratios—are mostly accounted for by the valuation effects of exchange rate movements on dollar debt, debt service, and GDP; a larger-than-earlier projected real depreciation of the dinar; a slight downward revision of the growth outlook; and the delayed agreements with the London Club and other bilateral

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[13] Excluding local governments and foreign loan-financed project spending—which are not under direct central government control—the fiscal deficit is still targeted to decline by ½ percentage point of GDP in 2003 as under the original program. The lower-than-programmed fiscal deficit in 2002 reflected in large part unprogramed surpluses by local governments, which, in light of developments through April, may well be repeated this year.

[14] The authorities also request an extension of the repurchase expectations arising in September–December 2003 to the obligations schedule, on the basis that SM's external position is not sufficiently strong to allow repayment without undue hardship or risk.

creditors. The public debt sustainability outlook also remains broadly similar to that in EBS/03/41 after taking into account the rephasing of the London Club agreement.

A. Fiscal Policy

15. **The 2003 fiscal program features no further fiscal stimulus as well as lower revenue and expenditure in relation to GDP (see EBS/03/41 for details).** Current expenditure (mainly subsidies and nonpriority spending) declines by 2 percentage points, making room for a lower tax burden in Serbia; the latter reflects tax relief, a lower consumption tax base in relation to GDP, and one-time losses from the domestic payments reform on January 1. The deficit is financed externally and by privatization proceeds, with domestic financing limited to seasonal needs. Excess privatization proceeds, after covering any shortfall in foreign budgetary financing, will be used to reduce net government indebtedness.

Serbia

16. **Achieving the fiscal deficit target of 4.1 percent of GDP in 2003 hinges on the government's commitment to keep expenditure at 0.5 percent of GDP below budget allocations on a net basis** (Text Table 2, memorandum item). The spending cuts will affect wages (through attrition and a freeze on the wage bill through the middle of the year), transfers, capital outlays, and net lending (¶10). At the same time, transfers to the pension fund and the unemployment fund will be increased to cover a revenue shortfall and finance a one-off partial payment of old unemployment benefits arrears, respectively. As envisaged under the program, excises on gasoline and administrative fees were raised in May (with expected full-year impact of 0.4 percent of GDP). In addition, the pension contribution rate was raised by 1 percentage point to cover an expected shortfall in pension fund revenue (yielding 0.2 percent of GDP on a full-year basis).

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

(In percent of GDP) 2/

	2000	2001	2002		2003		2004	2005
		Prel.	Prog.	Prel.	Prog.	Proj.	Proj.	Proj.
Total revenue	36.7	38.9	40.3	42.8	40.5	40.7	41.1	40.6
Tax revenue	33.1	35.5	37.5	39.6	37.8	37.4	38.4	37.9
Nontax revenue	3.6	3.5	2.8	3.2	2.7	3.4	2.7	2.7
Capital revenue	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0
Total expenditure and net lending	37.6	40.3	45.7	47.3	45.1	45.3	45.4	44.5
Purchases of goods and services	17.4	17.4	16.5	18.3	17.5	17.6	17.3	16.7
Of which : Wages and salaries	9.4	9.5	9.4	10.3	10.2	10.6	10.2	10.0
Interest payment	0.6	0.7	1.7	1.0	1.1	1.2	1.5	1.6
Subsidies	2.1	3.1	4.0	4.4	3.2	3.1	2.9	2.6
Transfers to households	14.3	16.4	18.9	19.6	19.4	19.7	19.2	18.7
Capital expenditure	3.1	1.6	3.5	3.4	3.4	3.0	4.0	4.4
Other	0.2	1.0	1.0	0.5	0.5	0.7	0.5	0.5
Unclassified spending (incl. stat. discr.) 3/	0.0	0.1	0.0	0.1	0.0	0.0	0.0	0.0
Overall cash balance	-0.9	-1.4	-5.3	-4.5	-4.5	-4.5	-4.3	-3.9
Financing	0.9	1.4	5.3	4.5	4.5	4.5	4.3	3.9
Domestic financing	0.2	0.7	0.6	-0.5	0.0	0.0	0.5	0.8
Foreign grants	0.7	0.7	0.9	1.1	0.7	0.9	0.7	0.5
Net foreign financing	0.0	0.0	2.5	1.8	2.0	1.9	1.9	1.6
Budgetary loans	0.0	-0.2	1.4	1.0	0.9	0.9	0.6	0.3
Project loans	0.0	0.2	1.1	0.8	1.1	1.1	1.4	1.3
Privatization receipts	0.0	0.0	1.2	2.2	1.8	1.7	1.2	1.0
Memorandum items:								
Social spending 4/	20.5	21.8	22.9	23.6	23.4	23.7	23.2	22.7
Overall cash balance excluding project spending	-0.9	-1.2	-4.2	-3.7	-3.4	-3.5	-2.9	-2.6
Overall cash balance of:								
Serbian general government	-0.2	-0.9	-5.0	-4.2	-4.1	-4.1	...	...
Montenegrin general government	-0.7	-0.4	-0.4	-0.3	-0.4	-0.4	...	...
Overall cash balance of general government in Montenegro (in percent of its GDP)	-6.7	-4.7	-4.7	-4.0	-5.6	-5.6	...	...

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

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

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

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

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

17. **Reform of tax administration and public expenditure management will continue broadly as originally programmed (¶11).** With increased efforts under a new tax administration management, progress is envisaged in strengthening and extending the large taxpayers unit (SB-monitored), improving tax audits, and introducing self-assessment. According to firmed-up plans, a VAT law will be adopted by mid-2004 for implementation by January 2005. Regarding treasury reform, a decision has been taken to close all direct budget users accounts and transfer them to the treasury single account (TSA) in the NBS; implementation of the decision is expected in September, except for the Interior Ministry which would take place at end-December.

Montenegro

18. **Montenegro's revised fiscal plan involves expenditure cuts to ensure achievement of the deficit target of 5.6 percent of Montenegro's GDP (0.4 percent of SM's GDP, ¶12).** Revenue appears to have recovered after a weak performance in 2003 Q1—attributed to temporary problems in tax administration—but is still projected to register a shortfall of 0.9 percent of GDP in 2003. Expenditure cuts affect mainly social transfers, subsidies, and investment, and also involve wage restraint and around 3,500 retrenchments, primarily from the overstaffed Interior Ministry and the education sector.

19. **Fiscal reform has continued to advance but significant challenges remain (¶13).** The VAT introduction has been relatively smooth (collection difficulties were apparently overcome by May), and future efforts will focus on controlling the Serbia-Montenegro border and ensuring effective processing of revenues and refunds. A proposed Pension Law—raising the retirement age by 5 years in a phased manner and modifying the indexation formula in line with World Bank recommendations—is expected to be adopted by end-July 2003 and come into effect by January 2004.

B. State Enterprises

20. **State enterprises are expected to improve their profitability through wage restraint, administered price adjustments, and restructuring (¶14–15).** The indicative ceiling on the wage bill in large state enterprises for January–April 2003 was exceeded by 2 percent (reflecting in part overtime due to the state of emergency) but the annual target appears to be within reach in light of planned employment cuts and renewed undertakings by the Finance Ministry to scrutinize personnel costs. Electricity prices in Serbia were raised by 15 percent on July 1 (against 20 percent specified in the end-June structural PC), in line with World Bank recommendations.[15] According to revised Bank and Fund staff estimates, a 15 percent price increase—in conjunction with significant measures to restructure EPS (spinning off non-core units, cutting core employment by 15 percent in 2003 Q3, and raising the collection rate)—should have similar implications for the budget and the financial position of EPS, including its ability to invest, as the originally envisaged 20 percent price increase. Electricity pricing policy in 2004 will be discussed in the next EA review. As of May 2003, the Serbian government had adopted medium-term strategic plans for two out of eight enterprises (the electricity company EPS and the airline JAT). Restructuring plans for the most of the rest involving significant employment cuts are expected by end-July.

C. Monetary and Exchange Rate Policies

21. **The NBS revised the 2003 monetary program (¶16).** The NFA floors for the remainder of the year were lowered to reflect larger-than-originally-envisaged foreign

[15] Montenegro raised electricity prices by 23 percent on April 1, 2003.

financing needs that could be met only in part by additional BOP/budgetary assistance from the EU and other donors of about $120 million, and the NDA ceilings were raised to avoid an undue tightening of liquidity conditions, albeit by smaller amounts consistent with a weaker-than-earlier-projected money demand (Text Table 3). Even with these adjustments, the monetary program envisages that NFA would increase, and NDA would decline, in the remainder of the year, while NBS' gross official reserves would rise by another $0.6 billion to $2.9 billion by end-2003 (3.6 months of projected imports). Reserve money is now targeted to rise by 11½ percent, compared to 13 percent under the original program. Credit to the nongovernment sector is targeted to increase by about 20 percent, compared with 50 percent in 2002.

Text Table 3. Monetary Indicators, 2001–2003

	2001	2002	2003								
	Dec.		April		June	June	Sep.	Dec.	June	Sep.	Dec.
	Act.		Orig. Prog.	Act.	Prel.	Orig. Prog.			Rev. Prog.		
	(Cumulative contribution to reserve money growth based on monthly average, in percent)										
NFA 1/	86.8	52.4	-15.0	-14.2	-9.5	-3.2	6.3	12.8	-14.6	-5.3	6.9
NDA 1/	2.3	-4.2	13.3	16.3	11.1	7.7	4.4	0.0	15.7	12.1	4.3
Reserve money 1/	89.1	48.1	-1.7	2.2	1.5	4.4	10.7	12.8	1.1	6.7	11.3
	(Cumulative change during the year based on monthly average, in percent)										
Currency in circulation 1/	131.6	49.4	-0.9	-0.8	-1.2	2.4	10.1	14.1	0.6	3.2	9.4
	(Cumulative change in millions of U.S. dollars from year-beginning; end-Dec.-previous year exchange rates)										
NFA 3/	306.6	354.9	-184.1	-152.9	-177.3	-65.0	30.0	91.8	-206.3	-86.3	42.0
Gross official reserves 3/	684.5	864.7	-9.0	-9.0	-23.2	91.7	328.0	384.3	-61.6	197.3	343.2
	(Cumulative percentage change from year-beginning)										
Memorandum items:											
Retail prices	39.0	14.2	2.4	2.6	3.9	5.9	7.2	9.0	3.9	6.8	9.0
Velocity (GDP/Reserve money) 2/	24.2	18.2	18.9	18.9	19.2	19.9	19.3	19.4	19.7	19.3	19.2
Cumulative change	-36.6	-24.8	3.9	3.9	5.6	9.8	6.3	6.8	8.6	6.3	5.8

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

1/ In 2001 and 2002, actual changes are based on monthly averages with end-year data as the base. Figures for 2003 reflect an assumed required reserve ratio of 23 percent.

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

3/ Excludes unfrozen foreign currency assets ($90.29 million) received in April 25, 2003.

22. **To improve monetary policy implementation and fiscal management, while maintaining stability in the banking system, the Serbian government will gradually shift its commercial bank deposits to the TSA in the NBS.** This shift will enhance treasury

cash management by improving the liquidity of government deposits, while strengthening fiscal-monetary policy coordination by assigning the main responsibility for liquidity management to the NBS. Accordingly, the government intends to halve its bank deposits during the remainder of the year to the equivalent of ⅔ of 1 percent of annual GDP at end-2003 and eliminate them during 2004 (¶17, monitored through an indicative target). The NBS will provide liquidity support against collateral to the banking system, which will be facilitated by the development in the coming months of monetary policy instruments such as repos and reverse repos, liquidity auctions, and an emergency credit facility for solvent banks experiencing liquidity problem. A committee will be established to coordinate NBS' monetary operations and treasury's cash and debt management (¶18).

23. **Exchange rate policy will continue to support external competitiveness (¶19).** As noted in EBS/03/41, exchange rate policy needs to strike a balance between the *external* and *inflation* objectives. Regarding the former, although there is no conclusive evidence of significant exchange rate overvaluation, the initial undervaluation of the dinar has been at least corrected (as indicated in part by the 50 percent real appreciation since end-2000) and a large current account deficit renders the external position vulnerable to shocks, raising questions about the economy's ability to sustain balanced growth. Regarding the latter, exchange rate stability has played an important role in firming price expectations and, by hardening budget constraints, in enterprise restructuring. Against this background and the need to assign increasing priority to the external objective, the mission welcomed the greater exchange rate flexibility in early 2003.

D. Bank Reform

24. **Bank restructuring and privatization will accelerate.** Serbia's banking system has undergone a major transformation over the past two years, notably with the 2002 closure of four large state banks and the entry of foreign and domestic private banks. The 2003 program envisages progress in resolving 12 banks nationalized through debt-equity swaps in late 2002, which account for about 55 percent of the bank assets (¶20 and Text Table 4). Based on diagnostic reports near completion, the government will adopt a resolution plan for the largest of these banks by end-September in consultation with the Fund and the Bank (SB-monitored) and offer another three banks for sale by end-December 2003 (SB-monitored). Controls and governance in nationalized banks have been strengthened to preserve their value.

Text Table 4. Serbia: Commercial Banks, End-March 2003 1/

	Number of Banks	Number of Employees	Share of Total Balance Sheet	Share of Total Deposits
(1) Banks with significant state equity participation (monitored by BRA)	9	10,547	50.1	42.9
(2) Banks under rehabilitation by BRA	3	1,044	4.5	0.8
(3) Bank under administration by NBS	1	39	0.3	0.3
(4) Other state and socially owned banks	9	3,771	15.3	17.0
(5) Domestic private banks	20	1,593	14.7	18.2
(6) Foreign banks	6	1,231	15.1	20.8
Total	48	18,225	100	100

Source: The National Bank of Serbia.

1/ The 12 nationalized banks include those in categories (1) and (2).

25. **The key challenge for banking supervision is to enforce prudential requirements.** The NBS has considerably enhanced the legal supervisory framework and its institutional capabilities over the past two years. Building on MFD and World Bank TA, the 2003 program envisages a strengthening of banking supervision and regulation through further improvements in off-site supervision (monthly reporting, regular analyses of banking system-wide data, and enhancement of the debt registry database) and intensification of on-site inspections to ensure full implementation of loan classification, provisioning, and minimum capital requirements (¶21). An early-warning system based on bank-specific indicators—phased in as accurate monthly data and analytical capabilities are developed—should allow timely initiation of corrective measures as needed, and provide input for pending bank resolution decisions.

E. Enterprise Restructuring and Privatization

26. **Further progress in privatization and enterprise restructuring is envisaged.** The tender program, seeking to sell large socially owned companies, regained momentum when costly social requirements—notably regarding guaranteed employment and high severance pay for laid-off workers—were relaxed this year (¶23). Auction sales of small firms have been sustained at high levels since late 2002, following a streamlining of the legislative framework. Total privatization sales are expected to reach €550 million (cash receipts of around €400 million) in 2003. The restructuring of some 30 large socially owned enterprises—so far primarily focused on reducing overstaffing prior to privatization through budget-financed severance packages—will benefit from envisaged amendments to applicable decrees and from administrative improvements. Total privatization receipts in Montenegro are expected at €70 million in 2003 (¶25).

IV. FINANCING ASSURANCES

27. **The London Club negotiations are ongoing.** Following reconciliation of the London Club data in February, the SM authorities will submit an Economic Paper to creditors by late July as a preparation for resumption of negotiations aimed at securing terms comparable to those granted by the Paris Club.[16]

28. **Overall, the external financing outlook remains satisfactory**. The current account deficit is projected to decline in 2003, reflecting continued export growth and contained demand for imported goods. Excluding the scheduled purchases from the IMF, total external grants and loans will reach $1.3 billion, including $388 million of budgetary assistance, based on existing commitments or indications from key donors.[17] These inflows, together with FDI and other capital inflows, will enable an increase in gross official reserves to $2.9 billion (3.6 month of imports) at end-2003.

V. STAFF APPRAISAL

29. **Serbia and Montenegro's performance under the EA has remained good, but there have been slippages in the structural reform area.** Given the vulnerable external position significant risks remain, and continued macroeconomic policy prudence and steadfast reforms are needed to achieve sustainable growth.

30. **The authorities have made further progress in stabilization and reform, while confronting new challenges**. In early 2003, inflation declined further and the trade deficit narrowed. Output and exports continued to grow, albeit at moderate rates and from low levels. While further progress has been made in enterprise and bank restructuring, this has yet to be reflected in stronger output performance. The key challenge remains to improve the growth performance, while keeping macroeconomic policies under close review, especially in light of developments in the external position. To this end, it will be critical to enhance the supply response through (a) an exchange rate policy geared to supporting competitiveness, (b) accelerated restructuring, and (c) an improved business environment. The recent agreement between Serbia and Montenegro on harmonizing the trade, customs, and indirect tax regimes should help strengthen the fiscal systems and improve efficiency in both states.

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[16] As of end-May 2003, 14 of 17 agreements with Paris Club creditors had been concluded or initialed.

[17] Of this amount, $120 million represents additional financing needs—arising from a shortfall in FDI and other capital inflows due to a decline in confidence after Premier Djindjic's assassination—that are expected to be covered by the EU and other donors.

31. **Achieving the fiscal deficit target will require maintaining expenditure commitments below budgeted amounts.** Spending restraint through end-April has demonstrated the capacity of the Serbian government to control commitments and augurs well for the future. In Montenegro, the staff welcomes the adoption of a revised spending plan to respond to revenue shortfalls and maintain the deficit target. In both states, the fiscal objectives as well as policy implementation should be kept under review in light of macroeconomic uncertainties. Ongoing fiscal reforms will be essential to achieve consolidation by strengthening tax collections, while further improving expenditure controls. Channeling all privatization receipts to the budget will ensure transparency and more efficient resource allocation.

32. **Monetary and exchange rate policies in Serbia should continue to balance the inflation and external objectives.** As the experience in early 2003 showed, the sensitivity of money demand to changes in market sentiment requires a flexible policy response, in close coordination with the treasury which still controls a large amount of liquidity in commercial banks. The staff welcomes the authorities' intention to move gradually all central government deposits from commercial banks to the NBS so as to enhance treasury cash management and the efficacy of monetary policy.

33. **The structural reform agenda is ambitious but achievable with increased effort.** The staff regrets the delays that led to the nonobservance of several structural benchmarks but welcomes the authorities' commitment to address them, and underscores the importance of reinvigorating reform. The NBS has properly emphasized the need to strengthen enforcement of prudential regulations, especially in light of weak compliance by some banks and the rapid growth in credit over the past year, which raise concerns about the quality of new lending. The authorities' plan to formulate and implement resolution plans for banks with significant state equity participation, while ensuring proper governance through intensified monitoring in the meantime, is key to establishing a sound banking system. As regards enterprises, the streamlined privatization procedures should help ensure investor interest in financially weaker companies and maintain the pace of privatization.

34. **The staff recommends completion of the second review under the extended arrangement and the financing reviews, and approval of waiver and modification of performance criteria.** The SM authorities have broadly adhered to the implementation of the program supported by the EA, making further progress in stabilization and reform. They have also been negotiating in good faith with their London Club and other creditors with a view to restructuring their debt on terms comparable to those granted by the Paris Club. The external financing of the program remains adequate.

VI. PROPOSED DECISIONS

The following draft decisions, which may be adopted by a majority of the votes cast, are proposed for adoption by the Executive Board:

Decision A: Completion of Second Program Review and Fourth and Fifth Financing Reviews

1. Serbia and Montenegro has consulted with the Fund in accordance with paragraphs 3(e) and (f) of the Extended Arrangement for Serbia and Montenegro to review program implementation, financing assurances and to reach understandings regarding the phasing of and conditions for disbursements during the second year of the arrangement.

2. The letter dated July 11, 2003 from the Minister of Foreign Economic Relations of Serbia and Montenegro, the Minister of Finance of the Republic of Serbia, the Minister of Finance of the Republic of Montenegro, the Governor of the National Bank of Serbia and the Governor of the Central Bank of Montenegro (the "Letter"), together with its Memorandum of Economic and Financial Policies (the "MEFP") and Technical Memorandum of Understanding (the "TMU") shall be attached to the Extended Arrangement for Serbia and Montenegro, and the letters dated April 1, 2003 and April 26, 2002 from the authorities of Serbia and Montenegro, and their attachments, shall be read as supplemented and modified by the Letter, and its attached MEFP and TMU.

3. Accordingly, the Extended Arrangement for Serbia and Montenegro shall be modified as follows:

(a) in paragraph 2(a) of the arrangement the date "August 15, 2003" shall be revised to read "July 28, 2003";

(b) for September 30, 2003 and December 31, 2003, the floor and ceilings for the quantitative performance criteria referred to in paragraphs 3(a)(i) to 3(a)(vii) of the arrangement shall be as set out in Annex A attached to the MEFP and further specified in Part II of the TMU;

(c) in paragraphs 3(a)(i) and 3a(ii) of the arrangement references to the "National Bank of Yugoslavia" shall be revised to read the "National Bank of Serbia";

(d) paragraph 3(f) of the arrangement shall be revised to read as follows:

"(f) after August 14, 2002, November 14, 2002, February 14, 2003, May 14, 2003, July 28, 2003, November 14, 2003, February 14, 2004, May 14, 2004, August 14, 2003, November 14, 2004, February 14, 2005, and April 30, 2005, until financing assurance reviews are completed, provided that no such reviews shall be necessary if Serbia and Montenegro does not have outstanding sovereign external payments arrears to private creditors and, by virtue of the imposition of exchange controls, there are no outstanding non-sovereign external payments arrears; or".

4. The Fund decides that the second review contemplated in paragraph 3(e), and the fourth and fifth financing reviews contemplated in paragraph 3(f) of the Extended Arrangement for Serbia and Montenegro are completed, and that Serbia and Montenegro may make purchases under the Extended Arrangement, notwithstanding the non-observance of the end-June 2003 quantitative performance criterion on net foreign assets specified in paragraph 3(a)(i), and of the end-June 2003 structural performance criterion on electricity

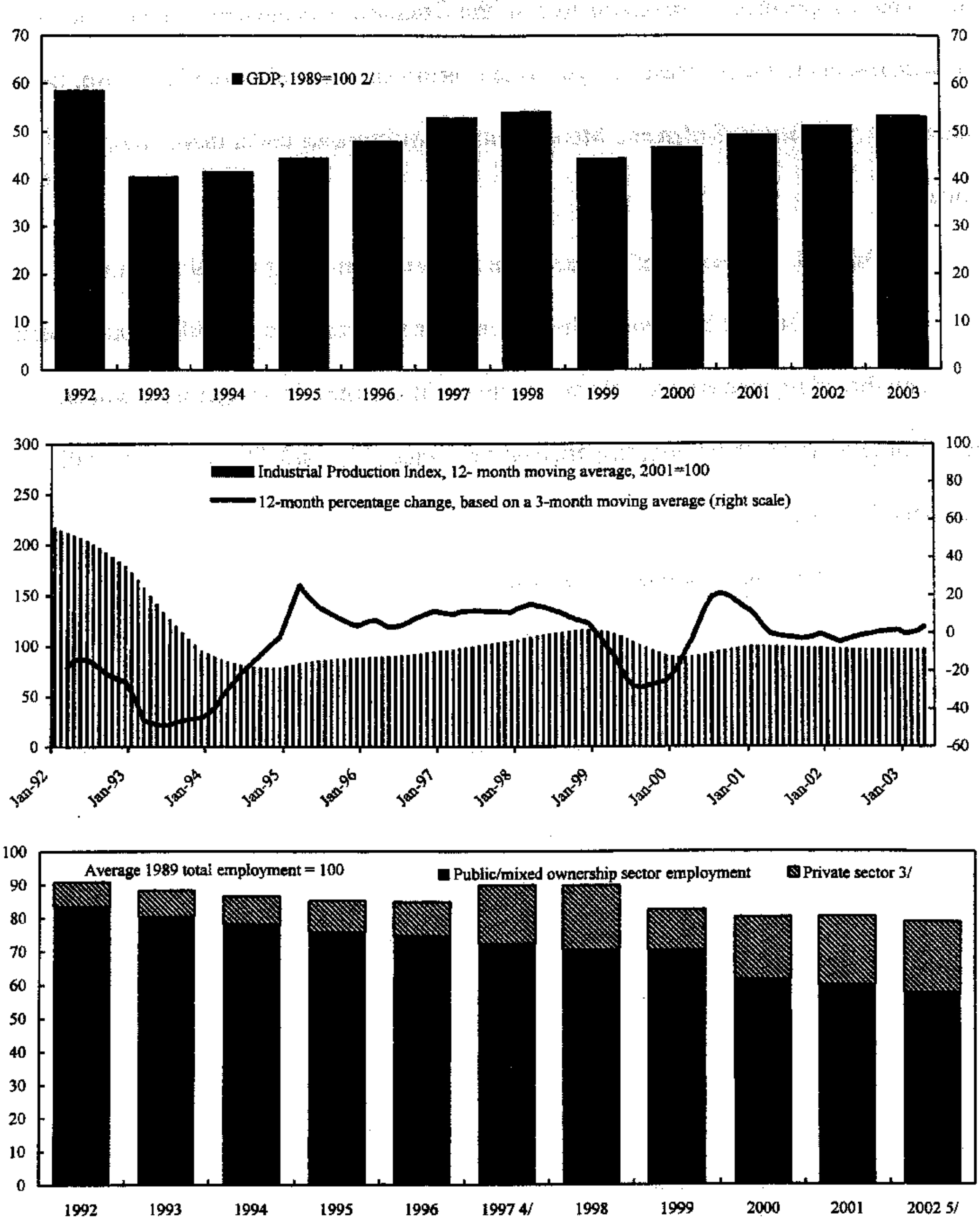
price increases specified in paragraph 3(cc) of the Extended Arrangement, on the condition that, with respect to the purchases subject to the performance criteria specified above, the information provided by Serbia and Montenegro on performance under these criteria is accurate.

Decision B. Extension of Repurchase Expectations in the Credit Tranches

1. Serbia and Montenegro has requested an extension to the obligations schedule of the time-based repurchase expectations in the credit tranches, in an aggregate amount equivalent to SDR 18.75 million, that arise on September 13, 2003, December 13, 2003, and December 23, 2003.

2. The Fund approves the request.

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



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

1/ Data refer to the territory of Serbia and Montenegro excluding Kosovo after February 1999.

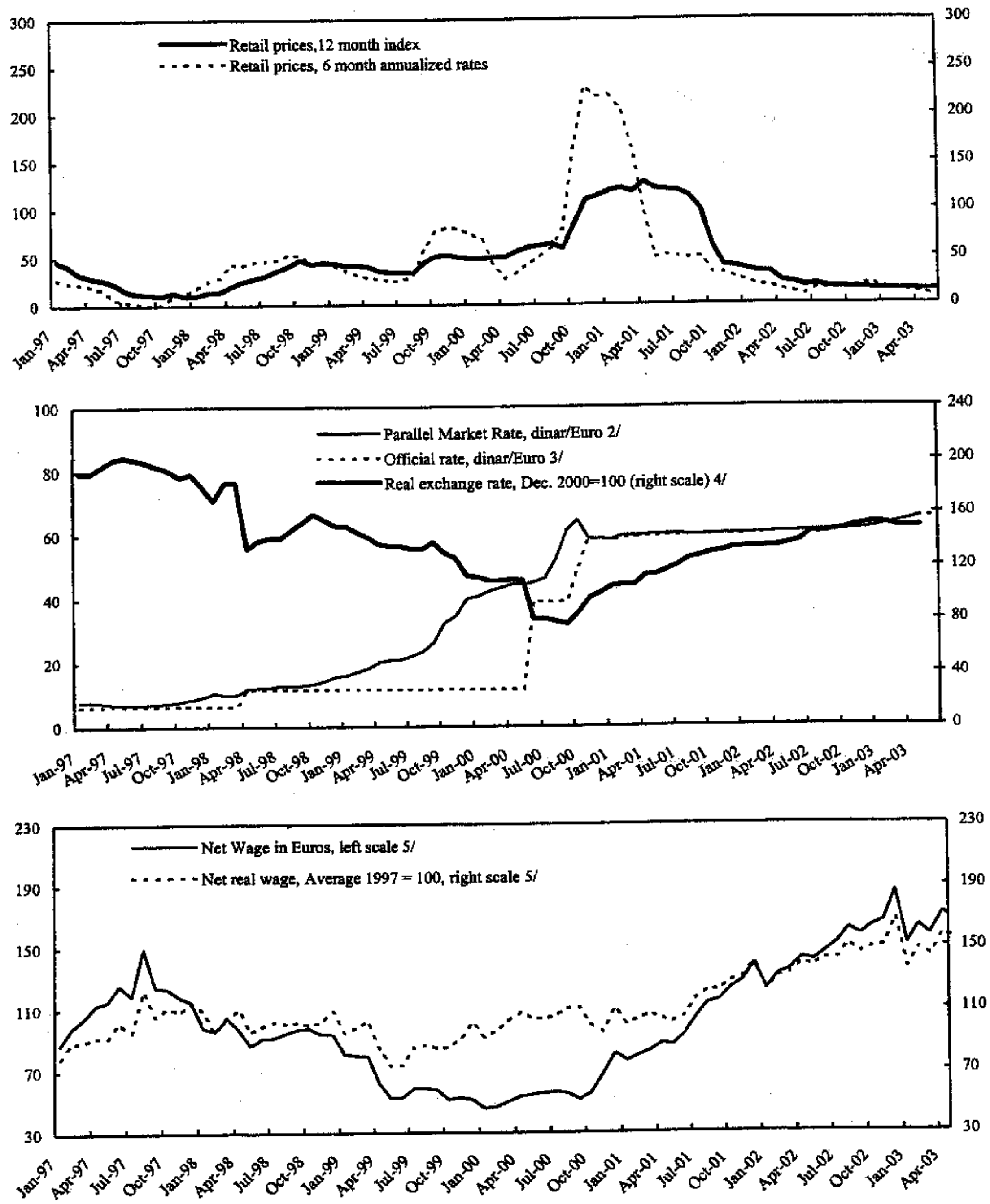
2/ Growth rates for 1990-94 refer to Gross Social Product (GSP), which excludes public and other services.

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

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

5/ 2002 data up to June.

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



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

1/ Data after February 1999 exclude Kosovo.

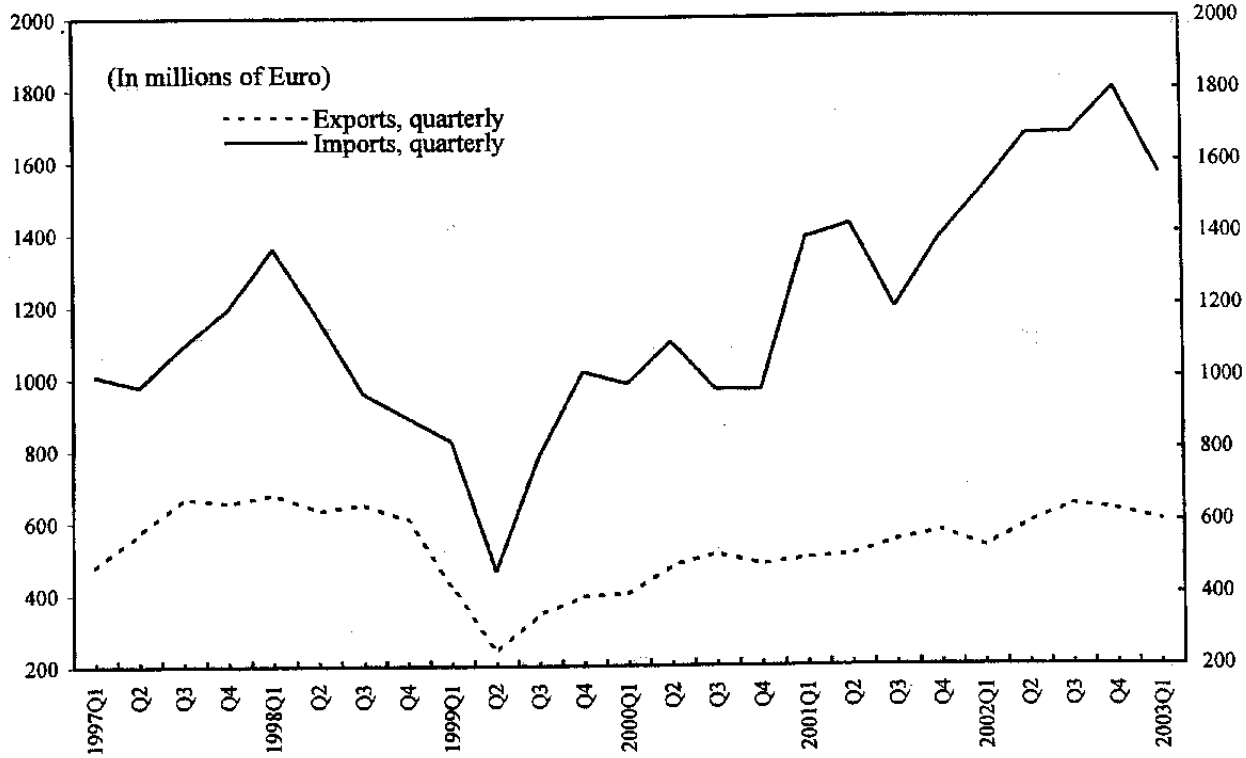
2/ Differences between official and parallel market rates have been negligible since December 2000.

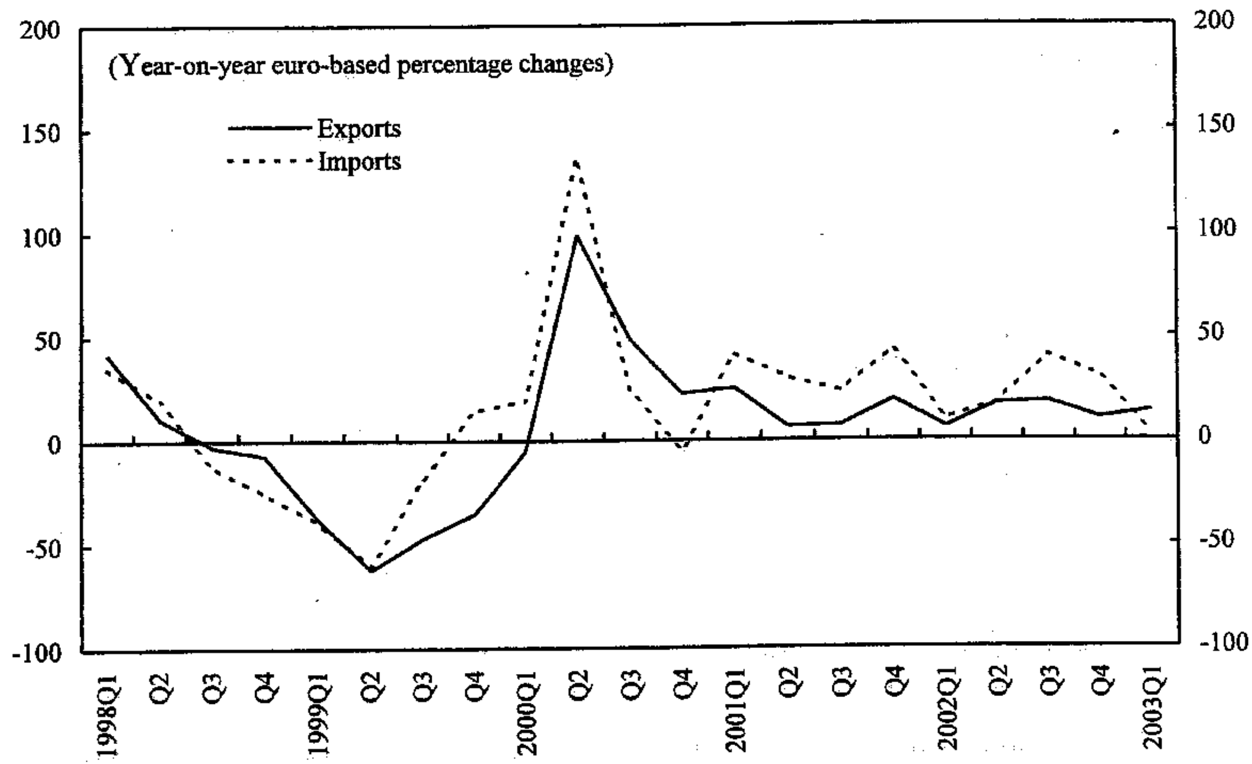
3/ The official exchange rate includes a premium which was applied in most but not all official transactions between May-November 2000. The exchange rate was unified on December 5, 2000.

4/ The index is calculated on the basis of a euro/dollar (70/30 percent) basket. Up to December 5, 2000 a weighted average of the official, commercial and parallel rates has been used; after December 5, 2000 the unified official exchange rate has been used. Increase denotes appreciation.

5/ Owing to a change in the definition of wages to include fringe benefits, the increase in the level of wages may be overestimated from June 2001. For the conversion to euro, a weighted average of the parallel, commercial and official exchange rates has been used.

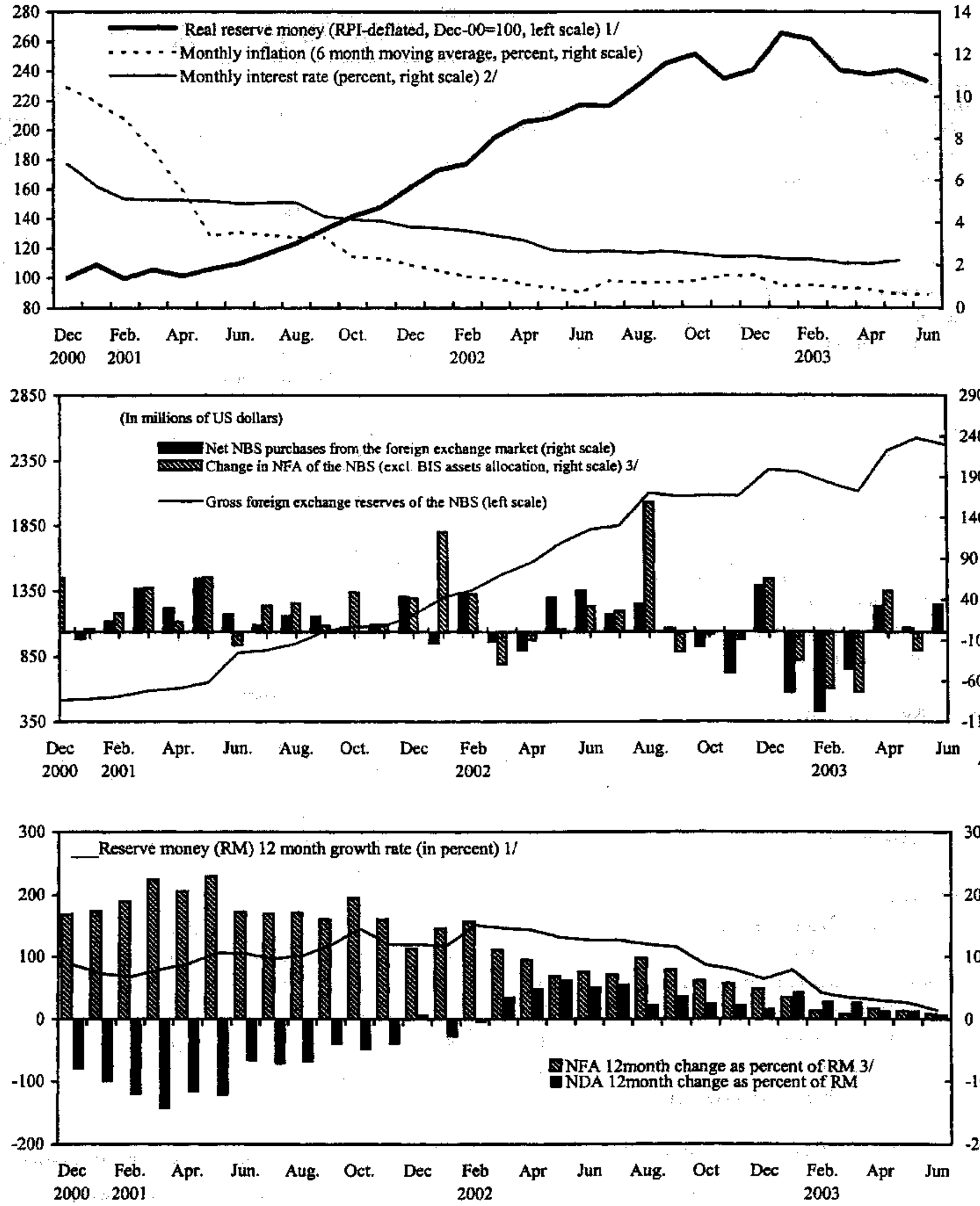
Figure 3. Serbia and Montenegro: Exports and Imports, 1997-2003





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

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



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

1/ Reserve money is based on monthly average and adjusted to be comparable with the widening of the reserve base in April 2002 and to a reserve ratio of 23 percent.

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

3/ NFA is at Dec. 01 exchange rates and excludes BIS assets allocation and write-off related to bank closures.

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

	2000	2001	2002		2003		
			Prog.	Prel. Est.	Prog.	Q1 Prel.	Rev. Proj.
Real economy							
GDP, in billions of DIN	381.7	771.8	1,043.5	1,006.9	...	...	...
GDP, in millions of U.S. dollars	8,603	11,577	13,687	15,681	...	...	...
Average net real wage, 1997 =100	103	115	...	142	...	143 6/	...
Average net wage in Euro	71	102	...	149	...	157 6/	...
			(Percent change)				
Real GDP	5.0	5.5	4.0	4.0	3½–4½	...	3½–4½
Industrial production	11.1	0.0	3.0	1.7	...	-3.1 7/	...
Retail prices (period average)	69.9	91.1	26.3	21.2	12-13	13.9	12-13
Retail prices (end of period, 12-month)	113.5	39.0	20.0	14.2	9-11	13.4	9-11
Unemployment rate (in percent)	25.9	27.0	...	28.9	...	...	...
		(Percent change)					
General government finances 2/							
Revenue	36.7	38.9	40.3	42.8	40.5	11.3 8/	40.5
Expenditure	37.6	40.3	45.7	47.3	45.1	11.8 8/	45.1
Cash balance	-0.9	-1.4	-5.3	-4.5	-4.5	-0.5 8/	-4.5
Foreign grants	0.7	0.7	0.9	1.1	0.7	0.0 8/	0.7
Foreign loans (net)	0.0	0.0	2.8	1.8	2.0	0.1 8/	2.0
Of which: Foreign financed projects	0.0	0.0	1.1	0.8	1.1	... 8/	1.1
Privatization receipts	0.0	0.0	1.2	2.2	1.8	0.3 8/	1.8
Domestic financing (Net)	0.2	0.7	0.4	-0.5	0.0	0.0 8/	0.0
Commitment balance 3/	-2.9	-1.4	-5.3	-4.5	-4.5	-0.5 8/	-4.5
		(12-month percent change)					
Money supply (end-of-period) 4/							
M1	85.2	114.4	45.0	80.3	13.9	30.1 8/	11.2
M2	61.4	79.1	49.5	76.8	11.9	38.7 8/	10.9
Balance of payments		(In billions of dollars)					
Merchandise exports	1.9	2.0	2.2	2.4	3.0	0.8 7/	3.2
Merchandise imports	-3.7	-4.8	-5.6	-6.3	-7.4	-2.1 7/	-7.9
Trade balance	-1.8	-2.8	-3.3	-3.9	-4.4	-1.3 7/	-4.8
Current account balance, after grants	-0.3	-0.5	-1.1	-1.4	-1.8	...	-1.7
(In percent of GDP)	-3.9	-4.6	-7.7	-8.8	-8.9	...	-8.2
Current account balance, before grants	-0.6	-1.1	-1.6	-2.0	-2.2	...	-2.3
(In percent of GDP)	-7.1	-9.7	-12.0	-12.8	-11.0	...	-10.9
Foreign debt (year-end) 5/	11.4	11.9	8.6	9.6	10.4	...	12.8
Gross official reserves	0.5	1.2	1.6	2.3	2.7	...	2.9
(In months of imports of goods and services)	1.2	2.4	3.0	3.2	3.8	...	3.6

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

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

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

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

4/ Excludes Montenegro.

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

6/ Period Average

7/ January–April, 2003; excluding Montenegro.

8/ January–April, 2003.

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

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

	1997	1998	1999	2000	2001	2002 Prel. Est.	2003 Orig. Prog.	2003 Revised Proj. 1/	2004 Revised Proj. 1/	2005 Revised Proj. 1/
Trade balance	**-2,070**	**-1,816**	**-1,619**	**-1,788**	**-2,834**	**-3,908**	**-4,404**	**-4,750**	**-4,852**	**-4,819**
Exports f.o.b.	2,756	3,033	1,676	1,923	2,003	2,412	2,972	3,185	3,796	4,366
(percent growth)		10.1	-44.7	14.7	4.2	20.4	23.2	32.1	19.2	15.0
(percent growth in euro)		11.8	-42.3	32.5	7.5	14.2	11.7	11.5	16.3	15.0
Imports f.o.b.	-4,826	-4,849	-3,295	-3,711	-4,837	-6,320	-7,375	-7,935	-8,648	-9,185
(percent growth)		0.5	-32.1	12.6	30.4	30.7	16.7	25.6	9.0	6.2
(percent growth in euro)		2.1	-29.1	30.0	34.5	24.0	5.2	5.0	6.1	6.2
Services (non-factor services, net)	**456**	**493**	**228**	**331**	**417**	**292**	**421**	**464**	**574**	**687**
Receipts	818	914	471	624	740	829	1,021	1,165	1,339	1,499
Expenditure	-362	-421	-243	-293	-323	-537	-600	-701	-765	-812
Net factor income	**25**	**8**	**-41**	**-1**	**-26**	**-111**	**-330**	**-246**	**-382**	**-459**
Of which: Net interest	25	8	-41	11	-26	-111	-330	-246	-382	-459
Earnings	59	57	43	53	48	62	99	103	122	135
Payments 2/	-34	-49	-84	-42	-74	-173	-429	-350	-504	-594
Private remittances, net	**310**	**655**	**668**	**848**	**1,324**	**1,719**	**2,124**	**2,260**	**2,442**	**2,570**
Inflows	662	1,033	948	1,132	1,698	2,089	2,499	2,650	2,832	2,960
Outflows	-352	-378	-280	-284	-374	-370	-375	-390	-390	-390
Current account balance, before grants	**-1,279**	**-660**	**-764**	**-610**	**-1,119**	**-2,007**	**-2,189**	**-2,272**	**-2,218**	**-2,021**
(In percent of GDP) 3/	-7.7	-4.8	-7.5	-7.1	-9.7	-12.8	-11.0	-10.9	-10.2	-8.9
Official grants 4/	0	0	0	271	591	624	0	0	0	0
Foreign direct investment, net 5/	740	113	112	25	165	562	731	623	747	827
Foreign loans, net	283	-10	-25	180	374	536	215	187	274	150
Medium and long term, net	54	25	12	213	299	378	135	97	184	60
Disbursements	128	50	29	227	332	421	240	253	298	322
Of which: Official creditors 4/					205	343	135	139	0	0
Amortization 1/	-74	-25	-17	-14	-33	-43	-105	-157	-114	-262
Short term, net	229	-35	-37	-33	75	158	80	90	90	90
Other capital inflows 6/	139	78	30	49	629	892	292	315	150	150
Commercial banks, net					-274	-144	-55	0	-60	-54
Capital account balance	**1,162**	**181**	**117**	**255**	**894**	**1,846**	**1,184**	**1,124**	**1,112**	**1,073**
(Capital account in euro terms)	1027	162	110	276	998	1955	1125	988	949	916
Errors and omissions	-103	278	410	267	239	320	250	409	300	290
Overall balance	**-220**	**-201**	**-237**	**183**	**605**	**783**	**-755**	**-739**	**-806**	**-658**
Financing	**220**	**201**	**237**	**-183**	**-5,981**	**-855**	**-4,737**	**-5,006**	**-193**	**-369**
Net foreign assets (increase, -)	18	115	111	-246	-395	-816	-140	-333	-193	-369
Central Bank, net					-395	-816	-140	-333	-193	-369
Gross foreign reserves (increase, -)	18	115	111	-227	-523	-1,111	-387	-611	-327	-318
Of which: IMF purchases				152	128	295	272	279	350	140
Gross foreign liabilities (increase +)	0	0	0	-19	128	295	248	279	134	-51
IMF repayment	0	0	0	20	0	0	-25	0	-216	-190
Arrears (reduction, -) 7/	202	86	126	63	-5,587	-39	-4,597	-4,673	0	0
Financing expected / to be secured						0	824	999	925	897
Official grants 4/						0	429	575	351	351
Official borrowing (excluding IMF) 4/						0	395	424	574	546
Residual gap					5,377	71	4,668	4,746	73	130
Arrears settlement with creditors 7/					5,377	39	4,597	4,673	0	0
Debt relief from creditors					0	32	71	73	73	101
Memorandum items:										
Current account balance, after grants	-1,279	-660	-764	-339	-528	-1,383	-1,760	-1,697	-1,867	-1,670
(In percent of GDP) 3/	-7.7	-4.8	-7.5	-3.9	-4.6	-8.8	-8.9	-8.1	-8.6	-7.3
Gross international reserves, USD mn (end period)			289	516	1,169	2,280	2,667	2,891	3,218	3,536
in months of prospective imports of goods & services			0.9	1.2	2.4	3.2	3.8	3.7	3.9	4.0
Debt service, cash	108	74	101	56	107	183	488	433	761	946
(In percent of GDP) 3/	0.7	0.5	1.0	0.6	0.9	1.2	2.5	2.1	3.5	4.1
Principal	74	25	17	14	33	43	130	157	330	452
Interest	34	49	84	42	74	141	358	277	431	494

Sources: SM authorities, and IMF staff estimates.

1/ Revised projection takes into account valuation impact of dollar exchange rate.

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

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

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

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

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

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

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

	1998	1999	2000	2001	2002 Est.	2003 Proj.	2004 Proj.	2005 Proj.
1. Gross financing requirements	**-720**	**-818**	**-1,074**	**-7,261**	**-3,200**	**-7,713**	**-2,875**	**-2,791**
External current account deficit (excluding official transfers)	-660	-764	-671	-1,119	-2,007	-2,272	-2,218	-2,021
Debt amortization	-60	-54	-47	-33	-43	-157	-114	-262
Medium- and long-term debt	-25	-17	-14	-33	-43	-127	-114	-262
Short-term debt 1/	-35	-37	-33	0	0	-30	0	0
Repayment of arrears	0	0	0	-5,587	-39	-4,673	0	0
Gross reserve accumulation	0	0	-227	-523	-1,111	-611	-327	-318
IMF repurchases and repayments	0	0	-129	0	0	0	-216	-190
2. Financing	**720**	**818**	**1,074**	**7,261**	**3,200**	**6,362**	**1,526**	**1,624**
Official grants 2/	0	0	271	591	624	0	0	0
Foreign direct investment (net)	113	112	25	165	562	623	747	827
Disbursement from private creditors	78	30	49	202	236	204	388	412
Medium and long-term financing	78	30	49	127	78	114	298	322
Short-term financing and other capital inflows	0	0	0	75	158	90	90	90
Disbursement from official creditors 2/	50	29	227	205	343	139	0	0
Multilateral 3/	...	...	...	205	285	139	0	0
Other	...	...	...	0	58	0	0	0
IMF disbursement	0	0	150	128	295	0	0	0
Accumulation of arrears (exceptional)	86	126	62	0	0	0	0	0
Debt Relief	0	0	0	5,377	71	4,673	0	0
Other flows 4/	393	521	290	594	1,068	723	390	386
3. Financing Gap	**0**	**0**	**0**	**0**	**0**	**1,351**	**1,349**	**1,167**
Expected disbursements of grants from donors 2/	0	0	0	0	0	575	351	351
EU	0	0	0	0	0	148	0	0
Others (mostly official bilateral creditors)	0	0	0	0	0	427	351	351
Expected disbursement of loans from donors 2/	0	0	0	0	0	703	924	686
World Bank	0	0	0	0	0	62	200	160
IMF	0	0	0	0	0	279	350	140
EBRD	0	0	0	0	0	123	117	117
EIB	0	0	0	0	0	129	117	117
EU	0	0	0	0	0	63	0	0
Others (mostly official bilateral creditors)	0	0	0	0	0	48	140	152
Debt relief	0	0	0	0	0	73	73	101
4. Residual Financing Gap	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**30**

Sources: SM authorities, and IMF staff estimates.

1/ Original maturity of less than 1 year.

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

3/ Not including amortization of the debt to IMF.

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

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

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

	2001	2002					2003										
	Dec.	Nov.	December				Jan.	Feb.	Mar.	April		May	June	Dec.	June	Sep.	Dec.
	Ex. Rate 4/		Prog. Orig.	Act.	End-02 Ex. Rates EOP	End-02 Ex. Rates Avg.				Orig. Prog.	Act. Prel.		Orig. Prog.	Orig. Prog.	Rev. Prog		
Net foreign assets of the NBS 1/	797	1,306	950	1,411	1,613	1,535	1,544	1,467	1,421	1,443	1,468	1,442	1,571	1,755	1,416	1,539	1,685
Net foreign assets of the NBS for program purposes 2/	583	874	736	938	1,056	1,005	1,006	929	848	872	903	878	992	1,148	850	970	1,098
Gross foreign assets	1,169	1,928	1,645	2,034	2,280	2,202	2,211	2,134	2,088	2,246	2,271	2,245	2,373	2,668	2,218	2,477	2,623
Gold	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
Foreign currencies	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
Foreign exchange accounts abroad	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
Reserve-related liabilities (-)	372	622	695	622	667	667	667	667	667	803	803	803	803	913	803	939	939
Gross reserve liabilities for program purposes (-)	586	1,054	909	1,095	1,224	1,197	1,205	1,205	1,240	1,374	1,368	1,367	1,382	1,520	1,368	1,507	1,525
IMF	272	522	595	522	567	567	567	567	567	703	703	703	703	813	703	839	839
Other	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100
Loan from China deposited by a closed bank	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100
Adjustments for program purposes	214	432	214	473	557	530	538	538	573	571	565	564	579	607	566	569	586
Foreign currency liabilities to domestic banks	214	432	214	473	557	530	538	538	573	571	565	564	579	607	566	569	586
Forex deposits from commercial banks	116	5	2	5	6	6	5	4	4	6	4	4	6	6	6	6	6
Unpaid interest	4	1	3	2	2	1	1	1	1	2	1	1	2	2	2	2	2
Short-term loan from commercial banks	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Required reserve and payments related deposits	71	417	208	453	526	500	520	525	564	540	552	552	548	576	535	538	555
Transaction and transitory deposits	23	9	0	13	23	23	12	8	4	23	8	7	23	23	23	23	23
Old obligations commercial banks	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Foreign currency liabilities to nonbank			0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
non-government residents	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Net foreign assets of commercial banks of Serbia 3/	580	749	916	709	709	...	719	706	602	725	678	664	729	766	631	626	649
Gross reserves	640	830	987	783	783	...	801	783	687	799	769	767	809	840	705	700	723
Reserve liabilities	59	81	71	74	74	...	82	77	85	74	91	103	74	74	74	74	74

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

1/ Exclude frozen assets and liabilities of Serbia; undivided assets of SFRY; in 2001, BIS gold and foreign currency deposits allocated to FRY in June 2001; and in 2003 other unfrozen assets received in May 2003.

2/ Program figures are floors.

3/ At current exchange rates.

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

Table 5. Balance Sheet of the National Bank of Serbia, December 2001–December 2003 1/

(In millions of dinars; end of period)

	2001		2002		2003														
		Dec. 01			January		February		March		April			May		June	June	Sep.	Dec.
	Dec.	ER	End -02 Ex. Rates								Orig. Prog.				Prel.		Rev. Program 10/ 12/		
	EOP	EOP 9/	EOP	Avg. Adj. 10/	EOP	Avg.	EOP	Avg.	EOP	Avg.	10/ 11/	EOP	Avg. Adj. 11/	EOP	Avg. Adj. 12/	Orig. Prog. 10/ 12/			
Net foreign assets 2/	-133	39,477	62,304	59,284	59,343	61,881	54,825	55,623	50,006	52,514	49,676	53,283	50,603	51,813	54,242	57,300	50,355	56,035	63,520
Net foreign assets in euro million	-2	661	1,044	964	994	1,036	918	932	813	854	808	866	823	842	882	932	819	911	1,033
Gross foreign assets 3/	65,623	79,100	134,491	129,879	130,409	133,901	125,891	126,758	123,137	124,829	126,926	133,961	125,927	132,433	135,051	138,744	131,126	143,584	153,302
Gross reserve liabilities (-) 4/	-65,756	-39,623	-72,187	-70,594	-71,066	-72,020	-71,066	-71,136	-73,131	-72,315	-77,250	-80,678	-75,324	-80,619	-80,809	-81,444	-80,771	-87,549	-89,782
Net domestic assets 5/	41,494	1,864	7,020	1,951	9,514	6,691	7,589	10,153	12,945	10,331	9,722	9,368	11,088	7,940	6,906	4,150	9,071	6,588	1,824
Domestic credit	154,502	8,912	14,455	...	19,298	...	17,461	...	23,494	...	...	20,546	...	19,811	...	...	...	...	...
Net claims on government	9,096	5,568	9,460	...	15,183	...	14,341	...	18,014	...	...	14,991	...	14,536	...	...	...	...	...
Claims	19,189	13,085	20,720	...	24,035	...	23,083	...	23,253	...	...	23,262	...	23,273	...	...	...	...	...
Dinar credits	10,681	13,085	20,720	...	24,035	...	23,083	...	23,253	...	...	23,262	...	23,273	...	...	...	...	...
Foreign currency credits	8,508	0	0	...	0	...	0	...	0	...	...	0	...	0	...	...	...	...	...
Liabilities (-)	-10,093	-7,517	-11,260	...	-8,852	...	-8,742	...	-5,239	...	...	-8,271	...	-8,737	...	...	...	...	...
Dinar liabilities	-3,113	-3,734	-5,101	...	-4,463	...	-4,382	...	-1,134	...	...	-3,224	...	-3,808	...	...	...	...	...
Foreign currency liabilities	-6,980	-3,783	-6,159	...	-4,389	...	-4,360	...	-4,105	...	...	-5,047	...	-4,929	...	...	...	...	...
Net claims on banks	143,360	3,299	6,054	...	4,979	...	3,956	...	6,354	...	...	6,493	...	6,311	...	...	...	...	...
Claims	144,137	4,076	7,731	...	7,508	...	6,510	...	7,740	...	...	7,462	...	7,185	...	...	...	...	...
Other dinar credits	1,820	1,740	5,562	...	5,370	...	4,371	...	5,585	...	...	5,283	...	5,056	...	...	...	...	...
Foreign currency credits	142,317	2,336	2,169	...	2,138	...	2,139	...	2,155	...	...	2,179	...	2,129	...	...	...	...	...
Foreign currency credits in euro million	2,426	39	36	...	36	...	36	...	36	...	...	36	...	36	...	...	...	...	...
Liabilities (-)	-777	-777	-1,677	...	-2,529	...	-2,554	...	-1,386	...	...	-969	...	-874	...	...	...	...	...
Of which: Stock of NBS bills	-715	-715	-1,549	...	-1,813	-1,343	-2,462	-2,765	-1,288	-1,585	...	-833	-962	-796	-915	...	...	...	...
Net claims on the rest of the economy	2,046	45	-1,059	...	-864	...	-836	...	-874	...	...	-938	...	-1,036	...	...	...	...	...
Claims	3,655	1,049	1,014	...	1,133	...	1,122	...	1,113	...	...	1,102	...	1,090	...	...	...	...	...
Dinar credits	3,453	1,049	1,014	...	1,133	...	1,122	...	1,113	...	...	1,102	...	1,090	...	...	...	...	...
Foreign currency credits	202	0	0	...	0	...	0	...	0	...	...	0	...	0	...	...	...	...	...
Liabilities (-)	-1,609	-1,004	-2,073	...	-1,997	...	-1,958	...	-1,987	...	...	-2,040	...	-2,126	...	...	...	...	...
Dinar deposits	-1,609	-1,004	-2,073	...	-1,997	...	-1,958	...	-1,987	...	...	-2,040	...	-2,126	...	...	...	...	...
Other assets, net	-113,008	-7,048	-7,435	...	-9,784	...	-9,872	...	-10,549	...	...	-11,178	...	-11,871	...	...	...	...	...
Reserve money (in dinar)	41,361	41,341	69,324	61,235	68,857	68,572	62,414	65,775	62,951	62,845	59,398	62,651	61,691	59,753	61,148	61,450	59,426	62,623	65,345
Currency in circulation	25,324	25,324	43,719	37,827	38,972	39,052	38,748	38,600	36,917	37,913	37,503	38,836	37,539	38,855	37,771	39,673	38,051	39,027	41,381
Reserve deposits	16,037	16,017	25,605	23,408	29,885	29,520	23,666	27,176	26,034	24,932	21,895	23,815	24,153	20,898	23,378	21,777	21,375	23,596	23,964
Required reserves	10,308	8,171	15,843	15,689	16,123	16,072	17,156	16,797	20,898	19,746	17,358	18,310	18,967	16,699	16,684	16,679	16,672	18,287	18,572
Shortfall (+) or excess (-) in required reserves 6/	2,286	169	4,377	403	551	1,161	2,190	1,657	1,398	2,353	0	552	935	1,409	-395	0	0	0	0
Excess reserves 7/	5,729	7,846	9,762	7,719	13,762	13,448	6,510	10,379	5,136	5,186	4,537	5,505	5,186	4,199	6,693	5,098	4,702	5,309	5,392
Memorandum items: (12-months growth rates, unless otherwise indicated)																			
Reserve money, nominal 8/	107.3	...	...	...	77.2	70.2	41.6	58.1	34.3	36.0	20.7	30.1	31.1	26.2	30.9	25.7	21.8	8.1	11.3
Reserve money, real 8/	49.1	...	...	...	55.0	48.9	24.4	38.9	18.4	20.0	6.8	14.8	15.7	11.3	15.4	1.5	1.4	1.2	1.2
Currency in circulation, nominal	131.6	...	...	...	50.0	58.1	26.4	45.4	22.4	27.9	36.1	21.2	27.6	23.3	27.6	29.6	24.3	3.6	9.4
Currency in circulation, real	66.6	...	...	...	31.2	38.3	11.0	27.7	7.9	12.7	20.4	6.9	12.6	8.7	12.5	11.8	9.4	-6.7	0.4
Required reserves, nominal 8/	109.2	...	...	...	113.7	77.4	113.9	94.7	136.1	104.2	50.0	86.5	96.9	70.8	73.9	59.3	59.2	43.5	18.4
Required reserves, real 8/	50.5	...	...	...	86.9	53.6	87.8	69.3	108.2	107.3	32.7	64.6	78.1	50.6	53.4	59.3	59.2	29.3	4.5
Velocity (based on annualized monthly GDP)	27.6		...	...	16.7	16.6	18.5	17.5	18.5	18.5	19.6	18.6	18.9	19.2	18.7	19.1	19.7	19.3	19.2
Excess reserves, nominal	40.1	...	...	...	161.6	105.6	20.9	61.1	-34.7	-24.7	-27.3	-29.7	-46.2	-47.7	-29.0	-47.8	-45.4	-40.2	-27.0
Excess reserves as a share of reserve deposits (percent)	35.7	49.0	38.1	...	46.0	45.6	27.5	38.2	19.7	20.8	20.0	23.1	21.5	20.1	28.6	23.4	22.0	22.5	22.5
Cash in circulation as share of quarterly GDP (percent)	13.1	...	...	...	15.3	15.4	15.1	15.1	14.3	14.7	14.8	14.4	13.9	14.2	13.8	14.2	13.6	13.3	13.5
Stock of NBS bills as share of reserve money (percent)	1.7	...	...	...	2.6	2.0	3.9	4.2	2.0	2.5	...	1.3	1.6	1.3	1.5	...	...	...	...

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

1/ At program exchange rates

2/ Program figures are floors.

3/ Exclude frozen assets and liabilities of Serbia; undivided assets of SFRY; in 2001, BIS gold and foreign currency deposits allocated to FRY in June 2001; and in 2003 other unfrozen assets received in May 2003.

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

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

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

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

8/ The growth rates of reserve money (in dinar) are adjusted for changes in dinar reserve requirements.

9/ At end-Dec. 2001 exchange rates; includes BIS gold and foreign currency deposits allocated to FRY in June 2001; and excludes undivided assets and liabilities of SFRY.

The dinar required reserve is adjusted to be consistent with the reserve requirement implemented on April 11, 2002.

10/ Reflects revision to NFA at end-2002, and assumes a reserve requirement of 23 percent at end-2002.

11/ Adjusted for reserve requirment changes in April 2003 (from 23 percent to 22 percent).

12/ Adjusted for the lowering of the required reserves ratio to 20 percent effective on May 11, 2003.

Table 6. Monetary Survey of Serbia, December 2001–December 2003
(In millions of dinars; end of period)

	2001		2002			2003									
	December		Dec.			Jan.	Feb.	March	April		Dec.	June	June	Sep.	Dec.
		Dec.01 Exch. Rate 5/	Prog. Orig.	Act.	End-02 Ex. Rates 6/ Adj.				Orig. Prog. 7/		Ori. Prog. 7/	Ori. Prog 7/	Rev. Prog.		
Net Foreign Assets 1/	66,783	93,179	133,043	137,440	136,996	132,560	127,267	118,779	127,904	125,309	148,701	135,994	120,744	127,682	137,648
(NFA in euro m.)	1,138	1,561	2,228	2,302	2,227	2,155	2,069	1,931	2,079	2,037	2,417	2,211	1,963	2,076	2,238
Assets	106,049	122,375	178,111	183,927	180,694	176,588	171,029	162,994	179,620	177,830	206,933	187,710	172,461	187,417	197,384
NBS	65,623	79,100	111,311	137,614	134,491	130,409	125,891	123,137	132,480	133,961	157,386	139,991	130,855	146,130	154,737
Commercial banks	40,426	43,275	66,801	46,313	46,203	46,179	45,138	39,857	47,141	43,869	49,547	47,719	41,605	41,288	42,647
Liabilities (-) 2/	-39,266	-29,196	-45,068	-46,486	-43,697	-44,028	-43,762	-44,215	-51,717	-52,521	-58,232	-51,717	-51,717	-59,736	-59,736
NBS	-17,686	-25,173	-40,264	-42,111	-39,333	-39,333	-39,333	-39,333	-47,352	-47,352	-53,867	-47,352	-47,352	-55,371	-55,371
Commercial banks	-21,580	-4,023	-4,805	-4,375	-4,365	-4,696	-4,429	-4,882	-4,365	-5,169	-4,365	-4,365	-4,365	-4,365	-4,365
Net Domestic Assets 3/	50,582	14,646	32,155	53,213	49,970	52,551	55,472	62,201	60,039	62,279	62,910	61,810	71,313	71,343	69,856
Domestic credit	233,366	97,006	...	143,425	143,607	145,438	151,772	159,507		160,181	...		...	...	...
Net credit to government 3/	4,567	1,258	6,730	-1,466	-11,774	-9,656	-12,753	-7,916	-744	-10,077	-12,570	1,230	-8,174	-10,274	-11,774
Credit	22,984	16,429	...	25,247	25,198	30,597	30,008	30,052	...	29,622	...	...	...	...	...
Dinar credit	12,859	16,154	...	23,497	23,497	28,822	28,145	28,030	...	27,692	...	...	...	...	...
NBS	10,681	13,085	...	20,720	20,720	24,035	23,083	23,253	...	23,262	...	...	...	...	...
Commercial banks	2,178	3,069	...	2,777	2,777	4,787	5,062	4,777	...	4,430	...	...	...	...	...
Foreign currency credits	10,125	275	...	1,750	1,701	1,775	1,863	2,022	...	1,930	...	...	...	...	...
NBS	8,508	0	...	0	0	0	0	0	...	0	...	...	...	...	...
Commercial banks	1,617	275	...	1,750	1,701	1,775	1,863	2,022	...	1,930	...	...	...	...	...
Liabilities	-18,417	-15,171	...	-26,713	-36,972	-40,253	-42,761	-37,968	...	-39,700	...	...	...	...	...
Dinar liabilities	-11,010	-11,052	...	-19,530	-21,079	-26,151	-27,805	-23,453	...	-24,749	...	...	...	...	...
NBS	-3,113	-3,734	...	-5,122	-5,101	-4,463	-4,382	-1,134	...	-3,224	...	...	...	...	...
Commercial banks	-7,897	-7,318	...	-14,408	-15,978	-21,688	-23,423	-22,319	...	-21,525	...	...	...	...	...
Foreign currency deposits	-7,407	-4,119	...	-7,183	-15,893	-14,102	-14,956	-14,515	...	-14,951	...	...	...	...	...
NBS	-6,980	-3,783	...	-6,027	-6,159	-4,389	-4,360	-4,105	...	-5,047	...	...	...	...	...
Commercial banks	-427	-336	...	-1,156	-9,734	-9,713	-10,596	-10,410	...	-9,904	...	...	...	...	...
Short-term government credits to banks	...	-768	...	-83	-191	-195	-187	-167	...	-184	...	...	...	...	...
Purchased bonds for repaying frozen deposit	...	...	...	609	563	617	797	847	...	760	...	...	...	...	...
Credit to the non-government sector 4/	228,799	96,515	...	144,364	155,009	154,671	163,915	166,744	154,049	169,682	168,746	153,846	178,504	183,225	185,898
Households	5,121	4,377	...	16,021	16,021	15,863	16,867	17,746	...	19,072	...	...	...	...	...
Non-profit and other sectors	29,896	2,658	...	3,891	4,553	4,413	4,263	4,266	...	4,095	...	...	...	...	...
Enterprises in dinar	46,557	40,416	...	70,892	70,946	77,702	78,371	79,754	...	81,143	...	...	...	...	...
Enterprises in foreign currency	147,225	49,064	...	53,560	63,489	56,694	64,414	64,978	...	65,372	...	...	...	...	...
Enterprises in foreign currency (euro million)	2,509	836	...	897	1,063	950	1,079	1,088	...	1,095	...	...	...	...	...
Other items, net.	-182,784	-82,360	...	-90,212	-93,637	-92,887	-96,300	-97,307	-93,637	-97,902	-93,637	-93,637	-99,593	-102,185	-104,844
Broad Money (M2)	117,365	107,825	165,198	190,654	186,966	185,111	182,739	180,980	187,943	187,588	211,611	197,804	192,057	199,024	207,505
Dinar-denominated M2	67,264	59,913	89,010	110,708	105,589	100,868	97,359	95,260	105,838	98,543	123,467	114,273	102,338	108,799	115,314
M1	57,803	52,686	77,792	94,981	88,839	87,483	85,300	82,426	90,964	84,930	106,983	98,541	88,938	92,965	98,881
Currency outside banks	25,324	25,324	36,720	43,719	43,719	38,972	38,748	36,917	38,054	38,836	48,346	42,578	41,339	42,850	46,870
Demand deposit	32,479	27,362	41,073	51,262	45,120	48,511	46,552	45,509	52,910	46,094	58,637	55,963	47,599	50,115	52,011
Time and savings deposits	9,461	7,227	11,218	15,727	16,750	13,385	12,059	12,834	14,874	13,613	16,484	15,732	13,400	15,834	16,433
Foreign currency deposit (non-frozen)	50,101	47,912	76,189	79,946	81,377	84,243	85,380	85,720	82,105	89,045	88,144	83,531	89,719	90,225	92,191
Foreign currency deposit (not-frozen), (euro million)	854	802	1,276	1,339	1,323	1,369	1,388	1,393	1,335	1,448	1,433	1,358	1,458	1,467	1,499
Memorandum items:															
12-months growth rates (in percent)															
Broad Money (M2)	79.1	...	49.5	76.8	...	62.2	36.7	35.3	39.0	38.7	11.9	31.2	27.4	12.9	11.0
Dinar-depominated M2	106.4	...	45.0	84.8	...	70.0	42.9	36.1	43.3	33.4	12.8	39.1	24.6	6.2	9.2
M1	114.4	...	45.0	80.3	...	66.6	40.5	33.5	39.4	30.1	13.9	35.3	22.1	2.7	11.3
Currency outside banks	131.6	...	45.0	72.6	...	50.0	26.4	22.4	18.7	21.2	11.8	30.1	26.3	5.9	7.2
Foreign currency deposits	...	...	55.2	66.9	...	49.2	26.4	30.6	29.9	40.8	10.5	18.3	27.0	18.6	13.3
Velocity (M1)	13.4	...	12.2	10.6	...	11.7	12.2	12.9	11.9	12.7	11.3	11.3	12.6	12.6	12.4
Multiplier (Dinar M2/Reserve money)	1.6	...	1.5	1.8	...	1.5	1.6	1.5	1.8	1.6	1.8	1.9	1.7	1.7	1.8
Currency/Dinar deposits (in percent)	60.4	...	70.2	65.3	70.7	63.0	66.1	63.3	52.3	65.0	64.3	59.4	67.8	65.0	68.5
Required reserve ratio (effective, in percent)	24.6	...	24.3	23.7	25.6	30.0	31.9	36.2	25.9	31.0	26.7	23.5	27.6	28.0	27.4
Excess reserves/Dinar deposits (in percent)	13.7	...	15.4	14.6	15.8	22.2	11.1	8.8	6.2	9.2	7.7	7.1	7.7	8.1	7.9
Foreign exchange deposit/Time deposit	5.3	...	6.8	5.1	...	6.3	7.1	6.7	5.5	6.5	5.3	5.3	6.7	5.7	5.6
Dinar-denominated M2/ annualized monthly GDP	7.4	...	8.8	10.0	...	8.8	8.4	8.1	9.0	8.5	9.5	9.4	8.4	8.6	8.8

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

1/ Foreign exchange denominated items converted at parallel market exchange rates up to June 2000, at YUD 30 = DM for September and at program exchange rates thereafter.
2/ Excluding undivided liabilities of the SFRY and, from 2002 onwards, liabilities to banks in liquidation.
3/ Program figures are ceilings.
4/ Data at 2001 exchange rates exclude 6 billion dinar of credit to the nongovernment sector that were added to balance sheet during 2002.
5/ At end-Dec. 2001 exchange rates; includes BIS gold and foreign currency deposits allocated to FRY in June 2001 and excludes undivided assets and liabilities of SFRY.
6/ Include foreign exchange liabilities to Paris Club creditors that banks were instructed in mid-November 2002 to book as liabilities to the government in the context of debt-for-equity swap.
December-02 and February-03 exclude credit to non-government sector written-off in March 2003.
7/ Reflect revision to NFA at end-2002.

Table 7A. Serbia and Montenegro: Consolidated General Government Fiscal Operations in 2002–2003 1/

Consolidated General Government Excluding Montenegro

	2002 Budget	2002 Prel.	2003 Prog.	2003 Rev. Prog.	2003 Jan.-April	2002 Budget	2002 Prel.	2003 Prog.	2003 Rev. Prog.	2003 Jan.-April
	(Billion dinars)					(Percent of GDP) 2/				
Total revenue	392.1	402.7	463.1	465.8	133.0	37.6	40.0	37.8	38.0	10.8
Current revenue	390.9	402.7	463.1	465.8	133.0	37.5	40.0	37.8	38.0	10.8
Tax revenue	367.0	372.8	431.9	426.7	123.6	35.2	37.0	35.2	34.8	10.1
Personal income tax	48.6	53.4	63.8	64.7	16.1	4.7	5.3	5.2	5.3	1.3
Social security contributions	101.7	98.9	119.5	118.4	34.2	9.7	9.8	9.7	9.7	2.8
Corporate income tax	4.6	4.3	4.6	4.6	2.3	0.4	0.4	0.4	0.4	0.2
Retail sales tax	106.4	110.8	129.5	130.3	38.5	10.2	11.0	10.6	10.6	3.1
Excises	48.1	45.3	58.2	57.9	14.6	4.6	4.5	4.7	4.7	1.2
Taxes on international trade	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
and operations	21.7	24.6	28.3	28.8	7.9	2.1	2.4	2.3	2.3	0.6
Other taxes	36.0	35.5	28.0	22.0	10.0	3.4	3.5	2.3	1.8	0.8
Extrabudgetary taxes	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Nontax revenue	24.0	30.0	31.2	39.0	9.4	2.3	3.0	2.5	3.2	0.8
Capital revenue	1.2	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0
Total expenditure and net lending	444.2	445.3	516.3	518.9	139.9	42.6	44.2	42.1	42.3	11.4
Current expenditure	399.3	407.8	471.8	479.1	135.7	38.3	40.5	38.5	39.1	11.1
Expenditure on goods and services	158.8	172.3	199.9	201.1	54.0	15.2	17.1	16.3	16.4	4.4
Wages and salaries	89.1	95.3	114.0	119.0	34.3	8.5	9.5	9.3	9.7	2.8
Other purchases of goods and services	69.7	77.0	85.9	82.1	19.7	6.7	7.7	7.0	6.7	1.6
Interest payment	16.5	8.8	12.0	13.3	2.9	1.6	0.9	1.0	1.1	0.2
Subsidies and other current transfers	224.1	226.7	259.8	262.3	75.7	21.5	22.5	21.2	21.4	6.2
Subsidies	40.4	42.6	38.0	36.5	11.8	3.9	4.2	3.1	3.0	1.0
Transfers to households	183.7	184.0	221.9	225.6	63.9	17.6	18.3	18.1	18.4	5.2
Capital expenditure	35.8	33.4	39.2	35.2	4.6	3.4	3.3	3.2	2.9	0.4
Of which: Financed by project loans	11.9	7.5	13.7	12.7	0.2	1.1	0.7	1.1	1.0	0.0
General reserves	9.0	1.8	4.5	3.7	0.6	0.9	0.2	0.4	0.3	0.0
Lending minus repayment	0.0	0.6	0.9	0.9	0.0	0.0	0.1	0.1	0.1	0.0
Net transfer to other levels of government	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net transfer from Montenegro	0.0	0.0	2.6	2.5	0.0	0.0	0.0	0.2	0.2	0.0
Unclassified spending (incl. stat. discr.)	0.1	1.7	0.0	0.0	-1.0	0.0	0.2	0.0	0.0	-0.1
Overall balance	-52.2	-42.6	-50.7	-50.6	-6.9	-5.0	-4.2	-4.1	-4.1	-0.6
Foreign grants	7.8	9.6	7.2	9.7	0.6	0.7	1.0	0.6	0.8	0.0
Overall balance including grants	-44.4	-33.0	-43.4	-40.9	-6.4	-4.3	-3.3	-3.5	-3.3	-0.5
Financing	44.5	33.0	43.4	40.9	6.4	4.3	3.3	3.5	3.3	0.5
Domestic financing	5.6	-2.1	0.0	0.0	1.1	0.5	-0.2	0.0	0.0	0.1
Bank financing	7.5	-2.1	0.0	0.0	1.1	0.7	-0.2	0.0	0.0	0.1
Non-bank financing	-1.9	0.0	0.0	0.0	0.0	-0.2	0.0	0.0	0.0	0.0
Foreign Financing	27.5	17.2	23.1	22.0	0.8	2.6	1.7	1.9	1.8	0.1
Privatization receipts	11.4	17.9	20.3	18.9	4.4	1.1	1.8	1.7	1.5	0.4

Consolidated General Government Including Montenegro

	2002 Budget	2002 Prel.	2003 Prog.	2003 Rev. Prog.	2003 Jan.-April	2002 Budget	2002 Prel.	2003 Prog.	2003 Rev. Prog.	2003 Jan.-April
	(Billion dinars)					(Percent of GDP) 2/				
Total revenue	421.0	430.5	496.7	499.4	138.5	40.3	42.8	40.5	40.7	11.3
Current revenue	419.8	430.5	496.6	499.4	138.5	40.2	42.8	40.5	40.7	11.3
Tax revenue	391.1	398.7	463.1	458.1	128.8	37.5	39.6	37.8	37.4	10.5
Personal income tax	53.1	56.9	68.5	69.4	16.9	5.1	5.7	5.6	5.7	1.4
Social security contributions	112.2	108.0	129.7	128.9	36.2	10.8	10.7	10.6	10.5	3.0
Corporate income tax	4.6	5.0	5.5	5.6	2.4	0.4	0.5	0.5	0.5	0.2
Retail sales tax	110.5	117.4	137.6	137.0	39.1	10.6	11.7	11.2	11.2	3.2
Excises	50.3	48.7	62.3	62.4	15.3	4.8	4.8	5.1	5.1	1.2
Taxes on international trade	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
and operations	23.9	27.0	31.3	32.5	8.7	2.3	2.7	2.6	2.7	0.7
Other taxes	36.4	35.8	28.2	22.4	10.1	3.5	3.6	2.3	1.8	0.8
Extrabudgetary taxes	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Nontax revenue	28.8	31.8	33.5	41.3	9.7	2.8	3.2	2.7	3.4	0.8
Capital revenue	1.2	0.0	0.1	0.1	0.0	0.1	0.0	0.0	0.0	0.0
Total expenditure and net lending	476.5	475.9	552.4	555.2	146.2	45.7	47.3	45.1	45.3	11.9
Current expenditure	429.4	436.1	504.7	512.5	141.0	41.2	43.3	41.2	41.8	11.5
Expenditure on goods and services	172.4	184.6	214.7	216.2	56.0	16.5	18.3	17.5	17.6	4.6
Wages and salaries	98.6	104.1	125.0	130.3	35.8	9.4	10.3	10.2	10.6	2.9
Other purchases of goods and services	73.8	80.5	89.7	86.0	20.2	7.1	8.0	7.3	7.0	1.6
Interest payment	18.0	9.6	13.2	14.5	3.1	1.7	1.0	1.1	1.2	0.3
Subsidies and other current transfers	239.0	241.9	276.8	279.3	78.8	22.9	24.0	22.6	22.8	6.4
Subsidies	42.0	44.1	38.9	37.5	12.0	4.0	4.4	3.2	3.1	1.0
Transfers to households	197.0	197.8	237.9	241.6	66.9	18.9	19.6	19.4	19.7	5.5
Capital expenditure	37.0	34.6	41.2	37.0	4.7	3.5	3.4	3.4	3.0	0.4
Of which: Financed by project loans	11.9	7.9	14.1	13.1	0.2	1.1	0.8	1.1	1.1	0.0
General reserves	9.3	2.6	5.1	4.3	0.8	0.9	0.3	1.8	1.7	0.4
Lending minus repayment	0.8	1.2	1.3	1.3	0.1	0.1	0.1	0.1	0.1	0.0
Net transfer to other levels of government	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net transfer from Montenegro	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Unclassified spending (incl. stat. discr.)	0.0	1.4	0.0	0.0	-0.5	0.0	0.1	0.0	0.0	0.0
Overall balance	-55.6	-45.4	-55.8	-55.7	-7.7	-5.3	-4.5	-4.5	-4.5	-0.6
Foreign grants	9.8	11.3	8.5	11.1	0.6	0.9	1.1	0.7	0.9	0.0
Overall balance including grants	-45.9	-34.1	-47.2	-44.7	-7.1	-4.4	-3.4	-3.9	-3.6	-0.6
Financing	45.8	34.1	47.2	44.7	7.1	4.4	3.4	3.9	3.6	0.6
Domestic financing	4.4	-5.3	0.6	0.6	1.3	0.4	-0.5	0.0	0.0	0.1
Bank financing	6.3	-5.3	0.6	0.6	1.3	0.6	-0.5	0.0	0.0	0.1
Non-bank financing	-1.9	0.0	0.0	0.0	0.0	-0.2	0.0	0.0	0.0	0.0
Foreign Financing	28.5	17.6	24.8	23.8	1.3	2.7	1.8	2.0	1.9	0.1
Privatization receipts	12.9	21.7	21.8	20.3	4.4	1.2	2.2	1.8	1.7	0.4

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

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

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

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

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

Sources: Federal authorities; and IMF staff estimates and projections.

1/ Expressed in terms of GDP of Serbia and Montenegro (formerly FRY) excluding Kosovo.

Table 7C. Serbia: Republican Government Fiscal Operations, 2000–2003

(In percent of GDP) 1/

	2000	2001	2002				2003 2/				
			Budget	Prel. EBS/03/41	Revised	Revised incl.Union	Revised Budget	Prog. EBS/03/41	Revised Program	Q1 Program	Q1 Prel.
A Total revenue and grants (1+2)	12.9	16.2	18.1	18.5	18.5	25.6	24.2	23.8	24.5	4.6	4.7
1 Total revenue (1.1+1.2)	12.9	15.8	17.3	17.6	17.6	24.7	23.4	23.2	23.5	4.6	4.7
1.1 Current revenue (1.1.1+1.1.2)	12.9	15.8	17.3	17.6	17.6	24.7	23.4	23.2	23.5	4.6	4.7
1.1.1 Tax revenue (1.1.1.1+...+1.1.1.6)	11.6	14.8	16.4	16.7	16.7	22.8	21.0	21.4	21.1	4.3	4.4
1.1.1.1 Personal income tax	3.2	4.1	4.3	4.4	4.4	4.4	4.2	4.1	4.2	0.9	0.9
1.1.1.2 Corporate income tax	0.3	0.4	0.4	0.4	0.4	0.4	0.3	0.3	0.3	0.1	0.2
1.1.1.3 Turnover (retail sales) tax	3.2	4.9	6.5	6.7	6.7	9.4	9.2	9.2	9.2	1.9	2.0
1.1.1.4 Taxes on international trade	0.0	0.0	0.0	0.0	0.0	2.4	2.3	2.3	2.3	0.4	0.5
1.1.1.5 Excises	2.1	3.2	3.7	3.6	3.6	4.5	4.7	4.7	4.7	0.9	0.8
1.1.1.6 Property taxes	0.2	1.3	0.8	1.0	1.0	1.0	0.3	0.3	0.3	0.0	0.1
1.1.1.7 Other taxes	2.5	0.9	0.7	0.6	0.6	0.6	0.0	0.5	0.0	0.1	0.0
1.1.2 Nontax revenue	1.3	1.0	0.9	0.9	0.9	1.9	2.4	1.8	2.4	0.3	0.3
1.2 Capital revenue	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
2 Transfer from Montenegro	0.0	0.0	0.0	0.0	0.0	0.0	0.2	...	0.2	0.0	0.0
3 Grants	0.0	0.4	0.7	1.0	1.0	1.0	0.6	0.6	0.8	0.0	0.0
B. Total expenditure and net lending (1+...+6)	13.2	17.0	22.4	22.2	22.2	29.1	28.1	27.3	27.8	5.8	5.6
1. Total expenditure (2+3+4)	13.2	16.2	22.4	22.1	22.1	29.0	28.0	27.2	27.8	5.8	5.6
2 Current expenditure (2.1+2.2+2.3)	11.5	15.7	19.4	20.2	20.2	27.1	25.3	23.5	25.1	5.1	5.3
2.1. Expenditure on goods and services (2.1.1+...+2.1.4)	6.4	6.7	6.6	5.9	5.9	5.9	7.6	6.2	7.4	1.5	2.0
2.1.1 Wages and salaries	3.5	3.5	3.9	3.5	3.5	3.5	4.5	3.6	4.4	1.1	1.2
2.1.2 Employer contribution	0.9	0.7	1.0	0.8	0.8	0.8	0.9	0.8	0.9	0.0	0.2
2.1.2.1 Contribution	0.0	0.0	0.7	0.6	0.6	0.6	0.8	0.7	0.8	0.0	0.2
2.1.2.2 Tax	0.0	0.0	0.3	0.2	0.2	0.2	0.1	0.1	0.1	0.0	0.0
2.1.4 Other purchases of goods and services	2.0	2.4	1.6	1.5	1.5	1.5	2.0	1.6	1.9	0.4	0.5
2.2. Interest payment	0.1	0.1	1.5	0.7	0.7	0.7	1.0	0.9	1.0	0.3	0.2
2.3. Subsidies and other current transfers	0.0	8.9	11.3	13.6	13.6	20.6	16.6	16.4	16.8	3.4	3.1
2.3.1 Subsidies	0.0	2.8	2.9	3.4	3.4	3.4	2.4	2.2	2.4	0.4	0.4
2.3.2 Transfers to households	5.0	2.8	3.0	3.2	3.2	3.2	4.3	3.5	4.2	0.5	0.8
Of which: Repayment for frozen foreign currency deposit	1.9	0.5	0.6	0.6	0.6	0.6	0.9	1.0	0.9	0.1	0.0
2.3.3 Current transfers to other levels of government	0.0	3.4	5.4	7.1	7.1	14.0	9.9	10.7	10.2	2.5	1.9
Federal budget	0.0	0.0	0.0	0.0	0.0	6.9	3.1	4.2	3.1	1.0	0.0
Republican budget	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Local Budgets	0.0	0.1	0.1	1.3	1.3	1.3	1.1	1.0	1.1	0.2	0.2
Pension Funds	0.0	2.8	4.2	4.9	4.9	4.9	4.4	4.4	4.6	0.0	1.4
Health Fund	0.0	0.3	0.5	0.4	0.4	0.4	0.5	0.5	0.5	0.0	0.1
Labor Market Fund	0.0	0.1	0.2	0.3	0.3	0.3	0.4	0.3	0.5	0.0	0.1
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
3. Capital expenditure	1.3	0.5	2.4	1.9	1.9	1.9	2.4	2.2	2.1	0.4	0.2
Of which: Budget for recovery and reconstruction	0.0	0.0	1.1	0.7	0.7	0.7	1.1	1.1	1.0	0.2	0.0
4. General reserves	0.0	0.0	0.6	0.0	0.0	0.0	0.3	0.4	0.3	0.0	0.0
5. New Serbian expenditure/Union spending	0.0	0.0	0.0	0.0	0.0	0.0	0.0	1.2	0.2	0.3	0.0
6. Lending minus repayment	0.0	0.8	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.0	0.0
Overall budget balance excluding grants	-0.3	-1.2	-5.0	-4.6	-4.6	-4.4	-4.5	-4.1	-4.1	-1.2	-0.9
Overall budget balance including grants (A-B)	-0.3	-0.8	-4.3	-3.6	-3.6	-3.5	-3.9	-3.5	-3.3	-1.2	-0.9
Overall budget balance excluding grants and project loans	0.0	-1.2	-3.9	-3.9	-3.9	-3.7	-3.4	-3.0	-3.1	-1.1	-0.9
Statistical Discrepancy/Gap	0.0	0.1	0.0	0.4	-0.1	0.0	0.0	0.0	0.0	0.0	-0.3
Financing (1+2+3)	0.3	0.9	4.2	4.1	3.6	3.5	3.9	3.5	3.3	1.2	0.6
1 Domestic financing (net) (1.1+1.2)	0.3	0.9	0.5	0.1	0.1	0.0	0.0	0.0	0.0	0.7	0.3
1.1 Banking system (1.1.1+1.1.2)	0.2	1.1	0.6	0.1	0.1	0.0	0.0	0.0	0.0	0.7	0.3
1.2 Nonbank	0.1	-0.2	-0.1	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	2.6	1.7	1.7	1.7	1.9	1.9	1.8	0.2	0.1
2.1 Program	0.0	0.0	1.4	1.0	1.0	1.0	0.9	0.9	0.9	0.0	0.0
2.2 Project	0.0	0.0	1.1	0.7	0.7	0.7	1.1	1.1	1.0	0.2	0.0
3 Privatization receipts 3/	0.0	0.0	1.1	2.2	1.8	1.8	2.0	1.7	1.5	0.3	0.2
Memorandum item:											
Nominal GDP (billion dinars)	381.7	771.8	1,043.5	1,006.9	1,006.9	1,006.9	1,225.9	1,225.9	1,225.9	1,225.9	1,225.9

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

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

2/ Serbia and Union.

3/ Total privatization receipts accruing to the republican government.

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

	2001	2002	2003		
	Outcome	Prel. Est.	Prog.	Rev. Prog.	Q1 Prel.
Total revenue	38.0	36.5	36.9	36.0	6.2
Current revenue	38.0	36.5	36.9	35.9	6.2
Tax revenue	32.9	34.2	34.4	33.5	5.8
Personal income tax	5.4	4.6	5.1	5.1	0.9
Social security contributions	10.8	11.9	11.2	11.2	2.3
Corporate income tax	0.6	1.0	1.0	1.0	0.1
Retail sales tax 1/	7.1	8.7	8.9	7.1	0.7
Excises	4.4	4.5	4.6	4.8	0.8
Taxes on international trade and operations	4.3	3.1	3.3	4.0	0.9
Other taxes	0.4	0.4	0.2	0.3	0.1
Extrabudgetary taxes	0.0	0.0	0.0	0.0	0.0
Nontax revenue	5.1	2.4	2.5	2.4	0.4
Capital revenue	0.0	0.0	0.1	0.1	0.0
Total expenditure and net lending	42.3	40.6	39.7	38.9	6.5
Current expenditure	38.6	37.3	36.3	35.8	6.1
Net wages, salaries and allowances	9.9	10.4	10.4	10.4	1.5
Payroll Tax	1.6	1.2	1.7	1.7	0.1
Employer contributions	0.0	0.0	0.0	0.0	0.0
Purchases of goods and services	5.9	3.9	3.7	3.6	0.5
Interest payment	0.1	1.0	1.3	1.3	0.2
Subsidies and other current transfers	20.7	20.1	18.7	18.2	3.6
Subsidies to enterprises	1.2	2.0	1.1	1.1	0.2
Transfers to households	19.5	18.1	17.7	17.1	3.4
Other non-interest current expenditure	0.5	0.7	0.5	0.5	0.1
Capital expenditure	2.0	1.6	2.3	2.1	0.1
General reserves	0.6	1.0	0.8	0.7	0.2
Net Lending	1.1	0.7	0.4	0.4	0.1
Transfer to the Union Budget	0.0	0.0	2.9	2.7	0.0
Overall balance	-4.2	-4.0	-5.6	-5.6	-0.3
Discrepancy	0.4	0.3	0.0	0.0	0.6
Overall balance before grants	-4.7	-4.3	-5.6	-5.6	-0.9
Foreign grants	3.1	2.2	1.4	1.4	0.0
Overall balance including grants	-1.6	-2.1	-4.2	-4.2	-0.9
Financing	1.6	2.1	4.2	4.2	0.9
Domestic financing	1.6	-3.5	0.6	0.6	0.3
Bank financing	0.8	-3.5	0.6	0.6	0.3
Nonbank financing	0.8	0.0	0.0	0.0	0.0
Net Foreign Financing	0.0	0.6	1.9	1.9	0.6
Program	0.0	0.0	1.5	1.5	0.6
Project	0.0	0.6	0.4	0.4	0.0
Amortization	0.0	0.0	0.0	0.0	0.0
Privatization receipts	0.0	5.1	1.7	1.7	0.0
Memorandum item					
Montenegro GDP (Euro million)	1,049	1,250	1,400	1,400	1,400

Source: Montenegrin Ministry of Finance.
1/ From FY2002 onwards, retail sales tax includes revenues that were redirected to the Army and the Railway.

Table 7E. Montenegro: Republican Government Fiscal Operations, 2001–2003

(As a percent of GDP)

	2001		2002			2003			
	Budget	Jan.-Dec. Est.	Budget	Jan.-Dec.	Jan.-Dec. (comparable with 2003) 1/	Prog.	Budget	Rev. Prog.	Q1
A Total revenue and grants (1+2)	20.9	23.3	23.9	20.3	26.7	26.7	27.4	25.8	3.8
1 Total revenue (1.1+1.2)	18.0	21.9	21.6	18.1	24.6	25.3	25.8	24.4	3.8
1.1 Current revenue (1.1.1+1.1.2)	18.0	21.9	21.6	18.1	24.6	25.3	25.8	24.4	3.8
1.1.1 Tax revenue (1.1.1.1+1.1.1.2+1.1.1.3+1.1.1.4)	16.3	17.9	16.7	16.4	22.9	23.2	23.7	22.3	3.5
1.1.1.1 Personal income	5.3	5.4	5.4	4.6	5.3	5.1	5.4	5.1	0.9
1.1.1.2 Turnover (retail sales) tax	5.3	5.6	5.0	4.2	8.6	8.9	7.0	7.1	0.6
1.1.1.3 Excises	3.2	3.4	2.7	4.1	4.5	4.6	6.2	4.8	0.8
1.1.1.4 Taxes on international trade and transactions	0.0	0.0	2.6	2.2	3.1	3.3	3.7	4.0	0.9
1.1.1.5 Other taxes	1.7	2.6	0.3	0.4	0.4	0.2	0.2	0.3	0.1
1.1.1.6 Corporate income taxes	0.0	0.0	0.6	1.0	1.0	1.0	1.1	1.0	0.1
1.1.2 Nontax revenue	1.7	4.0	4.9	1.7	1.7	2.1	2.1	2.1	0.3
1.2 Capital revenue	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
2 Grants	2.9	1.4	2.3	2.2	2.2	1.4	1.7	1.4	0.0
B Total expenditure and net lending (1+2)	21.6	24.3	25.8	20.8	23.0	23.7	24.6	23.1	3.1
1 Total expenditure (1.1+1.2)	21.6	23.7	24.8	19.9	22.2	23.1	24.0	22.6	2.9
1.1 Current expenditure (1.1.1+1.1.2)	19.9	21.8	23.5	18.5	20.7	21.1	22.0	20.8	2.8
1.1.1 Interest	0.0	0.1	1.9	1.0	1.1	1.3	1.8	1.3	0.2
1.1.2 Non-interest (1.1.2.1+1.1.2.2+1.1.2.3+1.1.2.4)	19.8	21.8	21.6	17.4	19.6	19.9	20.2	19.5	2.6
1.1.2.1 wages and salaries	11.2	10.3	10.8	8.5	9.1	10.9	10.9	10.8	1.0
Net Wages 2/	5.2	4.8	5.0	5.5	5.5	5.0	5.0	5.0	0.8
Allowances	1.1	1.0	1.1	1.0	1.0	1.1	1.1	1.1	0.1
PIT	1.2	1.2	1.2	0.6	1.3	1.2	1.2	1.2	0.0
Contributions	3.4	3.2	3.3	1.2	1.2	3.3	3.3	3.3	0.1
1.1.2.2. Goods and Services	3.7	5.3	4.3	3.3	3.3	2.9	3.1	2.9	0.4
1.1.2.3 Transfers and Social benefits to individuals and NGOs	3.0	3.9	3.1	2.9	3.9	4.1	4.1	3.8	0.7
1.1.2.4 Subsidies to enterprises	1.1	1.2	2.1	1.5	2.0	1.1	1.2	1.1	0.2
1.1.2.5 Other non-interest expenditure	0.8	1.1	1.3	1.3	1.3	0.9	0.9	0.8	0.2
1.2 Capital expenditure	1.7	1.8	1.3	1.5	1.5	2.0	2.0	1.8	0.1
2 Net lending	0.0	0.6	1.0	0.8	0.8	0.5	0.6	0.5	0.1
C Net transfer to other levels of government	0.0	0.4	0.5	0.7	5.0	6.6	6.6	6.2	1.1
1 Transfers to the PIO	0.0	0.1	0.0	0.0	4.2	3.1	3.1	2.9	0.9
2 Transfers to the Health Fund	0.0	0.1	0.2	0.4	0.4	0.2	0.2	0.2	0.1
3 Transfers to the Employment Fund	0.0	0.2	0.3	0.3	0.3	0.4	0.4	0.3	0.0
4 Transfers to the Union Budget	0.0	0.0	0.0	0.0	0.0	2.9	2.9	2.7	0.0
Overall balance (cash) (A-B-C-A.2)	-3.6	-2.8	-4.7	-3.4	-3.4	-5.0	-5.4	-5.0	-0.4
D Discrepancy	0.3	0.2	0.0	1.1	1.1	0.0	0.0	0.0	1.3
Overall budget balance before grants (cash) (A-B-C-A.2-D)	-3.9	-3.0	-4.7	-4.5	-4.5	-5.0	-5.4	-5.0	-1.7
Overall budget balance after grants (cash) (A-B-C-D)	-1.0	-1.6	-2.4	-2.3	-2.3	-3.5	-3.8	-3.5	-1.7
Financing (1+2+3)	1.0	1.6	2.4	2.3	2.3	3.5	3.8	3.5	1.7
1 Domestic financing (net) (1.1+1.2)	0.0	1.6	-1.4	-2.6	-2.6	0.0	0.2	0.0	1.1
1.1 Banking system (1.1.1+1.1.2)	0.0	0.8	-1.4	-2.6	-2.6	0.0	0.2	0.0	1.1
1.1.1 Central Bank of Montenegro	0.0	1.0	-1.4	0.3	0.3	-1.0	0.0	-1.0	-1.1
1.1.2 Commercial banks	0.0	-0.2	0.0	-2.8	-2.8	1.0	0.2	1.0	2.2
1.2 Nonbank	0.0	0.8	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	1.8	0.6	0.6	1.9	1.9	1.9	0.6
2.1 Disbursements	0.0	0.0	1.8	0.6	0.6	1.9	1.9	1.9	0.6
2.2 Amortization	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
3 Privatization receipts	1.0	0.0	1.9	4.3	4.3	1.7	1.7	1.7	0.0
Memorandum items:									
Gross wage bill on a commitment basis	11.2	10.3	10.8	11.5	11.5	10.9	10.9	10.8	2.0
Nominal GDP (Euro million)	1,049	1,049	1,250	1,250	1,250	1,400	1,400	1,400	1,400

Source: Montenegrin Ministry of Finance.

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

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

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

	2000	2001	2002 Prel.	2003 Prog.	2003 Rev. Proj.	2004 Rev. Proj.	2005 Rev. Proj.
GDP (DIN billion)	382	772	1,007	...	...	...	...
GDP (US$ million)	8,603	11,577	15,681	...	...	...	...
			(Percent change)				
End-period inflation (RPI)	113.5	39.0	14.2	9–11	9–11	7.0	5.0
GDP	5.0	5.5	4.0	3½–4½	3½–4½	4.0	4.5
			(In percent of nominal GDP)				
Gross domestic savings	-2.7	-7.2	-7.0	-3.5	-3.9	-2.0	1.3
Non-government	-4.4	-7.8	-6.9	-3.8	-3.7	-3.2	-1.2
Government	1.6	0.6	-0.1	0.3	-0.2	1.2	2.5
Net factor receipts and transfers from abroad	13.0	16.3	14.2	11.8	12.4	11.1	10.8
Non-government	12.3	15.6	14.6	12.8	13.2	12.1	12.3
Government	0.7	0.7	-0.3	-1.0	-0.8	-1.0	-1.5
Gross national savings	10.3	9.1	7.2	8.3	8.4	9.1	12.1
Non-government	7.9	7.8	7.6	9.0	9.4	8.9	11.1
Government	2.4	1.3	-0.4	-0.7	-1.0	0.2	1.0
Gross domestic investment 1/	14.2	13.6	16.1	16.5	16.6	17.8	19.5
Non-government	12.2	11.7	12.2	12.9	13.3	13.5	14.8
Government	3.1	1.6	3.6	3.4	3.0	4.0	4.4
Savings-investment balance 1/	-3.9	-4.6	-8.8	-8.2	-8.2	-8.7	-7.4
Non-government	-4.3	-3.9	-4.6	-4.0	-3.9	-4.6	-3.7
Government	-0.7	-0.3	-4.0	-4.0	-4.0	-3.8	-3.4
Foreign savings	3.9	4.6	8.8	8.2	8.2	8.7	7.4
Foreign savings including official grants	7.1	9.7	12.8	11.0	9.1	9.4	7.9
Net exports of goods and services	-16.9	-20.9	-23.1	-20.0	-20.6	-19.8	-18.2

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

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

Table 9. Serbia and Montenegro: Indicators of Capacity to Repay the Fund, 2000-2011

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
				Projections								
Fund repurchases and charges 1/												
In millions of SDRs	...	7.9	10.3	13.6	177.5	160.3	45.5	67.5	139.8	202.1	172.6	94.3
In millions of U.S. dollars	...	10.2	13.6	19.0	248.5	223.8	63.3	93.6	193.0	279.0	238.2	130.2
In percent of exports of goods and NFS	...	0.4	0.4	0.4	4.8	3.8	1.0	1.3	2.4	3.2	2.5	1.3
In percent of debt service	...	9.6	7.4	4.1	32.7	23.7	5.8	6.3	11.7	15.1	13.7	8.6
In percent of quota	...	1.7	2.2	2.9	38.0	34.3	9.7	14.4	29.9	43.2	36.9	20.2
In percent of gross official reserves	...	0.9	0.6	0.7	7.7	6.3	1.6	2.4	4.8	6.7	5.2	2.7
Fund credit outstanding												
In millions of SDRs	116.9	216.9	416.9	598.2	708.5	668.8	641.7	591.7	466.7	275.0	108.3	16.7
In millions of U.S. dollars	154.2	280.2	551.0	833.6	992.0	933.6	892.9	820.3	644.2	379.6	149.5	23.0
In percent of quota	25.0	46.4	89.1	127.9	151.5	143.0	137.2	126.5	99.8	58.8	23.2	3.6
In percent of GDP	1.8	2.4	3.5	4.0	4.6	4.1	3.7	3.2	2.4	1.3	0.5	0.1
In percent of gross official reserves	29.9	24.0	24.2	28.8	30.8	26.4	23.2	20.8	16.0	9.1	3.2	0.5
Memorandum items:												
Exports of goods and NFS (millions of US$)	2,547	2,743	3,241	4,350	5,135	5,865	6,553	7,225	7,914	8,671	9,449	10,289
Debt service, after debt relief (millions of US$)	56	107	183	466	761	946	1,100	1,482	1,644	1,851	1,737	1,505
Quota (millions of SDRs)	468	468	468	468	468	468	468	468	468	468	468	468
Quota (millions of US$)	617	604	618	652	655	653	651	648	646	646	646	646
Gross official reserves (millions of US$)	516	1,169	2,280	2,891	3,218	3,536	3,856	3,936	4,036	4,166	4,611	4,847
GDP (millions of US$)	8,603	11,577	15,681	20,881	21,697	22,821	23,971	25,269	27,137	29,139	31,286	33,635
U.S. dollar per SDR	1.32	1.29	1.32	1.39	1.40	1.40	1.39	1.39	1.38	1.38	1.38	1.38

Sources: SM authorities; and IMF staff estimates.

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

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

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

Sources: SM authorities, and IMF staff estimates.

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

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

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

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

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

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

	1997	1998	1999	2000	2001	2002
Financial indicators						
Public sector debt	...	...	...	119.1	123.2	84.5
Broad money (percent change, 12-month basis)	23.9	69.4	67.6	61.4	79.1	76.8
Private sector credit (percent change, 12-month basis)	...	...	128.4	68.6	7.6	45.3
Weighted interest rates (percent per month, December) 2/	6.3	7.0	3.9	6.8	3.8	2.4
Retail prices (percent per annum, end of period)	...	...	49.9	113.5	39	14.2
External Indicators						
Exports (recorded exports, percent change, 12-month basis in US$)	19.5	24.0	-44.7	14.7	10.4	19.5
Imports (percent change, 12-month basis in US$)	17.0	1.0	-32.0	14.4	30.4	30.7
Terms of Trade (percent change, 12-month basis)	...	-2.6	-4.4	0.0	...	...
Current account balance, before grants	-7.7	-4.8	-7.5	-7.1	-9.7	-12.8
Current account balance after grants and FDI	-3.3	-3.9	-6.4	-3.6	-3.1	-5.2
Errors and omissions	-0.6	2.0	4.0	3.1	2.1	2.0
Gross official reserves (in US$ million)	...	326	293	516	1,169	2,280
(in months of imports GS of the following year)		1.1	0.9	1.2	2.4	3.2
Central Bank short-term foreign liabilities (in US$ million) 3/	...	0	0	0	0	100
Gross reserves of the banking system (in US$ million)	...	774	659	882	1,809	3,063
(in months of imports GS of the following year)		2.6	1.9	2.1	3.2	4.3
Short term foreign liabilities of the commercial banks (in US$ million)	...	...	...	349	59	74
Foreign currency liabilities of the commercial banks (in US$ million)	...	...	...	871	715	1,409
Official reserves/Broad money (M2) (percent)	...	18	30	50	73	72
Official reserves/reserve money (percent)	...	59	126	164	191	199
Short term external debt by original maturity (in US$ million) 4/	1,048	1,021	987	1,153	1,026	1,020
Short term external debt by remaining maturity (in US$ million) 4/	1,073	1,038	1,001	1,186	1,069	1,202
Short term external debt to reserves by original maturity (in percent)	...	313.1	337.0	223.4	87.7	44.7
Short term external debt to reserves by remaining maturity (in percent)	...	131.9	149.8	130.7	56.7	33.3
Share of short term external debt to total debt by original maturity (in percent)	10.7	9.7	9.2	10.1	8.6	8.6
Share of short term external debt to total debts by remaining maturity (in percent)	11.0	9.8	9.3	10.4	8.9	10.2
Total external debt (in US$ millions)	9,770	10,539	10,744	11,403	11,948	11,839
Of which: Public and publicly guaranteed debt 5/	8,722	9,518	9,757	10,250	10,922	10,919
Total external debt (in percent of exports of G&S)	...	267	500	448	436	365
External interest payments, cash basis (in percent of exports of G&S)	...	...	...	1.6	2.7	4.3
External amortization payments, cash basis (in percent of exports of G&S)	...	...	...	0.0	1.2	1.3
Exchange rate, official (per euro, end of period)	3	12	12	59	61	61.5
Exchange rate, parallel (per euro, end of period)	5	16	21	30	31	61.5
REER (annual average, February-December 1994 = 100) 6/	100.4	91.7	66.9	51.4	82.0	91.5

Sources: SM authorities; and IMF staff estimates.

1/ All stocks are measured end-of-period. Excludes Kosovo, except for external debt.
2/ Weighted average of interest rates on commercial paper, bank bills, and certificates of deposit.
3/ Excluding IMF and liabilities to domestic residents. In 2002, NBS assumed short-tem external debt of commercial banks of $100 million.
4/ Includes overdue obligations on debt related to imports of oil and gas. Short-term external debt by remaining maturity also includes amortization due in the following year on medium- and long-term debt.
5/ Assuming all long- and medium-term external debt of banks and enterprises is government guaranteed.
6/ Increase denotes appreciation.

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

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

1/ The quota is SDR 467.7 million.

Serbia and Montenegro: Fund Relations
As of April 30, 2003

I. **Membership Status:** Succeeded to membership of SFRY on December 20, 2000; Article VIII

II. **General Resources Account:**	SDR Million	%Quota
Quota	467.70	100.00
Fund Holdings of Currency	984.64	210.53

III. **SDR Department:**	SDR Million	%Allocation
Net cumulative allocation	56.66	100.00
Holdings	4.40	7.77

IV. **Outstanding Purchases and Loans:**	SDR Million	%Quota
Stand-by arrangement	316.93	67.76
Extended arrangements	200.00	42.76

V. **Financial Arrangements:**

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

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

	Forthcoming				
	2003	2004	2005	2006	2007
Principal	18.75	139.71	139.71	27.08	50.00
Charges/Interest	9.22	11.71	8.22	5.78	5.12
Total	27.97	151.42	147.93	32.86	55.12

VII. **Safeguards Assessments:**

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

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

VIII. **Exchange Arrangement**

Serbia and Montenegro (SM) accepted the obligations under Article VIII as of May 2002. The currency of Serbia is the Serbian dinar. On January 1, 2001, Serbia adopted a managed float system. During 1994–99, the dinar was officially pegged to the DM; for most of the period, multiple exchange rates were in effect. Montenegro has adopted the euro as its sole legal tender.

IX. **Last Article IV Consultation**

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

X. **Technical Assistance During the Past 12 Months**

Department	**Timing**	**Purpose**
FAD	June-July 2002	Tax administration
FAD	September 2002	Treasury reform follow-up
MAE	December 2002	Integrated reform policies for a market-based financial system
MAE	May 2003	Establishing the infrastructure for a market-based financial system
STA	July 2002	Multi-sector mission

Technical assistance missions during the past 12 months from FAD, MFD and STA have contributed significantly to tax administration and treasury management; to the creation of a market-based financial system; and to improved statistical data provision, respectively. At this stage of Serbia and Montenegro's reforms, they have primarily focused on institution-building. Following the FAD missions' recommendations (i) a Treasury was set up in September 2002; (ii) a large taxpayers unit was created in Belgrade, and (iii) single tax identification numbers were introduced. MFD recommendations were key to (i) implementing successfully the pivotal payments system reform at the beginning of 2003, (ii) developing market-based instruments for monetary operations, (iii) improving public sector debt management, and (iv) providing a clear focus to future work on enhancing banking supervision practices. Finally, the multisector STA mission provided a coherent blueprint for improving statistical data provision (see paragraph 11 of Appendix III), which the authorities are in the process of implementing.

XI. **Resident Representative**

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

Serbia and Montenegro: IMF-World Bank Relations

Partnership in Serbia and Montenegro's Development Strategy

1. On May 8, 2001 the World Bank's Board approved the succession of the Federal Republic of Yugoslavia (FRY) to SFRY's membership in the International Bank for Reconstruction and Development (IBRD). FRY membership in the International Development Association (IDA) was confirmed on June 11, 2001. Following constitutional changes, FRY completed its transition to Serbia and Montenegro (SM) on February 4, 2003. The government of SM and its two constituent republics of Serbia and Montenegro have highlighted progress in structural reform and stabilization, and outlined their medium-term development strategies in an Interim Poverty Reduction Strategy Paper (I-PRSP) in August 2002. Both republics are working towards completion of the full PRSP by autumn 2003.

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

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

Bank Group Strategy

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

5. The first stage of World Bank assistance commenced even before SM's membership. In view of its urgent needs, and concurrent with the arrears clearance process, the Bank established in May 2001 a Trust Fund for FRY (TFFRY) using US$30 million of IBRD surplus net income to provide grant financing for selected priority activities. Five grants

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

6. The second stage of assistance began on May 8, 2001, when the Bank's Board of Directors endorsed a first Transitional Support Strategy (TSS) for SM.[1] The TSS contained a three-year IDA envelope of up to $540 million for SM on a temporary and exceptional basis, with actual lending to depend upon performance against agreed benchmarks. It was envisaged that up to 80 percent of the program could support policy-based lending. A first year program of lending, economic and sector work and technical assistance was outlined. The Transitional Support Strategy Update, discussed by the Bank's Board on August 8, 2002, confirmed the overall approach (including the focus on policy-based lending), and laid out the Bank's program for FY03. A second TSS Update, covering FY04 is underway. A full Country Assistance Strategy (CAS) following completion of the full PRSP, would be prepared during FY 2004 in collaboration with IFC.

7. Given the extensive *de jure* and *de facto* devolution of responsibility for economic policy to the member state level, the program of adjustment lending is focused at this level. So far, five operations have been approved. In Serbia, a multi-sectoral Structural Adjustment Credit (SAC) (approved in January 2002) was designed to enhance fiscal sustainability through reforms of public expenditure management, the energy sector, social protection, labor markets, and health care. A Social Sector Adjustment Credit (approved in April 2003), supports further reforms in pensions, health and labor, while enhancing the focus on social assistance and poverty monitoring. Parallel Private and Financial Sector Adjustment Credits (PFSAC I and II, approved May 2002 and June 2003) focus on the growth promotion agenda, assisting the government in: (i) strengthening the financial system through the liquidation of troubled banks and an improved policy and regulatory environment; (ii) privatizing and restructuring socially-owned enterprises; and (iii) improving the investment and business climate. A second multisectoral SAC for Serbia will be developed during FY04. In Montenegro, a single multi-sectoral Structural Adjustment Credit (approved in August 2002) supports reforms critical to fiscal sustainability as well as economic growth in the areas of public expenditure management, pensions, energy, labor markets, and the business environment; a proposed multi-sectoral SAC II is planned for late FY04, focusing on key reforms to enhance growth potential.

8. The Bank's program of adjustment lending has been underpinned by analytical studies. In June 2001, the Bank, working together with the European Commission and the federal and republican governments, completed an Economic Recovery and Transition

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

Program (ERTP), which was presented to the Donor Conference held the same month.[2] In 2002, the Bank focused on three complementary studies—a Public Expenditure and Institutional Review (PEIR), a Country Financial Accountability Assessment (CFAA), and a Country Procurement Assessment Review (CPAR). Studies of the agricultural (Serbia) and environmental sectors (both republics) were also completed. The Bank is now focusing its analytical work on improving the monitoring and analysis of poverty. Recently completed Poverty Household Surveys for both republics laid the foundations for a Poverty Analysis to be completed in 2003. In 2004, the Bank plans to complete a Country Economic Memorandum (CEM) focused on the agenda for sustained growth and employment creation.

9. In both republics, a program of selective investment lending has been designed to assist the authorities to tackle critical impediments to effective public sector management and private sector development, improve social policy and underpin reforms initiated under the Bank-supported adjustment programs. A Trade and Transport Facility for Southeast Europe and an Export Finance project have been approved which cover both Serbia and Montenegro's needs. In addition, IDA is supporting a Serbian Education project, a Serbian Enterprise and Bank Restructuring Technical Assistance operation, a Serbia Health Reform operation, a Serbia Employment Promotion Learning and Innovation Credit and a Montenegrin Energy Efficiency Learning and Innovation Credit. For FY04, five investment projects are under preparation (Serbia Transport Rehabilitation, Serbia Energy Efficiency, Serbia Real Property Registration and Cadastre, and Montenegro Environment and Montenegro Health Sector Reform operations). As of end-June 2003, 12 IDA credits totaling about $397 million had been approved for SM, with adjustment support comprising roughly 80 percent of the total.

10. Since SM became a member of IFC in May 2001, 5 projects have been approved, three in the financial markets and two in manufacturing, totaling for about US$50 million. In addition to a robust pipeline in both the financial and real sectors, IFC has developed a technical assistance program for institutional strengthening (insurance sector, leasing, banking). It has completed or is implementing 15 technical assistance assignments ranging from the energy sector to garments, light engineering, health and education. IFC is also pursuing the opportunities to implement the public-private partnership approach, especially in the energy sector, as a way to attract private sector and support the significant infrastructure needs in SM. MIGA has initiated programs in two areas: (i) guarantees for projects in SM (as of 31 May 2003, MIGA has issued guarantees to 2 projects for a total gross exposure of US$17.3 million); and (ii) investment marketing services (MIGA is currently working with the Serbian Investment and Export Promotion Agency (SIEPA) to implement an investment promotion capacity building and outreach program, funded under a World Bank Technical Assistance Grant).

Bank-Fund Collaboration in Specific Areas

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

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

12. **Public expenditure management.** SM's weak systems of public financial management had long contributed to macroeconomic instability, a lack of transparency, and the inefficient use of public resources. In response, the governments of Serbia and Montenegro have prioritized reforms and institution building in this area. The Bank is taking the lead with a multi-pronged assistance program, which the Fund is complementing with policy conditionality and technical assistance. The Bank's program began with the completion in 2002 of the PEIR, CFAA, and CPAR (see above), which in turn helped to define significant public expenditure management components in the first SACs for Serbia and Montenegro. In Serbia, key reforms supported by the Bank included the adoption of the Law on the Budget System (Organic Budget Law), the first steps toward introducing a treasury system, and enhanced inspection, auditing and procurement procedures. In Montenegro, where legal and institutional reforms had reached a more advanced stage, key reforms include the establishment of a more comprehensive multi-year framework for budget preparation, continued implementation of the interim treasury system, and improvements in the internal audit. Care is being taken to ensure consistency of the PRSP with available budgetary resources.

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

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

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

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

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

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

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

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

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Serbia and Montenegro: Statistical Issues

1. Serbia and Montenegro's (SM) statistical database uses definitions that are not in line with international standards, as they were developed to accommodate national characteristics and because they were not updated during the recent decade when the country was isolated from international developments. The authorities have, therefore, requested that the Fund send a mission to prepare the data module of the Report on the Observance of Standards and Codes (ROSC), which would include a comprehensive data quality assessment, as a basis for further technical assistance.

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

A. Real Sector

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

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

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

B. Balance of Payments

5. Balance of payments statistics are currently compiled by the NBS and the Central Bank of Montenegro (CBM). Principal data sources are customs data on merchandise trade as processed by the FSO and information of foreign exchange transactions provided by banks and exchange bureaus. These are complemented by data from the Ministry of International Economic Relations on external grants and loans. The NBS keeps appropriately detailed records of external debt held by commercial banks, the government and itself. While the data compilation procedures appear appropriate, some components of the balance of payments suffer from substantial underrecording owing to the large proportion of foreign exchange transactions carried outside official channels. Since 2001, the NBS has expended commendable efforts to improve its estimation of actual flows based on existing data.

6. However, the union's balance of payments statement is incomplete because not all information covers both constituent states and the statement shows large net errors and omissions. The NBS has begun compiling a balance of payments statement for Serbia by using existing information from the Union's statement, adjusted for imports and exports of Montenegro and financial flows pertaining to transactions between the two constituent states covered under the financial account of the union's statement. The CBM has begun compiling a similar statement for Montenegro. Close coordination between the NBS and the CBM will be needed to compile balance of payments data for the Union.

C. Government Finance

7. Fiscal statistics for Serbia are compiled by the Serbian Ministry of Finance and for Montenegro by the Montenegro Ministry of Finance. Principal data sources are the budget execution reports of the spending ministries and first-level budget units and—until end-2002—ZOP reports. Revenue data are more timely and reliable than expenditure data, which are compiled with longer delays, although the implementation of the Treasury in both member states has brought improvements.

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

9. During 2001, the government in Serbia made an effort to bring the existing budget reporting system in line with GFS methodology, but full compliance will require, *inter alia,*

full implementation of the new chart of accounts (generally consistent with the classifications of the *GFSM 2001*). Data on expenditure arrears are less reliable due to the lack of basic treasury functions in the existing system of expenditure management.

10. Fiscal data for the central government of Montenegro are based on the new GFS classification. Data for the social security funds are reported directly by the funds and are available only with delays and are not based on GFS classification. A new chart of accounts was introduced in Montenegro in 2001 and needs to be fully implemented at the local level. No data are available for local governments.

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

D. Monetary Accounts

12. Monetary and financial statistics are compiled by the NBS and the CBM following broadly the methodology set forth in the *Monetary and Financial Statistics Manual.* The July 2002 multisector statistics mission found that the authorities had made good progress in implementing the recommendations of the 2001 and 2002 STA missions. Nevertheless problems persist related to inadequate disaggregation of the resident sector, especially the government sector, and the lack of clearly defined criteria for distinguishing residents and nonresidents in monetary statistics. Although there is a methodological break for data prior to January 2002, the chart of accounts used since January 2002 will facilitate the production of consistent time series in the future. The NBS and CBM plan to introduce changes to their charts of accounts to provide additional details for the government sector, thereby increasing the accuracy and reliability of the data. During March 2003, STA provided extensive comments to the NBS authorities on their draft new chart of accounts for the commercial banks. With reference to periodicity and timeliness of data for the financial sector, both the NBS and the CBM meet the GDDS recommendations.

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

Table 13. Serbia and Montenegro: Core Statistical Indicators
(As of June 16, 2003)

	Exchange rates	Inter-national Reserves	Central Bank Balance Sheet	Reserve Money	Broad Money	Interest Rates	Retail Price Index	Exports/ Imports	Current Account Balance	Government Balance	Gross Domestic Product	External Debt/ Debt Service
Date of Latest Observation	June 13, 2003	May 30, 2003	April 30, 2003	June 6, 2003	April 30, 2003	May 30, 2003	May, 2003	April, 2003	Dec. 31 2002	Jan.-April., 2003	2000	Dec. 31 2002
Date Received	June 13, 2003	June 6, 2003	May 15, 2003	June 12, 2003	June 10, 2003	May 18, 2003	June 10, 2003	May 29, 2003	Feb. 2003	May 16, 2003	July 2002	Feb. 7, 2003
Frequency of Data	Daily	Daily	Monthly	Daily	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Annually	Monthly
Frequency of Reporting	Daily	Daily	Monthly	Weekly	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Annually	Monthly
Source of Update	NBS	NBS	NBS	NBS	NBS	NBS	FBS	FBS	NBS	Ministries of Finance of Serbia and Montenegro	FBS	NBS
Mode of Reporting	Report to the Fund	Report to the Fund	Report to the Fund	Report to the Fund	Report to the Fund	Report to the Fund	Website	Website	Website	Report to the Fund	Website	NBS
Confiden-tiality	Public	Confi-dential	Confi-dential	Confi-dential	Public	Public	Public	Public	Public	Public	Public	Confiden-tial
Frequency of Publication	Daily	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Annually	Annually	Monthly

Serbia and Montenegro: External Debt Sustainability Analysis

This note updates the debt sustainability analysis in EBS/03/41.

A. Medium-Term Balance of Payments Projections

1. The baseline scenario assumes that: (a) exports will grow at an annual average of 20 percent in the first half and 10 percent in the second half of the next decade in dollar terms (about 14 percent and 10 percent in euro terms, on account of the large dollar depreciation at the beginning of the projection period); (b) imports will grow at a rate slightly higher than nominal GDP (around 6 percent in euro terms);[1] (c) FDI will rise steadily, reflecting progress in privatization and the improving business environment, although the 2003 number has been adjusted downwards from earlier projections (EBS/03/41) in the aftermath of Premier Djindjic's assassination; (d) commercial borrowing will increase steadily as the business environment improves; (e) official borrowing will increase moderately, with declining program support being offset by increasing project support; (f) there will be no IMF support after the current arrangement; (g) the payment to London Club creditors and non-Paris Club official creditors will start in early 2004 after agreements are reached with these creditors on terms comparable to those of Paris Club creditors; and (h) gross international reserves will build to around 3.8 months of imports of goods and services.

2. Under the baseline scenario, the debt ratios improve over the next 10 years, although the improvement is more modest in the first half of the period. The debt-to-GDP ratio will average around 53 percent in the first 4 years, and around 39 percent in the next five years. Debt service ratios, on the other hand, will increase until 2009 and decline gradually afterwards, partly reflecting the increased debt service after the end of the grace period offered by the IBRD and bilateral creditors. The rise of debt service ratios in the latter half of the projection period argues for a steady buildup of official reserves in the years ahead to guard against possible risks, while keeping on schedule with the country's external obligations. The difference with the projections in EBS/03/41—somewhat higher debt-to-GDP and debt service-to-GDP ratios—are mostly accounted for by the valuation effects of

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[1] The assumptions on export and import growth rates take into consideration the experience of other transition economies and the performance of exports and imports of SM since 2000. The rapid growth of imports in the past three years partly reflects the large needs for basic investment and consumption goods following the end of sanctions and war. It is also important to note that the share of investment goods to total imports rose substantially, particularly last year. With a decline in pent-up demand and policies to rein in domestic demand, imports are expected to grow more gradually in the projection period. In the meantime, exports are expected to show sustained growth as the impact of the structural reforms and the domestic and foreign investments starts to play out. Under these assumptions, the average export and import growth rate amounts to about 13.5 and 12 percent, respectively, in euro terms during 2000-2011, in line with the experience of other transitional European economies in the past decade.

exchange rate movements on dollar-denominated debt, debt service, and GDP; a larger-than-projected real depreciation of the dinar; a slight downward revision of the growth outlook; and delays in agreements with the London Club and other bilateral creditors (Tables 14 and 15).

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

B. Stress Testing: Applying the Standardized Sustainability Framework

4. As explained in EBS/03/41, the standard framework of the debt sustainability analysis has been modified in the case of Serbia and Montenegro owing to the uncertainties related to the historical data. In particular, the 2002 outturn was used to replace historical averages, and the 1996-2001 data for 4 countries in the region, namely Albania, Bulgaria, Croatia, and Romania, were used to derive the standard deviation.

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

6. Applying shocks to the parameters, the stress tests indicate that the higher debt burden stemming from shocks to the external current account deficit, GDP deflators, and/or a significant economic downturn would increase the debt ratios substantially, before the ratios improve slightly following the end of the shocks. On the other hand, shocks to the interest rate from the 2002 level do not have a significant impact on the debt ratios, reflecting the fact that the interest rate in 2002 was effectively low, partly associated with the delayed start of debt service to the Paris Club creditors. As a result, stress tests for the interest rate do not cause major deviations form the baseline projections because of the starting point. The combination of smaller shocks in all the above variables would also yield higher debt ratios than the baseline. Finally, a large one-time real depreciation would substantially worsen the debt ratios.

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

(In percent of GDP, unless otherwise indicated)

	Actual					Projections				
	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
					I. Baseline Medium-Term Projections					
External debt	**75.9**	**105.8**	**132.5**	**103.2**	**75.5**	**63.7**	**55.0**	**51.9**	**51.1**	**47.3**
Change in external debt	16.9	29.9	26.8	-29.3	-27.7	-11.8	-8.7	-3.1	-0.8	-3.8
Identified external debt-creating flows (4+8+11)	15.3	33.7	26.6	-25.8	-17.8	-10.9	4.4	2.5	1.4	0.7
Current account deficit, excluding interest payments	4.4	6.7	6.6	9.0	11.9	9.6	8.2	6.7	5.2	4.4
Deficit in balance of goods and services	-9.5	-13.7	-16.9	-20.9	-23.1	-20.5	-19.7	-18.1	-17.1	-16.3
Exports	28.4	21.1	29.6	23.7	20.7	20.8	23.7	25.7	27.3	28.6
Imports	-37.9	-34.8	-46.5	-44.6	-43.7	-41.4	-43.4	-43.8	-44.4	-44.9
Net non-debt creating capital inflows (negative)	-0.8	-1.1	-0.3	-1.4	-3.6	-3.0	-3.4	-3.6	-3.7	-3.6
Net foreign direct investment, equity	0.8	1.1	0.3	1.4	3.6	3.0	3.4	3.6	3.7	3.6
Net portfolio investment,equity	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Automatic debt dynamics 1/	11.7	28.1	20.3	-33.4	-26.1	-17.5	-0.4	-0.5	-0.2	-0.1
Contribution from nominal interest rate	0.4	0.8	0.5	0.6	0.9	1.3	2.0	2.2	2.3	2.5
Contribution from real GDP growth	-4.7	18.6	-6.3	-5.4	-3.0	-2.3	-2.5	-2.4	-2.2	-2.4
Contribution from price and exchange rate changes 2/	16.0	8.7	26.1	-28.6	-24.0	-16.5	0.1	-0.4	-0.3	-0.2
Residual, incl. change in gross foreign assets (2-3)	1.6	-3.8	0.1	-3.5	-9.9	-0.9	-13.1	-5.6	-2.1	-4.5
External debt-to-exports ratio (in percent)	267.0	500.4	447.7	435.6	365.3	305.6	232.3	201.8	186.9	165.4
Gross external financing need (in billions of US dollars) 3/	1,758.1	1,818.5	1,624.1	2,337.8	3,118.8	3,657.9	3,708.2	3,780.1	3,796.1	3,929.4
in percent of GDP	12.7	17.9	18.9	20.2	19.9	17.5	17.1	16.6	15.8	15.6
Key Macroeconomic and External Assumptions										
Nominal GDP (US dollars)	13,888.8	10,155.0	8,602.8	11,577.3	15,681.0	...	...	...	...	...
Real GDP growth (in percent)	6.7	-18.0	5.0	5.5	4.0	4.0	4.0	4.5	4.5	5.0
Exchange rate appreciation (US dollar value of local currency, change in percent)	-39.0	-44.2	-57.4	-33.5	3.8	...	...	...	...	...
GDP deflator (change in domestic currency)	29.0	60.8	88.5	91.7	25.5	17.1	8.9	6.3	4.8	3.6
GDP deflator in US dollars (change in percent)	-21.3	-10.3	-19.8	27.6	30.3	...	...	...	...	...
Nominal external interest rate (in percent)	0.5	0.8	0.4	0.6	1.2	2.3	3.2	4.1	4.7	5.2
Growth of exports (US dollar terms, in percent)	10.4	-45.6	18.6	7.7	18.2	34.2	18.0	14.2	11.7	10.3
Growth of imports (US dollar terms, in percent)	1.6	-32.9	13.2	28.9	32.9	25.9	9.0	6.2	6.5	6.5
					II. Stress Tests for External Debt Ratio					
1. Real GDP growth, nominal interest rate, dollar deflator, non-interest current account, and non-debt inflows are at 2002 level in 2003-2007					**75.5**	**64.3**	**43.7**	**35.6**	**33.0**	**28.7**
2. Nominal interest rate is at 2002 level plus two standard deviations in 2003 and 2004					**75.5**	**64.2**	**55.6**	**52.5**	**51.7**	**47.9**
3. Real GDP growth is at 2002 level minus two standard deviations in 2003 and 2004					**75.5**	**70.3**	**69.6**	**66.3**	**65.5**	**61.7**
4. Change in US dollar GDP deflator is at 2002 level minus two standard deviations in 2003 and 2004					**75.5**	**74.4**	**60.0**	**56.9**	**56.1**	**52.3**
5. Non-interest current account is at 2002 level minus two standard deviations in 2003 and 2004					**75.5**	**72.3**	**73.5**	**70.2**	**69.4**	**65.5**
6. Combination of 2-5 using one standard deviation shocks					**75.5**	**77.1**	**65.9**	**62.7**	**61.9**	**58.0**
7. One time 30 percent nominal depreciation in 2003					**75.5**	**96.3**	**87.4**	**84.0**	**83.1**	**79.2**

Statistics of the key variables used for stress testing	2002 outturn Prel.	Standard 4/ Deviation	Average 2002-07
Current account deficit, excluding interest payments	11.9	3.1	7.7
Net non-debt creating capital inflows	3.6	1.8	3.5
Nominal external interest rate (in percent) 5/	2.1	0.6	3.5
Real GDP growth (in percent)	4.0	5.3	4.3
GDP deflator in US dollars (change in percent)	30.3	11.1	10.0

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

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

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

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

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

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

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Average 2003-06	Average 2007-11
						(In millions of U.S. dollars, unless indicated otherwise)								
Export growth (US$ terms, in percent)	14.7	4.2	20.4	32.1	19.2	15.0	13.0	11.0	10.3	10.3	9.5	9.3	19.8	10.1
Export growth (euro terms, in percent)	32.5	7.5	14.2	11.5	16.3	15.0	13.0	11.0	10.3	10.3	9.5	9.3	14.0	10.1
Import growth (US$ terms, in percent)	12.6	30.4	30.7	25.6	9.0	6.2	6.5	6.5	6.3	6.3	6.3	6.3	11.8	6.3
Import growth (euro terms, in percent)	30.0	34.5	24.0	5.0	6.1	6.2	6.5	6.5	6.3	6.3	6.3	6.3	6.0	6.3
Current account balance, before grants	-610	-1,119	-2,007	-2,272	-2,218	-2,021	-1,798	-1,752	-1,592	-1,415	-1,201	-963	...	...
percent of GDP	-7.1	-9.7	-12.8	-10.9	-10.2	-8.9	-7.5	-6.9	-5.9	-4.9	-3.8	-2.9	-9.4	-4.9
Current account balance, after grants	-339	-528	-1,383	-1,697	-1,867	-1,670	-1,505	-1,518	-1,358	-1,181	-967	-729	...	...
percent of GDP	-3.9	-4.6	-8.8	-8.1	-8.6	-7.3	-6.3	-6.0	-5.0	-4.1	-3.1	-2.2	-7.6	-4.1
Gross official reserves	516	1,169	2,280	2,891	3,218	3,536	3,856	3,936	4,036	4,166	4,611	4,847	...	...
in months of imports of goods and services	1.2	2.4	3.2	3.7	3.9	4.0	4.1	3.9	3.8	3.7	3.8		3.9	3.8
External debt 2/	11,403	11,948	11,839	12,795	11,440	11,387	11,797	11,508	11,494	11,314	11,243	11,361	...	...
As percent of exports of goods and services	448	436	365	294	223	194	180	159	145	130	119	110	222.8	132.9
As percent of GDP	133	103	75	61	53	50	49	46	42	39	36	34	53.3	39.3
As percent of government revenue	361	265	178	151	128	123	121	114	106	97	90	85	130.9	98.3
External debt service 2/	56	107	183	466	761	946	1,100	1,482	1,644	1,851	1,737	1,505	...	...
As percent of exports of goods and services	2.2	3.9	5.7	10.7	14.8	16.1	16.8	20.5	20.8	21.3	18.4	14.6	14.6	19.1
As percent of GDP	0.6	0.9	1.2	2.2	3.5	4.1	4.6	5.9	6.1	6.4	5.6	4.5	3.6	5.7
As percent of government revenue	1.8	2.4	2.8	5.5	8.5	10.2	11.3	14.7	15.1	15.9	13.8	11.2	8.9	14.2
Sensitivity Analysis														
Lower foreign direct investment scenario 3/														
Debt service to exports of goods and services		...	...	11.9	15.6	18.0	19.2	23.3	23.8	24.5	21.7	18.1	16.2	22.3
Debt to exports of goods and services		...	...	312.8	245.6	220.2	209.7	192.0	180.4	167.5	157.4	149.8	260	169.4
Debt to GDP		...	...	65.2	58.1	56.6	57.3	54.9	52.6	49.8	47.5	45.6	60	50.1

Sources: SM authorities, and IMF staff estimates.

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

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

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

Serbia and Montenegro: Public Sector Debt Sustainability Analysis

1. This public sector debt sustainability analysis updates that in EBS/03/41, 4/2/03. Under the baseline scenario for fiscal debt sustainability analysis, SM's debt-to-GDP ratio would decline steadily from 84½ percent of GDP in 2002 to 51 percent of GDP in 2007 (Table 16). The debt-to-revenue ratio would decline by 63 percentage points over the same period, from 192½ percent in 2002. The baseline scenario is broadly unchanged from the one presented in EBS/03/41, although the debt-to-GDP ratio is higher in 2003 by 8 percentage points of GDP owing mainly to the assumed deferment of the London Club debt rescheduling agreement to 2004; as of 2004, the ratios return to the same broad magnitude. The scenario assumes a gradual fiscal adjustment during 2002–2007. Current primary spending would gradually decline as a share of GDP, while allowing for a small increase in real terms. This decline reflects the consequence of structural reform in public enterprises and the social security system, as well as a general reduction in the size of the government. As the revenue-to-GDP ratio would drop slowly, the primary deficit gradually falls from 2 percent of GDP in 2002 to reach 0.7 percent in 2007. Privatization receipts are projected to remain high in the coming three years (although below the authorities' expectations), then decline to lower levels.

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

3. In the first test, real GDP growth rate, real interest rate, and the primary balance remain at the 2002 level. This scenario results in a much faster reduction in the debt-to-GDP ratio, which would decline by 64.6 percentage points of GDP by 2007. This is due mainly to nominal and real interest effects which were more conservative under the baseline scenario. This also indicates that the baseline scenario is rather conservative. A similar test, but using regional standard deviation instead of the 2002 outturn would also result in a stronger reduction in the debt-to-GDP ratio than under the baseline scenario.

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

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

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

(In percent of GDP, unless otherwise indicated)

	Actual 2001	Prel. 2002	Projections 2003	2004	2005	2006	2007
	I. Baseline Medium-Term Projections						
1 Public sector debt 1/	123.2	**84.5**	**70.0**	**60.8**	**56.1**	**54.7**	**52.3**
Of which: Foreign-currency denominated	113.3	77.6	64.3	55.2	50.3	48.6	45.6
2 Change in public sector debt	17.7	-38.7	-14.5	-9.3	-4.7	-1.3	-2.4
3 Identified debt-creating flows (4+7+12)	-25.1	-39.2	-18.4	-0.5	-0.5	-0.4	-0.2
4 Primary deficit	-0.2	2.4	2.5	2.1	1.8	1.2	0.7
5 Revenue and grants	39.6	43.9	41.6	41.8	41.1	41.0	40.4
6 Primary (noninterest) expenditure	39.5	46.3	44.1	43.9	42.9	42.2	41.1
7 Automatic debt dynamics 2/	-24.9	-39.5	-19.6	-1.5	-1.6	-1.1	-0.9
8 Contribution from interest rate/growth differential 3/	-52.6	-28.0	-13.9	-6.7	-4.4	-3.2	-2.4
9 *Of which*: Contribution from real interest rate	-49.7	-24.2	-11.2	-4.2	-2.0	-0.9	0.1
10 *Of which:* Contribution from real GDP growth	-2.9	-3.8	-2.8	-2.5	-2.5	-2.3	-2.5
11 Contribution from exchange rate depreciation 4/	27.7	-11.5	-5.7	5.3	2.9	2.0	1.4
12 Other identified debt-creating flows	0.0	-2.2	-1.3	-1.2	-0.8	-0.5	0.0
13 Privatization receipts (negative)	0.0	-2.2	-1.3	-1.2	-0.8	-0.5	0.0
14 Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0
15 Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0
16 Residual, including asset changes (2-3)	42.7	0.6	4.0	-8.7	-4.2	-1.0	-2.2
Public sector debt-to-revenue ratio 1/	310.8	192.6	168.2	145.4	136.4	133.6	129.6
Gross financing need 5/	1.2	4.1	4.8	4.8	4.8	4.5	4.3
In billions of U.S. dollars	0.1	0.6	1.0	1.0	1.1	1.1	1.1
Key Macroeconomic and Fiscal Assumptions							
Real GDP growth (in percent)	5.5	4.0	4.0	4.0	4.5	4.5	5.0
Average nominal interest rate on public debt (in percent) 6/	1.4	1.0	1.7	2.4	3.0	3.4	3.9
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	-90.3	-24.7	-15.4	-6.5	-3.3	-1.4	0.4
Inflation rate (GDP deflator, in percent)	91.7	25.7	17.1	8.9	6.3	4.8	3.5
Growth of real primary spending (deflated by GDP deflator, in percent)	12.3	21.8	-1.0	3.5	2.1	2.8	2.4
	II. Stress Tests for Public Debt Ratio						
1. Real GDP growth, real interest rate, and primary balance are at 2002 projection in 2003-2007		**84.5**	**65.4**	**46.5**	**34.5**	**28.1**	**21.9**
2. Real interest rate is at 2002 projection plus two standard deviations in 2003 and 2004		**84.5**	**75.6**	**66.0**	**61.2**	**59.8**	**57.2**
3. Real GDP growth is at 2002 projection minus two standard deviations in 2003 and 2004		**84.5**	**76.2**	**73.9**	**69.1**	**67.6**	**65.1**
4. Primary balance is at 2002 projection minus two standard deviations in 2003 and 2004		**84.5**	**73.5**	**68.0**	**63.1**	**61.7**	**59.1**
5. Combination of 2-4 using one standard deviation shocks		**84.5**	**75.1**	**64.9**	**56.4**	**51.3**	**45.4**
6. One time 30 percent real depreciation in 2003 7/		**84.5**	**133.6**	**123.0**	**116.7**	**114.2**	**110.7**
7. 10 percent of GDP increase in other debt-creating flows in 2003		**84.5**	**80.0**	**70.6**	**65.6**	**64.1**	**61.5**

Variables used for stress tests	Standard Deviation 8/	2002 Prelim.		Average 2002-07
Primary deficit	1.8	2.4		1.8
Real GDP growth (in percent)	4.4	4.0		4.3
Nominal interest rate (in percent) 6/	11.1	3.1	9/	2.6
Real interest rate (in percent)	7.9	-22.6	9/	-8.5
Inflation rate (GDP deflator, in percent)	6.7	25.7		11.1
Revenue to GDP ratio	2.6	43.9		41.6

1/ Consolidated governments of Serbia and Montenegro. Covers gross public and publicly guaranteed external debt, and net domestic general government debt.

2/ Derived as [(r - p(1+g) - g + ae(1+r)]/(1+g+p+gp)) times previous period debt ratio, with r = interest rate; p = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

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

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

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

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

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

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

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

July 11, 2003

Mr. Horst Köhler
Managing Director
International Monetary Fund
700 19th Street
Washington, D.C. 20431

Dear Mr. Köhler:

Firm implementation of our medium-term economic program supported by the Fund under the extended arrangement has ensured progress toward lowering inflation as well as setting the foundation for sustainable growth. To ensure continued progress, we have updated our economic and policy targets for 2003–05, as described in detail in the attached Memorandum on Economic and Financial Policies, to reflect the latest developments. On this basis, we request waivers for the non-observance of three end-June performance criteria, completion of the second review under the current extended arrangement and of the fourth and fifth financing assurances reviews, and a rephasing of the sixth purchase to July 28, 2003. Given our balance of payments need, we also request an extension of repurchase expectations arising in the period September-December 2003 to the obligations schedule.

We believe that the policies and measures described in the attached memorandum are sufficient to achieve our program objectives, but we stand ready to take timely additional measures and seek new understandings with the Fund, as necessary, to keep the program on track. We will remain in close consultation with the Fund in accordance with the Fund's policies on such consultations, and will provide the Fund with all information that it requests to assess the implementation of the program. The program will continue to be reviewed by the Fund on a semiannual basis, with the third review expected to be brought to the IMF Board in January 2004. The 2004 annual budget and financial program, the timetable for transferring central government deposits in commercial banks to the treasury single account in the NBS, exchange rate policy, and progress in bank and enterprise reform will be the main subjects of the third review. The fifth review will focus on the annual budget and financial program for 2005. Moreover, each purchase under the arrangement will continue to be subject to a review of the financing of the program.

Yours sincerely,

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

Bozidar Djelic /s/
Minister of Finance
Republic of Serbia

Mladjan Dinkic /s/
Governor
National Bank of Serbia

Miroslav Ivanisevic /s/
Minister of Finance
Republic of Montenegro

Ljubisa Krgovic /s/
Chairman
Central Bank of Montenegro

SERBIA AND MONTENEGRO

MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

July 11, 2003

I. Introduction

1. **This memorandum updates and supplements the Memorandum of Economic and Financial Policies (MEFP) attached to the Letter of Intent of April 1, 2003.** It reports on recent developments under the program supported by the Extended Arrangement (EA) approved in May 2002 and updates the economic objectives and policy agenda for 2003. Annex A, attached to this memorandum, contains information on the quantitative performance criteria and indicative limits for 2003. Annexes B and C contain information on the structural performance criterion and benchmarks. Annex D (Technical Memorandum of Understanding (TMU)) defines the performance criteria and indicative targets and describes the reporting arrangements.

2. **The new constitution—that replaced Yugoslavia by the state union of Serbia and Montenegro—has been in force since February 4, 2003.** Both states are committed to the timely execution of expenditure commitments of the Union through transfers to the Union budget. A streamlining of responsibilities and institutional overlap will generate fiscal savings. Meanwhile, agreement has been reached on a plan to harmonize the two states' customs, trade and indirect tax regimes, as a step toward a Stability and Association Agreement with the EU.

3. **Economic performance has been so far broadly in line with the 2003 targets but is subject to downside risks.** Real GDP is projected to grow by 3½–4½ percent in 2003, driven primarily by increasing activity in services. However, mixed signals in recent data point to risks. Inflation declined further to 13½ percent by May 2003, consistent with the 9–11 percent target by end-2003. The external current account deficit (before grants) is projected to decline to around 11 percent of GDP in 2003 in line with the program target and recent trends. The overall balance, however, is expected to be weaker than programmed on account of lower FDI and "other capital inflows" in response to adverse changes in market sentiment. Accordingly, the external financing needs are estimated to be higher than earlier projected by about $120 million. This gap is expected to be filled by additional BOP/budgetary financial assistance from the EU and other donors. After declining in January-March 2003, the foreign exchange reserves of the National Bank of Serbia (NBS) have recovered and are projected to reach $2.9 billion (3.7 months of total imports) by end-2003.

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

	2002 Prel. Est.	2003 Prog.	2003 Rev. Prog.	2004 Proj.	2005 Proj.
	(Percentage change)				
Real GDP Growth	3½–4	3½–4½	3½–4½	4	4½
Inflation (end period)	14	9–11	9–11	7	5
Of which: Montenegro	9½	8	9	5	4
	(In billions of US$)				
Current account deficit (before grants)	2.0	2.2	2.3	2.2	2.0
In percent of GDP	12.8	11.0	10.9	10.2	8.9
Gross official reserves	2.3	2.7	2.9	3.2	3.6
In months of projected imports	3.2	3.8	3.7	3.8	4.0
	(In percent of GDP)				
Fiscal deficit	4.5	4.5	4.5	4.3	3.9
Of which: Serbia	4.2	4.1	4.1	...	...
Montenegro	0.3	0.4	0.4	...	...
(in percent of Montenegro's GDP)	3.6	5.6	5.6	...	...
Fiscal deficit, excluding foreign-financed project spending	3.7	3.4	3.5	3.0	2.7
Government credit from the banking system	-0.4	0.0	0.0	0.5	0.8
	(In percent of end-year reserve money)				
Reserve money growth	48.1	12.8	11.3	...	...
NDA contribution	-4.2	0.0	4.3	...	...
NFA contribution	52.4	12.8	6.9	...	...

4. **In Serbia, fiscal policy implementation remained on track in early 2003, while problems in government cash management complicated the conduct of monetary policy.** The end-April performance criteria (PCs) were observed, with the exception of the NDA ceiling. The Serbian republican budget recorded a deficit of 0.6 percent of GDP in 2003 Q1, while the federal government deficit was about 0.3 percent of GDP. Revenue performance was weak in January—owing to the dismantlement of the payments agency (ZOP) and some glitches with the introduction of the single tax identification number—but has fully recovered since February. At the consolidated level, the deficit amounted to 0.6 percent of GDP reflecting surpluses of the local governments and indirect budget users. Meanwhile, the NDA of the NBS rose during January–April 2003 by the equivalent of 17 percent of end-2002 reserve money compared with a program ceiling of 13 percent. This resulted in part from difficulties in government revenue collection and cash management under the new payments system that led to a large accumulation of government deposits in commercial banks. However, NDA was brought under the end-April ceiling by end-May as fiscal-monetary coordination improved. Bank lending continued to grow in early 2003, albeit at a slower

pace, and partially attributable to the financing of a repurchase from Italian Telecom of equity in Serbian Telecom. The indicative target for wage bill growth in large Serbian state enterprises was exceeded by about 2 percent at end-April, owing to faster-than-expected wage growth in EPS (electricity) and PTT (post and telecommunications, Annex A).

5. **In Montenegro, budget implementation in early 2003 was constrained by a revenue shortfall.** Revenue in the first quarter was about 11 percent lower than programmed, as the adoption of self-assessment of tax liabilities on January 1, together with preparations for VAT introduction on April 1, placed undue pressures on tax administration. This—together with limited financing—forced a containment of expenditures that kept the consolidated deficit at €11.9 million (0.9 percent of GDP) on the basis of below-the-line data, below the program target of 1.1 percent of GDP, while also giving rise to new arrears. Revenue returned to normal levels by May but, due to the earlier shortfall, is expected to be around €13 million (0.9 percent of GDP) lower than programmed in 2003 (or €20 million below the Budget).

6. **Progress has continued on a broad array of reforms.** Privatization has remained on track in Serbia with €125 million of sales in January to mid-May 2003, generating cash receipts of €85 million for the government. The four end-April structural benchmarks were not met—owing largely to disruptions in government activity in Serbia in the aftermath of the Premier Djindjic's assassination and the holding of Presidential elections in Montenegro—but progress has been made toward their implementation. Specifically, agreement on a timetable for harmonizing the trade, customs, and indirect tax regimes was reached in early July; the Serbian government approved restructuring plans for only 2 of the seven large state-owned enterprises by end-April, 2003, with the remaining ones expected to be approved by end-July; draft pension legislation in Montenegro has been approved by the cabinet and is expected to be approved by parliament by end-July; and the elimination of export quotas in Montenegro will be addressed in the context of the trade harmonization with Serbia by end-June 2003. Meanwhile, Serbia adopted a pension law in April, which based old-age benefits on the entire work history and tightened eligibility for disability benefits, in line with World Bank and Fund recommendations. Montenegro introduced a single-rate VAT on April 1, 2003.

7. **In the aftermath of the Serbian Prime Minister's assassination, the government renewed its commitment to reform and cracked down on organized crime.** Several thousand arrests were made during the state of emergency that followed, concomitant with a substantial reduction in criminal activity. While serious challenges remain, fight against organized crime has set the stage for a strengthening of the rule of law and an improvement in the business environment.

8. **The debt restructuring process will continue with the implementation of Paris Club agreements, negotiations with the London Club, and regularization of other debt.** Bilateral agreements have been concluded or initialed with 14 Paris Club creditors, with three remaining to be signed. Negotiations with other bilateral official creditors and the London Club are ongoing, with a view to achieving terms comparable to those agreed by the Paris Club. Following the reconciliation of London Club data in February, an Economic Paper will

be submitted to the creditors in July as preparation for the resumption of negotiations. The 2004 budget will include an appropriation for debt service on London Club debt on Paris Club terms. Restructuring of the short-term debt owed to and by Russia on oil and gas imports is also under discussion.

II. Economic Policies for the Remainder of 2003

9. **The current macroeconomic policy stance remains broadly appropriate.** In line with the program, the fiscal deficit will be kept to 4.5 percent of GDP in 2003, unchanged from last year, to contain imports and the current account deficit to sustainable levels. The government will ensure that wage bills in state enterprises will be brought back within the program ceilings with a view to improving the financial position of these enterprises and signaling wage restraint to the rest of the economy. In light of a decline in the projected capital inflows owing to a deterioration in market sentiment and subdued inflation so far, a relaxation of the NFA and NDA targets for the remainder of the year will support the growth objectives without jeopardizing the inflation objective. Exchange rate policy will remain flexible and subject to review in light of trade, wage, and price developments.

A. Fiscal Policy

Serbia

10. **The deficit target of 4.1 percent of GDP in 2003 can be achieved with substantial efforts in revenue collection and containment of expenditure.** The supplementary budget adopted in April was supported by two revenue measures implemented in May: an increase in the excise tax on gasoline and a seven-fold increase in administrative fees (yielding full-year revenue of SRD 3 billion and SRD 2 billion, respectively). In addition, the pension fund contribution rate was increased by 1 percentage point and the contribution base was widened (revenue of SRD 3 billion). As envisaged under the program, expenditure commitments will be maintained below the revised budget allocation by about 0.5 percent of GDP on a net basis. Savings relative to the budget will be effected in the wage bill (0.2 percent of GDP) through attrition (at least 700 employees) as well as a freeze on wages through the middle of the year. Other savings relate to transfers (0.2 percent of GDP), capital spending and net lending (0.2 percent), and nonpriority current spending (0.1 percent of GDP). At the same time, transfers to the Pension Fund will be increased by 0.2 percent of GDP to offset a revenue shortfall, and those to the Employment Fund by 0.1 percent of GDP for a one-off partial reduction of its outstanding arrears in unemployment benefits. Expenditure will be kept in check through the new treasury system which allows improved control over spending as well as the active use of advance monthly ceilings on commitments to avoid the accumulation of arrears. In any event, the government stands ready to take any additional measures needed should the deficit target be at risk.

11. **Ambitious fiscal reforms will continue in 2003.** In tax administration, following the relatively successful transfer of tax collection functions from ZOP to the Public Revenue Agency (PRA), efforts will focus on improved audits, the extension of the large taxpayers unit (LTU) to regional offices by end-September 2003 (SB-monitored), and preparations for the VAT introduction by January 2005 at the latest. The Treasury will continue to expand its

role in managing budgetary expenditure and financing and increasingly use the Treasury Single Account (TSA) in the NBS. In this context, a decision to bring all line ministries and other direct budget users (except the Interior Ministry) under the TSA was adopted at end-June 2003 (SB-monitored) and is expected to be implemented in September; the Interior Ministry will be brought under the TSA by end-2003. In addition, a centralized payroll at the Treasury will be put in place by end-2003. To enhance treasury operations, coordination and information flow among the treasury, the PPA and the NBS will be ensured through (a) daily data-sharing and reconciliation and (b) regular meetings covering liquidity management and planning, including issuance of securities.

Montenegro

12. **A projected revenue shortfall will be addressed by expenditure restraint.** With a view to safeguarding the deficit target of 5.6 percent of Montenegro's GDP in 2003, the government adopted a revised fiscal plan that lowers expenditure commitments by €26 million from budgeted levels primarily in the areas of social transfers, investment, and goods and services, while also providing for the settlement of expenditure arrears accumulated earlier this year and the avoidance of new arrears. In addition, the government undertook to keep expenditures below the revised commitments by €7 million by cutting subsidies, as well as transfers to public organizations and the Pension Fund, unless revenues exceed their revised projected level. The wage bill will be contained through a rationalization of the civil service—that involves around 3,500 redundancies, primarily in the Ministry of Interior and the education sector, which account for the bulk of government employment—and foregoing further wage increases. In addition, to safeguard its debt position from unanticipated future liabilities, the government will assume no new guarantees.

13. **Following the introduction of the VAT, fiscal reforms in Montenegro will focus on the pension system and expenditure and debt management.** The introduction of VAT has been relatively smooth, with collection difficulties subsiding in May. Concerns over the adequacy of controls at the Serbia-Montenegro border and the capacity for processing revenues and refunds persist, however, and will continue to be addressed in the remainder of the year. A new Pension Law that lengthens the retirement age by 5 years in a phased manner and provides for the indexation of pensions according to the Swiss formula (equal weight to price and wage increases) will be adopted by end-July 2003 and come into effect no later than January 1, 2004 (SB). On the basis of a new law on Foreign Debt and Frozen Foreign Currency Deposits (FFCDs)—expected to be adopted during 2003—the government will assume, inter alia, obligations arising from old FFCDs in authorized banks (see below). In light of important fiscal implications, the Ministry of Finance intends to determine the timetable of FFCD repayments in consultation with the Fund staff. The implementation of a permanent treasury has set the basis for the improved monitoring of expenditure arrears, and further steps will be taken to establish the capacity for recording and auditing arrear stocks by end-October, 2003.

B. Wage and Pricing Policies in State Enterprises

14. **Wage bills in state enterprises will be controlled to contain inflation pressures and encourage restructuring through labor shedding.** Although the end-April ceiling was exceeded slightly—owing to one-off bonuses in EPS (electricity) and PTT (post and telecommunications)—the Finance Ministry will ensure that the targets for the remainder of the year are achieved by monitoring closely developments in wage bills as well as implementing retrenchment measures to improve the overall financial position of state enterprises. In the event of spin-offs as a result of restructuring, the wage-bill envelope monitored will include the wage-bills of the spun-off units.

15. **The restructuring process of state enterprises is moving to the implementation phase.** Despite delays in the government approval of restructuring strategies for 7 large state enterprises, the first phase of restructuring—involving redundancies and the spin-off of non-core activities—is underway in several large state enterprises and being prepared in others. The average electricity price was raised by 15 percent on July 1, 2003. In addition, EPS will streamline employment this year (through a 15 percent in core employment in Q3, and spinning-off and privatizing or closing non-core units); implement measures to raise the collection rate to 90 percent by end-2003, and 95 percent in 3 years; eliminate its arrears on accounts payable over the same time frame; and reorganize its core business in preparation for the privatization of selected spun-off components, as the necessary regulatory framework envisaged under the Energy Law is put into place.

C. Monetary and Exchange Rate Policies

16. **Monetary policy will aim at further disinflation and strengthening the external position.** The NBS has lowered somewhat the NFA accumulation target during 2003 owing to lower-than-originally-estimated FDI and other capital inflows, and larger BOP/budgetary financing needs that can be filled partly by additional foreign assistance. Consistent with a 11½ percent target for reserve money growth in 2003, the NBS has raised the NDA targets for the remainder of the year. The NBS will continue to follow credit developments closely and strengthen the implementation of prudential regulations to ensure that new lending decisions are sound. The NBS lowered the reserve requirement on deposits from 22 percent in April to 20 percent in May and 18 percent in July in conjunction with the ongoing shift of government deposits from commercial banks to the NBS.

17. **A gradual, coordinated shift of government deposits to the NBS will improve the conduct of monetary and fiscal policies.** To ensure unencumbered monetary policy implementation while maintaining stability in the banking system, the Serbian government will gradually shift its deposits in commercial banks to the Treasury Single Account in the NBS. Central government dinar sight and term deposits in commercial banks—which amounted to RD 15.2 billion at end-April and an estimated SRD 12.2 billion at end-June—will be further reduced to SRD 9.2 billion by end-September and SRD 6.2 billion by end-December 2003 (indicative target, Annex A). A timetable for the elimination of central government deposits in commercial banks will be a topic of the third review under the EA. If needed to offset the liquidity impact of this measure, and in line with the NDA targets, the NBS will provide liquidity support against collateral to the banking system through its

standing credit facilities, which will be expanded to include repos and reverse repos during the second half of the year. The level of remuneration on the government's TSA funds will be set in line with international practice.

18. **The NBS will expand its monetary policy instruments, while coordination between the NBS and the Ministry of Finance will be strengthened.** The NBS introduced weekly auctions of two-week instruments to set the broad parameters of monetary policy in May 2003 and will put in place an emergency credit facility for solvent banks experiencing temporary liquidity problems by September 2003. In June 2003, the NBS and MOF established a policy committee to coordinate NBS' monetary operations and MOF's cash and treasury bill management (SB-monitored).

19. **Exchange rate policy in Serbia will continue to strike a balance between safeguarding the external position and supporting disinflation.** The NBS will maintain a flexible exchange rate policy taking into account conditions in the interbank foreign exchange market and developments in trade, prices, and domestic costs, with a view to supporting external competitiveness, while continuing to provide a nominal anchor for price expectations. To increase the role of market forces in the foreign exchange market, the NBS, by mid-2004, will phase out remaining restrictive regulations, while the Ministry of Finance will equalize the tax treatment of all cash financial transactions by end-2003. The requirement that NBS discount rate be used in calculating foreign exchange swap rates was eliminated on June 1, 2003.

D. Bank Restructuring and Financial Sector Supervision

20. **Progress will continue in bank restructuring.** The government has begun implementing a strategy aimed at resolving 12 banks in which it acquired significant stakes through debt-equity swaps in 2002. Based on diagnostic audit reports that are expected to be completed for 9 banks in the coming months, the government will reach agreement with the IMF staff, in consultation with the World Bank, on a plan for the largest bank by end-September 2003 (SB-monitored); resolution plans for the remaining 8 banks will be prepared by end-November 2003. Regarding the latter, tenders offering majority or controlling stakes for three banks will be launched by end-December 2003 (SB-monitored). Tenders for a strategic advisor to the government on bank privatization and for privatization advisers for the three banks have already been initiated. Meanwhile, the Bank Rehabilitation Agency (BRA) will strengthen control and governance in nationalized banks to preserve their value prior to resolution. Any envisaged use of budgetary resources will be incorporated in the 2004 budget. Finally, a privatization advisor will be appointed for Niska Banka by end-2003.

21. **Financial sector supervision and regulation will be strengthened further in Serbia.** Building on advances in developing the institutional framework for banking supervision—notably the adoption of a Supervisory Development Plan, and the establishment of a Supervisory Council—the NBS will place heightened emphasis on compiling timely analytical information on bank liquidity and solvency. In particular, monthly aggregate banking indicators will be developed with a view to establishing an early warning system by end-2003. To this end, banks will shift from quarterly to monthly reporting for off-site supervision by end-September; and on-site examinations will be

intensified to ensure proper asset and risk classifications. In addition, the large loan registry will be enhanced to complement regular reporting; a regulation will be published requiring that banks' management boards issue an opinion on all large exposures; and consolidated supervision (that would include leasing subsidiaries) will be introduced in the new NBS law to be adopted by end-2003 (SB-monitored). The government will implement a framework for supervising non-bank financial institutions—involving comprehensive audits and setting minimum capital requirements for insurance companies—following the enactment of a new law on insurance expected by end-2003. On the regulatory side, the government will publish in the Official Gazette by end-September 2003 the newly adopted law on Accounting and Auditing prescribing the use of International Accounting Standards (IAS); and the NBS will issue the revised chart of accounts consistent with the new accounting law by end-September 2003.

22. **In Montenegro, bank restructuring is supported by measures to strengthen supervision and the adoption of new laws.** The forthcoming Law on Settlement of Obligations and Claims from Foreign Debt and Frozen Foreign Currency Savings (FFCD) will: (a) only allow transfer of liabilities from commercial banks to the budget at the time of privatization or liquidation, if they had been incurred under explicit government guarantee; (b) contain the budgetary impact of the transfer of liabilities to the Republic through phased repayment; (c) ensure that the CBM does not incur liabilities arising from the transfer to the budget of FFCD-related obligations with a view to protecting the financial soundness of the CBM; and (d) establish an effective mechanism to maximize collections against the bank assets underlying transferred liabilities. The institutional framework for banking supervision was modernized with the introduction of new regulations on licensing, minimum capital, asset classification and provisioning, connected lending and large exposures. Banks are required to prepare reports based on IAS. To eliminate the regulatory and supervisory loophole that exists for off-shore bank operations, the CBM has published the list of 432 offshore banks and instructed on-shore banks to cancel their accounts with these banks; to strengthen the CBM's legal power over offshore banks, the Ministry of Finance of Montenegro will provide individual decisions on revoking their licenses. The government will also adopt a new draft anti-money-laundering law, which is expected to be enacted by end-July, 2003.

E. Enterprise Restructuring and Privatization

23. **Serbia is making progress in privatizing and restructuring socially owned enterprises.** Fifty large socially owned enterprises will be offered through tenders in 2003, with the sale of the largest ones (Beopetrol and two tobacco companies) expected in the fourth quarter. About 1,000 small socially owned enterprises will be auctioned. In total, privatization is expected to generate cash receipts of about €400 million in 2003. Progress will also be made in restructuring 49 socially sensitive conglomerates—originally employing over 150,000 workers—prior to privatization to ensure orderly ownership transfer and employment reduction. About 50,000 workers have already been laid off with social support from the budget; a further 30,000 are expected to go through the same process this year at a cost to the budget of some €60 million. To continue ensuring transparency of the use of privatization receipts, all privatization proceeds will be channeled through the budget and

spending will follow normal budgetary procedures. Excess privatization proceeds, after covering any shortfall in foreign budgetary financing, will be used to reduce net government indebtedness and—if consistent with achieving program objectives and in consultation with the Fund in the context of program reviews—to cover investment and restructuring costs.

24. **Forthcoming legislative changes will reinforce the impact of rapid privatization in enhancing competition in the enterprise sector.** Several new laws aimed at bolstering the business environment will be adopted by parliament in the second half of the year, including the laws on bankruptcy, on executive procedures and on business registration, as well as amendments to the laws on public procurement and on financial markets and securities.

25. **Privatization in Montenegro is proceeding.** In addition to privatization through tenders, auctions and sales of minority government share packets in the local stock exchanges, some companies' assets are privatized by applying the bankruptcy law adopted in 2002. The recent tender privatization of Montenegro Banka to a strategic investor will be followed by the initiation of the same process for Podgoricka Banka. In addition, the downstream component of the aluminum company (KAP) will be spun off and privatized this year. To ensure transparency, the Privatization Law will be amended by end-September 2003 to allow channeling all privatization proceeds to the budget without earmarking, with spending to follow normal budgetary procedures. Privatization sales are expected to yield €70 million in 2003; however, for caution, one-third of this amount has been budgeted.

F. Foreign Trade System

26. **Agreement has been reached on an action plan to harmonize member states' trade regimes.** Agreement on tariff rates has been reached on all goods, with most rates to be harmonized immediately and the remainder by 2006. Following the elimination of export quotas in Serbia early in the year, Montenegro plans to eliminate the small number of remaining quotas in the process of harmonization. All quantitative import restrictions in Serbia and Montenegro—other than those maintained for health, environment and security reasons—will be eliminated by end-2004. In addition, trade and custom laws in the two republics will be harmonized by end-2003, and free trade agreements with the neighboring countries will be signed and implemented.

III. Program Monitoring

27. **Macroeconomic policy performance under the EA will continue to be monitored on the basis of quarterly quantitative performance criteria and indicative targets** (Annex A). Progress in structural reform will be monitored through structural benchmarks on key policy measures (Annex C). To enhance program monitoring, both member states have appointed contact persons responsible for regular provision of standard data on fiscal and monetary developments as well as privatization, as described in the TMU.

28. **Further improvements will be made in the provision of statistical data.** Improving the timeliness of national accounts statistics is a top priority, with the 2001 GDP figures expected to be published by July 2003. Improvements will also be made in publishing

data on wages and the external sector for both member states and SM. Montenegro will publish a consistent monetary survey starting from end-August 2003.

Serbia and Montenegro: Quantitative Performance Criteria and Indicative Limits for 2003 Under the 2002-2005 Extended Arrangement 1/

(In millions of dinars, unless otherwise noted; end of period)

	2002	2003										
	Dec. Est.	April			May	June		June			Sep.	Dec.
	End-02	Prog. 14/		Prel.	Prel.	Ori. Prog 14/		Rev. Proj.		Prel.	Rev. Prog.	Rev. Prog.
	Ex. Rates		w/ adjustor				w/ adjustor		w/ adjustor			
A. Quantitative performance criteria												
Floor on the net foreign assets of the NBS 2/ 3/	1,056	872	872	903	878	992	992	850	782	879	970	1,098
Ceiling on net domestic assets of the NBS 2/ 4/	1,951	9,722	9,744	11,088	6,906	4,150	6,650	9,071	10,108	6,219	6,588	1,824
Ceiling on net credit of the banking system to the consolidated general government 2/ 5/ 6/	-14,325	-2,834	-2,404	-11,970	...	-370	...	-10,570	...	...	-13,023	-13,779
Ceiling on contracting or guaranteeing by the public sector of new nonconcessional external debt with original maturity of more than one year 3/ 7/	0	0	0	0	...	0	0	0	0	0	0	0
Ceiling on new external debt contracted or guaranteed by the public sector with an original maturity of up to and including one year 3/ 8/	0	0	0	0	...	0	0	0	0	0	0	0
Ceiling on new guarantees and the assumption of bank or enterprise debt by the public sector 9/	0	0	0	0	...	0	0	0	0	0	0	0
Ceiling on outstanding external debt service arrears 3/ 10/	0	0	0	0.8	...	0	0	0	0	0	0	0
B. Indicative targets												
Ceiling on net credit of the banking system to												
consolidated general government of Serbia 2/ 5/ 11/	-11,774	-744	-499	-10,077	-8,983	2,026	5,913	-8,174	-7,137	-7,258	-10,274	-11,774
consolidated general government of Montenegro 2/ 5/ 11/	-2,551	-2,090	-1,905	-1,893	...	-2,396	...	-2,396	...	...	-2,749	-2,005
Ceiling on net domestic assets of the banking system 2/ 12/	49,970	60,039	60,039	62,910	67,699	61,810	61,810	71,313	71,313	...	71,343	69,856
Ceiling on Serbian central government dinar deposits in commercial banks	10,498	...	...	15,187	13,147	...	...	12,187	12,187	...	9,187	6,187
Ceiling on change in the arrears of												
the federal government	0	0	0	0	0	0	0	0	0	0	0	0
the consolidated general government in Serbia	0	0	0	2,884 15/	...	0	0	0	0	...	0	0
the consolidated general government in Montenegro	0	0	0	...	...	0	0	0	0	...	0	0
Ceiling on the wage bill of the 7 largest public enterprises, cumulative from beginning of year 13/	22,398	8,030	8,030	8,190	...	12,261	12,261	12,261	12,261	...	18,684	25,399

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

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

3/ In millions of U.S. dollars. The net foreign assets floor will be adjusted downward by the shortfall relative to the programed level of net external budgetary financing with a maximum adjustment of US$100 million.

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

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

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

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

8/ Excludes normal import-related credits.

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

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

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

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

13/ JP Elektroprivreda Srbije, JP Nafna Industrija Srbije, JP PTT Srbije, JP Jugoslovenski Aerotransport, JP Zelenicko Transportno Preduzece Srbije, JP Srbija Sume, and JP Srbija Vode. To the extent that monitoring systems are not in place to compile data on a comparable basis, the ceiling will be adjusted downwards to prorate for spin-offs from these companies of activities through the creation of new companies.

14/ Adjusted for reserve requirement changes from 23 percent to 22 percent in April and 22 percent to 20 percent thereafter; also adjusted to revisions to end-2002 NFA and credit to government.

15/ As of end-March 2003.

Serbia and Montenegro: Extended Arrangement, March 2002-March 2005
Prior Actions, Structural Performance Criteria, and Structural Benchmarks, January-December 2003
(As specified in MEFP of April 1, 2003 (EBS/03/41, 4/02/03))

	Target Date	Implementation Status
I. Structural Performance Criterion		
1. Serbia: Effective July 1, 2003, increase weighted average electricity price for sales to end-users by at least 20 percent in dinar terms from the level prevailing at end-2002.	end-June 2003	Waiver requested on the basis of revised policy understandings (15 percent increase on July 1 and measures to restructure the electricity company, see MEFP ¶15).
II. Structural Benchmarks		
A. Fiscal Sector		
1. Montenegro: Adopt a pension law that shifts the indexation of pensions to a weighted average of changes in wages and prices (with the weight of wages not to exceed 50 percent) and raises the minimum retirement age by 5 years in a phased manner.	end-April 2003	Delayed to July 2003. Legislative activity suspended owing to presidential election.
2. Serbia, Montenegro: Reach agreement on timetable for harmonizing at the latest by end-2005 trade, customs, and indirect tax regimes.	end-April 2003	Met in early July. Agreement on harmonization within two years reached in early July 2003 with the main exception that harmonization for 56 agricultural commodities of strategic importance to Montenegro is envisaged within 3 years with a possible extension of two more years.
3. Montenegro: Begin reporting quarterly budgetary arrears data	end-May 2003	Met, but data reported only in flow terms.
4. Serbia: Bring all line ministries and other direct budget users under the treasury single account.	end-June 2003	Met largely. Decision was adopted to close all bank accounts of direct budget users.
5. Serbia: Establish Large Taxpayers Units (LTUs) for Nis, Novi Sad and Kragujevac.	end-September 2003	...
6. Serbia: Establish and implement a centralized payroll system under the Central Accounting Division of the Treasury.	end-December 2003	...
B. Financial Sector		
1. Serbia: Adopt new National Bank of Serbia law to provide for a National Bank Supervisory Board.	end-December 2003	...
2. Serbia: Offer majority or controlling stakes to strategic investors in at least 3 of the banks affected by the July 2002 laws on Paris and London Club debt and frozen foreign currency deposits.	end-December 2003	...
C. Foreign trade		
1. Montenegro: Eliminate all export quotas	end-April 2003	Not met. Revised policy understanding reached.
D. Enterprise restructuring and privatization		
1. Serbia: Government to approve restructuring strategies for the 7 large state enterprises consistent with a significant improvement in their profitability through streamlining of operations and cost-cutting.	end-April 2003	Done only for 2 companies; the remaining 5 are expected to be adopted by end-July.

Serbia and Montenegro: Extended Arrangement, March 2002-March 2005
Prior Actions, Structural Performance Criteria, and Structural Benchmarks, January-December 2003
(As revised in MEFP of July 11, 2003)

	Target Date	Implementation
I. Structural Performance Criterion		
1. Serbia: Effective July 1, 2003, increase weighted average electricity price for sales to end-users by at least 20 percent in dinar terms from the level prevailing at end-2002.	end-June 2003	Waiver requested on the basis of revised policy understandings (15 percent increase on July 1 and measures to restructure the electricity company, see MEFP ¶15).
II. Structural Benchmarks		
A. Fiscal Sector		
1. Montenegro: Adopt a pension law that shifts the indexation of pensions to a weighted average of changes in wages and prices (with the weight of wages not to exceed 50 percent) and raises the minimum retirement age by 5 years in a phased manner.	end-July 2003	...
2. Serbia, Montenegro: Reach agreement on timetable for harmonizing at the latest by end-2005 trade, customs, and indirect tax regimes.	end-July 2003	Met. Final agreement on harmonization within two years reached in early July 2003 with the main exception that harmonization for 56 agricultural commodities of strategic importance to Montenegro is envisaged within 3 years with a possible extension of two more years.
3. Serbia: Reach agreement between the Ministry of Finance and the NBS outlining mutual responsibilities in government debt and cash management and establishing a committee to coordinate NBS' monetary operations and MOF's cash and treasury bill management.	end-June 2003	Met. Agreement on creating the committee has been signed on June 30, defining its members and key duties.
4. Serbia: Bring all line ministries and other direct budget users under the treasury single account.	end-June 2003	Met largely. Decision was adopted to close all bank accounts of direct budget users.
5. Serbia: Establish Large Taxpayers Units (LTUs) for Nis, Novi Sad and Kragujevac.	end-September 2003	...
6. Serbia: Establish and implement a centralized payroll system under the Central Accounting Division of the Treasury.	end-December 2003	...
B. Financial Sector		
1. Serbia: Adopt Secured Transactions Law.	end-September 2003	...
2. Serbia: Adopt Resolution plan for the largest bank in consultation with the Fund staff.	end-September 2003	...
3. Serbia: Adopt new National Bank of Serbia law to provide for a National Bank Supervisory Board.	end-December 2003	...
4. Serbia: Offer majority or controlling stakes to strategic investors in at least 3 of the banks affected by the July 2002 laws on Paris and London Club debt and frozen foreign currency deposits.	end-December 2003	...
C. Foreign trade		
1. Montenegro: Eliminate all export quotas	To be implemented in the context of trade harmonization.	All remaining export quotas will be eliminated at the time the harmonized tariff system becomes effective (expected in August 2003).
D. Enterprise restructuring and privatization		
1. Serbia: Government to approve restructuring strategies for the 7 large state enterprises consistent with a significant improvement in their profitability through streamlining of operations and cost-cutting.	end-July 2003	...

Union of Serbia and Montenegro: Technical Memorandum of Understanding

I. Introduction

1. This memorandum replaces the Technical Memorandum of Understanding attached to the Memorandum of Economic and Financial Policies of April 1, 2003. It sets out the understandings regarding the definitions of quantitative and structural performance criteria and benchmarks, as well as indicative targets, for the program supported by the Fund under an Extended Arrangement (EA), as well as the related reporting requirements. The key changes in this updated memorandum include definitional changes in the fiscal area stemming from the implementation of the new Constitutional Charter, an adjustor to the NFA floor, and data revisions owing to revised monetary data for end-2002.

2. To monitor developments under the program, the authorities will provide the data listed in each section below to the European 1 Department of the Fund, in accordance with the indicated timing. The quantitative performance criteria and indicative targets will be monitored on the basis of the methodological classification of monetary and financial data that was in place on December 31, 2002, except as noted below. Quantitative performance criteria and indicative targets for end-June, end-September and end-December 2003 are specified in Annex A of the Memorandum of Economic and Financial Policies (MEFP).

3. For program purposes, the public sector consists of the consolidated general government (comprising union operations, Serbian state and local governments, the Montenegrin state government, the Serbian and Montenegrin social security funds, and the Serbian special budgetary programs), the National Bank of Serbia (NBS), and the Central Bank of Montenegro (CBM). The authorities will inform the Fund staff of any new funds or special extrabudgetary programs that may be created during the program period to carry out operations of a fiscal nature as defined in the IMF's *2001 Manual on Government Financial Statistics,* and will ensure that these will be incorporated within the definition of consolidated general government.

II. Quantitative Criteria: Definitions and Reporting Standards

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

4. **Definition.** Net foreign assets (NFA) of the NBS consist of foreign reserve assets minus foreign reserve liabilities.

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

- For purposes of the program, **foreign reserve liabilities** shall be defined as any foreign currency-denominated short-term loan or deposit (with a maturity of up to and including one year), swaps (including any portion of the NBS gold that is collateralized), and forward liabilities of the NBS—to residents and nonresidents; IMF purchases; and loans contracted by the NBS from international capital markets, banks or other financial institutions located abroad, and foreign governments, irrespective of their maturity. Undivided foreign exchange liabilities of SFRY are excluded. On December 31, 2002, the NBS's foreign reserve liabilities, as defined above, to nonresidents were US$667 million and to residents were US$567 million.

- All assets and liabilities denominated in convertible currencies other than the U.S. dollar shall be converted at their respective exchange rates against the U.S. dollar prevailing on December 31, 2002. All changes in definition or in valuation of assets or liabilities, as well as details of operations concerning sales, purchases or swap operations with respect to gold shall be communicated to the Fund staff within one week of the operation.

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

6. **Adjustors.** For program purposes, net foreign assets will be adjusted upward pari passu to the extent that: (i) after December 31, 2002, the NBS has recovered frozen assets of the FRY, assets of the SFRY, long-term assets, and foreign-exchange-denominated claims on resident banks and nonbanks, as well as SM commercial banks abroad; and (ii) the restructuring of the banking sector by the Bank Restructuring Agency (BRA) involves a write-off of NBS foreign-exchange-denominated liabilities to resident banks. The net foreign assets floor will be adjusted downward by the shortfall relative to the programed level of net external budgetary financing cumulative from May 1, 2003 (US$109 million through end-June, US$258 million through end-September, and US$336 million through end-December) with a maximum adjustment of US$100 million. The net foreign assets floor will also be

adjusted by the amount that revised estimates differ from the preliminary estimates of the end-2002 outcome.

B. Ceiling on Net Domestic Assets of the NBS

7. **Definition.** For purposes of the program, net domestic assets (NDA) of the NBS are defined as the difference between reserve money (as defined in section E) and net foreign assets (as defined in section A), with the latter being converted from U.S. dollars into dinars at the program accounting exchange as specified above. The ceiling is established as the monthly average of each month with an end-month test date (i.e., the averages of April, June, September, and December, 2003, respectively). The monthly average of NDA for program purposes will be calculated as the difference of the monthly average of reserve money and monthly average of NFA. The monthly average of NFA will be adjusted so that the disbursements of World Bank program loans and EU macro-financial assistance are counted as if they occurred on the first day of the month in which they were effected. As of December 31, 2002, NDA of the NBS so defined were valued at SRD 1,951 million (Annex A).

8. **Adjustors.** The NBS's NDA ceiling is subject to the same adjustor for excess or shortfall in combined budgetary external financing and privatization proceeds for the consolidated Serbian government as defined in Section C, except that the limit for upward adjustment is SRD 2.5 billion. The adjustment for excesses/shortfalls in combined budgetary external financing and privatization proceeds is asymmetric: (a) it applies to the NDA ceiling but not to the NFA floor (except that shortfalls in budgetary external financing trigger an equal downward adjustment in NFA up to a limit of US$100 million); and (b) upward adjustments in NDA are capped at the equivalent of 0.2 percent of GDP, while no limits apply to downward adjustments. This treatment takes into account that: (a) privatization proceeds reflect partly sales to residents (i.e., not directly affecting NFA), so that a downward adjustment in NDA in response to higher than programmed privatization proceeds may not necessarily lead to a corresponding increase in NFA or may do so with a considerable lag (money demand is not stable in the short run); and (b) the need to safeguard foreign reserves.

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

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

10. **Definition.** The banking system comprises the NBS, commercial banks in Serbia, the CBM, and commercial banks in Montenegro. The consolidated general government was defined above.

- For program purposes, **net credit of the banking system to the consolidated general government** is defined as all claims other than frozen foreign currency deposit (FFCD) bonds (i.e., credits, securities, and other claims in both dinar and foreign currencies) of the banking system on the consolidated general government less all deposits of the consolidated general government with the banking system, including foreign currency deposits. Foreign currency deposits and foreign-currency-denominated credits to the general government will be reported at the December 31, 2002 exchange rates. Net bank credit to the consolidated general government in Montenegro will be monitored on the basis of data supplied by the Montenegrin authorities; at end-December 2002, net credit of the banking system in Montenegro to the consolidated general government in Montenegro amounted to €-41.5 million (equivalent to SRD -2,551 million). At end-December 2002, net credit of the banking system to the consolidated general government so defined was SRD -15,121 million.

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

12. **Adjustors.** For program purposes, the ceilings on net credit of the banking system to the consolidated general governments will be adjusted downward by the cumulative increase in the stock of government debt held by the nonbank public (other than that related to the frozen foreign currency deposits), starting from January 1, 2003, and upward for any decrease. These performance criteria will be adjusted by the amount that revised estimates differ from the preliminary estimates of the end-2002 outcome. In addition, in the event of a shortfall in the sum of net foreign budgetary financing and privatization proceeds, the ceilings will be adjusted upward by 75 percent of the shortfall subject to the total adjustment limit of SRD 5 billion for Serbia's and €10 million for Montenegro's consolidated government. The ceilings will be adjusted downward for the excess of combined net external budgetary financing and privatization proceeds relative to budgeted levels that are not used (1) to reduce the government's external indebtedness by more than envisaged under the program, or (2) to cover investment and restructuring costs in consultation with the Fund in the context of reviews under the EA. Privatization receipts are defined to include all cash privatization receipts (defined as cash received by the government including the privatization agency), including those channeled to extrabudgetary funds. Net external budgetary financing is defined to include all budgetary (i.e., non-project) grants and loans, less amortization (on a cash basis). The estimation of the shortfalls (excesses) in the sum of net foreign budgetary financing and privatization receipts will be based on the following projections (cumulative from the beginning of 2003) with the actual inflows evaluated at the average exchange rates of the month when funds are received:

Serbia (In billions of dinars)

	end-June EBS/03/41	end-June Revised	end-Sep.	end-Dec.
Foreign financing	7.6	7.1	15.7	19.7
Privatization proceeds	9.0	5.7	8.2	18.2

Montenegro (In € million)

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

D. Ceiling on Change in Domestic Arrears

13. For program purposes, indicative targets will be set on the change in domestic arrears. Separate indicative targets will be set for the consolidated general government of Serbia (including union-level spending), and the consolidated general government of Montenegro.

14. **Definition**

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

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

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

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

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

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

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

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

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

- € denominated claims on government will be converted at the program exchange rate; claims denominated in currencies other than the € will first be converted at their respective program exchange rates against the €. The change in arrears is defined as the change in the end-period stock of arrears. Changes in wage and pension arrears will be adjusted for the changes in the average wage and average pension in the economy relative to their respective values in December 2002.

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

E. Definition of Reserve Money

16. **Definition.** Reserve money is defined as the sum of currency in circulation (NBY Bulletin, September 2000, Table 3A, column 8) and dinar reserves banks are required to hold at the NBS, plus excess reserves of the commercial banks. Shortfalls in reserves that banks are required to hold will be included in required reserves (and therefore in reserve money), as well as in bank borrowing from the NBS. Reserves that banks are required to hold were set at 20 percent effective on April 11, 2002 of the base as defined in NBS Decision of March 28, 2002. As of March 1, 2003 the required reserve ratio was raised to 23 percent but was reduced to 20 percent in two steps by May 11, 2003. Subsequent changes in the reserve requirement will be reflected in program definitions. The amounts that banks are permitted to hold in securities to satisfy the statutory reserve requirement will be limited to the amount that banks were holding as of December 31, 2000 (SRD 174.1 million). Excess reserves include commercial banks' (1) balances in Giro accounts 620, 621, 623, and 625, (2) overnight deposit in account 205 at the NBS, (3) excess balances (with the shortfall in required reserves counted as negative excess) above required reserves on account 201 at the NBS, and (4) cash in vaults.

17. Data on reserve money will be monitored from the daily monetary indicators of the NBS, which shall be supplied to the European 1 Department of the Fund weekly by the NBS with a three-day lag. The end-month data is based on the NBS balance sheet, which is provided to the Fund with a lag of less than three weeks. On December 31, 2002, currency in circulation amounted to SRD 43,719 million, while required reserves amounted to SRD 15,843 million, and excess reserves to SRD 9,762 million. For program and projection purposes, monthly averages of reserve money and its components were used. On the assumption that the increase in required reserves would be met through a corresponding

decline in excess reserves, the hypothetical December 2002 average required reserves associated with a 23 percent reserve requirement would have been SRD 18,043 million, while excess reserves would have been SRD 5,365 million. Data on effective reserve requirements and the deposit base used in reserve requirement calculations will be supplied to the European 1 Department on a ten-day basis with a lag of less than a week.

18. **Adjustors.** For program monitoring purposes, reserve money will be adjusted as follows. Should the standard reserve requirement increase (decrease) from the level prevailing on May 11, 2003, the ceiling on net domestic assets would be increased (decreased) by an amount equivalent to the change in the standard reserve requirement ratio multiplied by the deposit base used in the calculation of required reserves. Before making any changes to the reserve requirement, the NBS will consult with Fund staff. Required reserves of banks placed under BRA administration or liquidation will remain part of reserve money for program purposes.

F. Ceiling on External Debt-Service Arrears

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

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

G. Ceilings on External Debt

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

meaning set forth in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt adopted on August 24, 2000 (Decision No. 12274-(00/85). Excluded from this performance criterion are normal short-term import credits.

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

III. Other Reporting Requirement for Program Monitoring

A. Macroeconomic Monitoring Committee

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

B. Developments on Structural Performance Criteria and Benchmarks

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

C. Data Reporting

Production and prices

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

Public finance

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

- The revenue data by each major item, including that collected by the state and local governments, as well as the social funds (also including "own revenue" of direct budget users);

- Details of the recurrent and capital expenditure of the union, state, and local governments, as well as the social funds (also including "own expenditure" of direct budget users); and

- Details of budget financing, both from domestic, and external sources, including total privatization receipts and Treasury bill issues and repayments (in the format described in paragraph 27).

In addition, Montenegro will augment the quarterly reporting of arrears data for the consolidated general government in Montenegro from November 2003 by separating out normal float; and providing end-quarter stocks of arrears and gross repayments of outstanding arrears during each quarter.

Monetary sector data

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

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

- Daily movements in foreign exchange-denominated liabilities of the NBS to (i) non-residents; (ii) SM banks; and (iii) other SM residents.

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

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

- Outstanding stocks of Treasury bills, Treasury bill repayments made during the reporting period, and auction details (rates, amounts per maturity and number of banks participating in the auction per maturity).

- Interbank foreign exchange rates and volume of transactions, including rates and volume of trading outside the fixing session.

- Ten-day report on public sector borrowing and lending from commercial banks and the NBS.

- Ten-day report on required reserves and the reserve base.

28. The balance sheet of the NBS and the consolidated balance sheets of the commercial banks, including all banks in Montenegro, will be transmitted on a monthly basis within three

weeks of the end of each month. The stocks of government and mandatory and voluntary NBS securities held by banks and by non-banks, as available to the NBS, detailed information on interbank money market transactions (terms, duration, and participating institutions), and interest rate developments will be transmitted on a monthly basis within two weeks of the end of each month. Credit to government by the banking system is provided with detailed breakdowns on the union, state, and local governments.

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

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

External data

30. The data below will be transmitted as follows:

- The interbank market exchange rate, as the simple average of the daily-weighted average buying and selling rates, will be transmitted on a weekly basis within five business days of the end of the week;
- Balance of payments data on services, private transfers, and capital account transactions will be transmitted on a quarterly basis within four weeks of the end of each quarter; and
- Detailed monthly data on the volume and prices of exports and imports, separating out imported petroleum products.

In addition, Montenegro will provide quarterly updates of the Montenegro balance of payments, including projections for the current and subsequent year.

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.

Statement by the IMF Staff Representative
July 30, 2003

1. This statement updates the staff report with recent information on (a) program conditionality, (b) fiscal and external sector developments, and (c) the adoption of a new central bank law that set the basis for the election of a new Governor. This information does not alter the thrust of the staff appraisal.

Program conditionality

2. The latest information confirms that all end-June **performance criteria** (PCs) were observed with the exception of those on (a) NFA of the National Bank of Serbia (NBS) and (b) the electricity price increase. The authorities have requested waivers on the basis of revised policy understandings as described in EBS/03/101 (¶12 and 20). In particular, according to recent data, credit to the government at end-June was below the program ceiling by the equivalent of over 1 percent of annual GDP.

3. According to the latest information, four of the six **structural benchmarks** (SBs) for the period through end-June had been met by late July, compared with three SBs as of early July as reported in EBS/03/101. In particular, the SB on the adoption of restructuring plans for 7 large state enterprises in Serbia has been recently implemented. However, parliamentary adoption of a pension law in Montenegro has been delayed to September (after the summer recess), and the elimination of export quotas in Montenegro has been decided, but it can be implemented only when the harmonized tariff system comes into effect (in September). By the same token, several later benchmarks have been met. The end-December 2003 SB on the adoption of a NBS law providing for a Supervisory Council (in line with a Safeguards Assessment recommendation) has been adopted (see below). In addition, two *proposed* SBs for the period through end-September relating to Serbia (establishment of a joint NBS-Finance Ministry Committee to coordinate liquidity and cash management operations, and parliamentary adoption of a Secured Transactions Law) have been implemented.

Fiscal and external sector developments

4. Preliminary data through end-June show that the **fiscal deficit** (cash basis) amounted to about 1.5 percent of annual GDP compared with an original program target of 2.9 percent of GDP. Revenue remained buoyant. Owing to limited domestic financing (EBS/03/101, ¶8-9) and delays in foreign assistance, expenditure was contained below program levels mainly by keeping expenditure commitments below the budget but also by incurring new arrears (related to farmer pensions, child allowances, and the road directorate) of 0.6 percent of GDP. (As a result, the end-June indicative ceiling of zero new expenditure arrears was exceeded.) The authorities noted that they have begun to settle these arrears in July, following the receipt of delayed foreign budgetary assistance, and that the remainder will be settled in the coming months. The **foreign exchange market** has remained stable despite the

public confrontation between the former NBS Governor and the Serbian government (see below), with net NBS purchases in the interbank market reaching about $50 million during July 1-23, increased from June. The **exchange rate** of the dinar vis-à-vis the euro depreciated by 1.3 percent from end-June 2003 (6.2 percent from end-2002).

New central bank law and election of a new Governor

5. On July 22, 2003, the Serbian parliament approved a new **central bank law**, confirming central bank independence and enhancing accountability of its top management, broadly in line with Fund staff recommendations. This set the stage for the election by parliament of a new Governor. The government decided not to support incumbent Mr. Dinkic's reelection, citing his active involvement in politics and public criticism of government's economic policies. The newly-elected **Governor**—Ms. Udovicki—pledged to maintain the NBS's prudent monetary and exchange rate policies, thus helping calm markets, while re-focusing attention toward the critical issues facing the NBS, including banking supervision and bank restructuring. The parliament also elected five members of the newly-instituted NBS Supervisory Council.

INTERNATIONAL MONETARY FUND
EXTERNAL RELATIONS DEPARTMENT

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International Monetary Fund
Washington, D.C. 20431 USA

IMF Completes Second Review Under the Extended Arrangement, Approves Request for Waivers and Modification of Performance Criteria, and for Extension of Repurchases for Serbia and Montenegro

The Executive Board of the International Monetary Fund (IMF) has completed the second review of Serbia and Montenegro's economic performance under the Extended Arrangement and approved waivers for non-observance of the end-June 2003 quantitative performance criteria on net foreign assets and on electricity price increases. This decision enables Serbia and Montenegro to draw the equivalent to SDR 100 million (about US$140 million) under the arrangement immediately.

The Board also approved a request by Serbia and Montenegro to extend to an obligations basis the repurchase expectations for amounts totaling SDR 18.75 million (US$26 million) arising between September and December 2003.

The Extended Arrangement was approved on May 14, 2002 for a total equivalent to SDR 650 million (about US$911 million) to support Serbia and Montenegro's economic program in 2002-2005 (see Press Release No. 02/25). So far, Serbia and Montenegro has drawn SDR 200 million (about US$280 million) from the IMF under the Extended Arrangement.

Following the Executive Board discussion on July 30, 2003, Anne Krueger, First Deputy Managing Director and Acting Chair, said:

"Serbia and Montenegro's economic outlook continues to improve, through a further decline in inflation, an improved external trade balance, and a sustained, though moderate, growth in output and exports, even in the face of unsettled domestic conditions. Although macroeconomic policy is on track, the large current account deficit leaves the external position vulnerable to shocks. The recent adoption of structural reforms, especially harmonizing member states' trade, customs and indirect tax regimes and restructuring large state enterprises in Serbia, will contribute to improved efficiency.

"The authorities' economic objectives for the remainder of 2003 are sound and aim at disinflation, sustained growth, a strengthening of the external position, and improved economic competitiveness. The attainment of these objectives will require the continued implementation of sound macroeconomic policies and acceleration in the pace of structural reforms.

"The authorities' intention to contain the overall fiscal deficit to an unchanged 4½ percent of GDP in 2003 is appropriate. Achievement of this objective will require efforts to contain expenditure commitments, especially in view of Montenegro's relaxation of expenditure restraint, and to improve tax administration.

"The authorities' monetary and exchange rate policies, which aim at protecting the external position while further lowering inflation, are appropriate, and supported by recent increased exchange rate flexibility.

"To safeguard the central bank's policy credibility, recent legislation to protect central bank independence, enhance accountability, and internal controls, and the incoming Governor's pledge to continue adhering to prudent policies are welcome.

"The authorities' intention to press ahead with structural reforms is critical to attracting foreign direct investment. The key to building a healthy banking system is attracting strategic investors in state-owned banks, ensuring proper governance in these banks pending their privatization, and enforcing prudential requirements. The pace of enterprise privatization needs to be sustained, including the envisaged large privatization sales later in 2003.

"Continued donor and creditor support and efficient use of these resources will be critical for alleviating the social burden of ongoing reforms. The authorities should continue negotiating in good faith with their London Club and other creditors to restructure their debt on terms comparable to those granted by the Paris Club," Ms. Krueger stated.

Statement by Fritz Zurbrügg, Executive Director for Serbia and Montenegro and Srblojub Antic, Advisor to Executive Director
July 30, 2003

Introduction

1. The staff papers prepared for today's discussion present a candid and fair picture of the recent economic developments in Serbia and Montenegro. Our authorities broadly share the staff's assessment of the economic trends and agree with their recommendations. They appreciate the continuation of a fruitful dialogue with staff that has helped delineate the set of macroeconomic and structural policies for the third transition year.

2. The prospects of a Stabilization and Association Agreement with the EU provide a strong framework and a unique opportunity for pushing ahead with the reform process. The formation of the union state, that replaced FR Yugoslavia, was a first important step that enabled closer relations with the EU institutions. Member states reached an agreement on a plan to harmonize customs, trade, and the indirect tax regime that will make the road toward the EU faster.

3. The two and half years of reforms has affected all segments of the society. The focus of the reforms has shifted twice. Following the move from crisis management to macroeconomic stabilization, the authorities are now focusing on tackling the deep-rooted structural problems. The objective is to accelerate the implementation of efficiency-enhancing measures that are necessary to stimulate private sector investment, enhance the competitiveness of the economy, and diversify the sources of growth.

4. After one year under the Extended Arrangement, Serbia and Montenegro is closer to achieving the main reform goals. On the political front, the country has made the first steps toward integration into the European institutions. As regards the economy, the authorities are paving the way to create a dynamic market economy with clear ownership rights and efficient institutional arrangements.

Macroeconomic developments

5. Although the economic indicators are broadly in line with the 2003 projections, the authorities of Serbia and Montenegro are aware that downside risks exist. Those risks stem from the challenges of transition that proved to be of a very complex nature. The authorities are addressing the sources of risks, while taking into account the sensitivity of this particular moment in the reform process.

6. The projected growth is achievable mainly due to a strong increase of activity in the service sector. The export and fiscal revenue figures contradict the official data regarding industrial production. This underscores the divergence between statistics and reality that is often experienced in transition countries. One source of the discrepancy could be inadequate coverage of the emerging private sector by official statistics.

7. Inflation has fallen steadily thanks to the monetary authorities' timely policy actions. The authorities are confident that the significant increase of electricity prices in June will not have a substantial effect on future inflation. While the current account deficit has declined in line with program, the overall balance will be weaker in response to adverse changes in market sentiment.

Fiscal policy

8. The fiscal policy stance remains appropriate and in line with the program. Lowering the revenue-to-GDP ratio, partly through tax relief for businesses, will have a positive impact on the investment climate. Also cutting current expenditure, mainly subsidies, was a clear sign that the authorities would not tolerate prolonged enterprise restructuring. Overall, lower revenue and expenditure to GDP ratios underline that the role of the state in economy has started to diminish.

9. As regards Serbia, the fiscal deficit will stay at the 2002 level, in order to contain the current account deficit. The authorities share the staff's view that under the present circumstances a further fiscal tightening would not have a significant effect on external indicators. They stand ready to take any additional measures, should the deficit target be at risk.

10. The fiscal deficit in January-June 2003 was contained to 1.5 percent of annual GDP compared with a program target of 2.9 percent. While revenue was in line with program projections, expenditure as kept below budgeted levels because of temporary financing constraints. This led to accumulation of some expenditure arrears. With improved availability of budgetary financing, the authorities are committed to eliminate these arrears in the coming months and avoid incurring new ones.

11. The ambitious reforms that started with the dismantling of ZOP at the beginning of this year will continue. Efforts in tax administration are focused on establishing regional Large Tax Payers offices and on preparing for the introduction of a VAT, which should be introduced by January 2004. The Treasury will fully develop the expenditure management system. The decision to close all direct budget users accounts and their transfer to the Treasury Single Account in the NBS is an important step in the reform of the Treasury.

12. As regards Montenegro, the authorities have lowered expenditure commitments and will keep a part of current expenditures below the revised levels to safeguard the deficit target in view of the temporary revenue shortfall. The wage bill will be contained through a rationalization of the civil service. First results with the introduction of the VAT are encouraging, while remaining concerns are being addressed.

13. Fiscal reform will continue with the adoption of the new Pension Law that will introduce more appropriate indexation of benefits and increasing the retirement age. The obligations stemming from the frozen foreign currency deposits will be moved from banks to the government and a repayment timetable will be determined in cooperation with the staff.

Monetary and exchange rate policy and the new National Bank law

14. Monetary policy of the NBS has been successful in balancing different objectives, as is characteristically the case for transition countries. The monetary authorities continue to focus on further disinflation and the strengthening of the external position, while taking into account the effects of implementing the coordinated shift of government deposits from banks to the NBS account. The are keeping credit developments under close scrutiny, in order to prevent any negative effects of credit expansion on the external accounts.

15. The revision of the monetary program for 2003 was necessary to take into account the larger foreign financing needs, which will not be fully covered by additional BOP/budgetary assistance from donors. Notwithstanding the lowering of the NFA target, gross official reserves are still programmed to increase during the rest of the year. To improve the conduct of monetary and fiscal policy, the Serbian authorities are moving rapidly to shift government deposits from commercial banks to the Treasury Single Account in the NBS.

16. The NBS will continue with its flexible exchange rate policy that was successfully implemented in first part of the year. This policy has been successful in safeguarding the external position, while providing a strong nominal anchor for price expectations and contributing to an outstanding inflation performance. Using one instrument to achieve two targets requires carefully balancing the objectives.

17. The authorities attach great importance to the independence of the central bank, given its key role in a transition economy. The new central bank law spurred an intense debate regarding the independence issue, which mainly reflected some newly emerging political differences within the reformists. In the authorities' view, the new central bank law will improve the operations of the central bank and enhance the transparency of monetary policy decision making. Our authorities would like to assure the Executive Board that the independence of the central bank will not be put into question because of any short or medium term policy objectives. In her first public appearance, the new Governor of the NBS pledged to continue the prudent policies, thus reinforcing the attitude of the authorities.

Privatization and restructuring

18. The authorities share the staff's view that the key challenge remains the improvement of growth performance through privatization and restructuring as well as the creation of a business climate that is conducive for investment. The relaxation of costly social requirements (such as guaranteed employment and high severance payments) and the streamlining of the auction procedures has enabled faster privatization. The authorities are confident that the business climate will improve following the new laws that regulate market exit and business registration as well as the bylaws that will curtail bureaucracy related to investments.

19. Significant budget revenues are expected from the sale of the two tobacco factories through tenders in Serbia and one in Montenegro. The privatizations through auctions and the sale of minority shares of previously partly privatized companies will also generate

substantial revenues. The restructuring process is less successful due to high number of industrial "hot spots" that are not easy to tackle. The authorities achieved an important breakthrough in the energy sector, when the underground coal mines were separated from the core electricity business, despite the miner's strike. The authorities will take the same attitude in restructuring other public utilities and large industrial enterprises.

External debt restructuring

20. The authorities of Serbia and Montenegro remain engaged in the debt restructuring process. After the agreement with the Paris Club in 2001, bilateral arrangements were concluded with 14 countries and three are still pending. Negotiations with the London Club creditors are ongoing and the authorities are looking to ensure comparable treatment with Paris Club creditors. The next meeting with London Club creditors is scheduled for end of August this year.

Transparency

21. Finally, we would like to stress that Serbia and Montenegro continues to be fully committed to publishing all staff documents. Since regaining membership in December 2000, all documents have been published. Sometimes this full transparency has caused prolonged public debates about specific policy measures, thereby consuming valuable time and resources. However, our authorities are convinced that the benefits of transparency significantly outweigh all political and economic costs that a publication of IMF reports can cause. Their commitment to transparency not only holds in situations without significant challenges, but also in situations when different views about the pace of the reform exist within the reformists. Thus, the authorities of Serbia and Montenegro consent to the publication of the staff report.