International Monetary Fund

Republic of Serbia
and the IMF

Press Release:
IMF Executive Board Completes Third Review Under Stand-By Arrangement with Serbia and Approves €360 Million Disbursement
March 31, 2010

Country's Policy Intentions Documents

E-Mail Notification
Subscribe or Modify your subscription

Republic of Serbia: Letter of Intent and Technical Memorandum of Understanding

March 18, 2010

The following item is a Letter of Intent of the government of Republic of Serbia, which describes the policies that Republic of Serbia intends to implement in the context of its request for financial support from the IMF. The document, which is the property of Republic of Serbia, is being made available on the IMF website by agreement with the member as a service to users of the IMF website.

Letter of Intent (LOI)

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington, D.C., 20431
U.S.A.

Belgrade, March 18, 2010

Dear Mr. Strauss-Kahn:

1. Our program has continued to perform well. All end-December 2009 quantitative performance criteria were observed, most of them with a considerable margin, including the ceiling on the general government deficit (Table 1). We have also made progress on our structural reform agenda, including the highly sensitive reform of the pension system, the design of new fiscal responsibility legislation, and the complex revision of the corporate debt collection and restructuring framework. But most importantly, supported by the tailwinds of a global recovery and the strong commitment of foreign banks to Serbia, the economy is on the mend: output has started to recover following a precipitous decline through mid-2009; capital inflows have recently surprised on the upside; and disinflation is on track, with inflation expectations receding.

2. While the program is on track, clearly not all is well in our economy. The global financial crisis hit hard, and the need to correct the economy's external and fiscal imbalances now acts as a brake on the recovery. Corporate insolvencies and payment problems are still on the rise. Job opportunities, particularly for low-paid workers, have become scarce, reflected in increasing poverty. As a result, firms and households have cut back spending sharply relative to their incomes. This is also reflected in moderate credit demand and the sharp import contraction. Coming on the heels of an unsustainable private-sector boom, lower spending has led to a welcome rebalancing of the external account; the 2009 current account deficit was likely limited to only 5½ percent of GDP. But rapid private-sector adjustment has also unmasked a weak underlying fiscal position; with nominal tax revenues stagnant at their 2008 level, the fiscal deficit rose to 4¼ percent of GDP in 2009, notwithstanding across-the-board nominal freezes of most current spending and cuts in subsidies and capital spending.

3. In consideration of our strong implementation record and our continued commitment to the program's objectives, we request the completion of the third review of the SBA and the disbursement of SDR 319.6 million. The fourth program review, assessing performance relative to end-March performance criteria and benchmarks, and financing assurances review are envisaged for June 2010. The fifth program review assessing end-June performance criteria and financing assurances review are envisaged for September 2010.

4. We believe that the policies and measures set forth in this memorandum are adequate to achieve the objectives of the program, and stand ready to take any additional measures that may be appropriate for this purpose. The Government of the Republic of Serbia will consult with the IMF in advance on the adoption of such additional measures in accordance with the IMF's policies on such consultations.

Revised Macroeconomic Framework for 2010-11

5. We continue to expect a gradual recovery of economic activity, with real GDP projected to grow at 2 percent in 2010 and 3 percent in 2011. Investment and exports are expected to be the main engines of growth, while consumption is likely to lag. The moderate pace of recovery, along with the rebalancing of the economy away from absorption-led growth and the delays in matching unemployed workers with new jobs, will continue to put strains on the fiscal position, mainly through subdued tax revenues.

6. Inflation is expected to continue to decline, providing the National Bank of Serbia (NBS) with a window of opportunity to lock in a new regime of lower and more stable inflation rates. A sizeable output gap, decelerating nominal wage growth, and favorable food price trends have substantially moderated inflationary pressures, which in turn has allowed a substantial easing of the monetary policy stance. Inflation could undershoot the NBS's target band during the first half of 2010, but we expect it to end the year close to the target of 6 percent (±2 percent). In 2011, inflation is expected to decline further to around 4½ percent.

7. External current account adjustment is expected to pause in 2010, with the continued decline in the trade imbalance more than offset by projected higher external income payments and lower remittances. Following a contraction in 2009, export volume growth is expected to regain double-digit strength only in 2011. We are now projecting a current account deficit of 8 percent of GDP in 2010, followed by a gradual improvement over the medium term.

8. The external financing situation is projected to remain favorable in 2010 and beyond, but there are significant risks. Foreign parent banks are expected to broadly maintain their exposure to Serbia, notwithstanding a relaxation of exposure floors under the Bank Coordination Initiative. Other private inflows, along with financing from the IMF, other international financial institutions, and the EU, should be more than sufficient to meet all external financing needs in 2010. We expect a further increase in international reserves, albeit at a more modest pace than in 2009. These projections are, however, subject to downside risks, in part because some parent banks of local subsidiaries could face domestic funding pressures or restructuring needs.

Fiscal Policy

9. A decisive break with Serbia's pre-crisis pattern of growth driven by production of nontradables and high consumption to one led more by exports calls for improving external competitiveness and raising investment. While other economic policies will have to make their contribution as well, a paradigm shift in fiscal policy will be key to achieving this transformation of the economy. We are committed to implementing the painful and difficult measures in the public sector that are required.

10. Our fiscal strategy will continue to be based on four main principles: (i) the presently high structural fiscal deficits will be gradually reduced over the next few years; (ii) the economy's overall tax burden will be kept roughly unchanged; (iii) balanced and coordinated spending restraints will continue to be imposed on public wages and pensions; and (iv), the fiscal space freed up by spending restraints will be utilized to raise public investment. To succeed with this fiscal strategy, we will also have to enforce financial discipline in the still large public enterprise sector, especially by containing wage increases.

11. Consistent with this fiscal strategy, we will contain the general government deficit in 2010 to 4 percent of GDP, and plan to reduce the deficit to 3 percent of GDP in 2011. As in 2008 and 2009, we will execute spending cautiously to stay within the agreed general government spending envelope of about 1,340 billion dinars. Should the recovery in economic activity turn out to be somewhat stronger than presently expected, we will save any revenue overperformance during the first half of the year. The 2010 gross financing needs of about 2 billion euros will be covered by loans from international financial institutions and the EU, and, to a significant extent, through borrowing from the domestic T-bills market, where we intend to increasingly tap longer maturities to reduce rollover risk and foster local financial market development.

12. As regards revenue policies, we plan to keep any further changes to the tax system at least revenue neutral, while taking measures to strengthen tax administration. At this point, we have submitted to parliament limited amendments to simplify and broaden corporate and personal income taxes. To increase tax compliance, we will adopt an integrated taxpayer compliance strategy by end-July (structural benchmark).

13. We remain committed to reducing the wage bill of the general government to about 8 percent of GDP by 2015. To achieve this medium-term objective, we plan to implement the following specific policies during 2010-12:

- The level of wages of government employees will remain nominally frozen; the case for any wage increases will only be reviewed during the second half of 2010, and only provided revenue trends during the first half of 2010 are more favorable than presently expected. We will also ensure a wage bill freeze at the level of local government utilities, and we have approved 2010 business plans for ten large state enterprises monitored under the program that are consistent with a nominal freeze of their respective wage bills.

- The announced cuts in public administration staff at central and local government levels by about 10 percent will be implemented by April 2010, and a strict hiring freeze across all levels of government, including for temporary workers, implemented.

- During 2011-12, public sector wage increases will be limited to what is consistent with our medium-term objective of bringing the wage bill to 8 percent of GDP by 2015.

- To rationalize public employment further, we will finalize reform plans in the health care and education sectors, along the lines of recent World Bank recommendations, with the objective of starting their implementation in the context of the 2011 budget.

14. To ensure fair burden sharing between public sector employees and pensioners, we also remain committed to reducing the net spending by pension funds to about 10 percent of GDP by 2015. Our specific policies during 2010-12 are as follows:

- In line with the agreements presented in the last Letter of Intent, we have agreed on a comprehensive package of parametric pension reforms that will be submitted to parliament by end-May (structural benchmark). These reforms include an increase in the minimum retirement age for old-age pensions from 53 to 58 years for men and women, longer effective contribution periods for women, a cut in service credits for the military and police, and a tightening of survivor pension entitlements. To address the hardship of the poorest pensioners, we will increase minimum and farmers' pensions, while putting a tighter cap on maximum pensions.

- In line with the freeze of public wages, nominal pensions will remain frozen until April 2011.

- We believe strongly that continued but also balanced restraints on both public pensions and wages will be required during 2011-12. As an alternative to the CPI indexation plus GDP growth premium rule, we have proposed during the third review a link between pension and public wage growth during the 18-month period starting in April 2011. We recognize that IMF support for any indexation rule linking pensions and public wages will require assurances in May that public wage growth and fiscal targets during 2010-12 will remain credibly anchored in line with the agreed economic program, including through fiscal responsibility legislation. After the indexation adjustment of April 2012, we will shift to a CPI indexation rule. The new indexation arrangement will be consistent with bringing pension spending to about 10 percent of GDP by 2015.

15. We recognize that jointly anchoring public wage and pension growth during 2010-12 in line with these undertakings will be a difficult task. We will establish binding nominal ceilings on the general government wage and pension bills for the period 2010-12 in the framework of the planned fiscal responsibility legislation to be submitted to parliament by end-May (structural benchmark).

16. Finally, we will review the recently adopted public debt provisions relaxing restraints on local government borrowing and guarantees to ensure that local governments do not engage in fiscal activities that could ultimately require financial bailouts by the central government.

Monetary and Exchange Rate Policy

17. Monetary policy will remain focused on keeping inflation close to the pre-announced 6 percent (±2 percent) target for 2010. The NBS expects to continue easing its monetary stance, albeit cautiously given the risks associated with still high, though receding, inflation expectations, the possibility of faster-than-expected recovery of aggregate demand, further increases in energy prices, and the planned upward adjustments of regulated prices. Under the program, inflation developments will continue to be monitored using a standard consultation clause. In line with our inflation targeting framework, we will maintain the existing managed float exchange rate regime.

18. We plan to streamline and lower reserve requirements. The present reserve requirement regime is overly complex, with a large number of exemptions and multiple statutory rates. In response, many banks have targeted asset and liability structures to lower their effective reserve requirement rates. Under the new regime, almost all exemptions will be phased out, and there will be only two statutory rates, one for foreign exchange liabilities, and a lower one for dinar liabilities. This reform seeks to achieve several goals: (i) enhance transparency; (ii) promote more efficient operations of the banks; (iii) encourage de-euroization; and (iv) reclaim for the NBS the ability to use reserve requirements as an effective policy tool. At the same time, the new effective rate will be lower than the current one, complementing the monetary policy easing achieved through the lowering of the policy interest rate. The new regime will be phased in gradually and should be fully in place by March 2011. This much-needed reform is at the same time a complex policy change, and we will have to continuously monitor monetary conditions to achieve our inflation targets and prevent excessive volatility of the exchange rate.

19. We will also continue to strengthen our inflation targeting framework. In December 2009, to improve the functioning of the money market, we reduced the number of repo auctions from two to one per week; and we are assessing the case for further simplifying the auction system. We have also taken steps to improve coordination between the government and the NBS regarding plans for regulated price adjustments. To this effect, we have recently

set up a working group comprising technical experts from the NBS, Ministry of Finance, and other relevant ministries and agencies.

Financial Sector Policies

20. Serbia's level of euroization is high, even by regional standards, and it constrains the effectiveness of monetary policy while imposing financial stability risks. A precondition for any successful de-euroization strategy will be to achieve a lower and more stable inflation rate. Moreover, we will continue to use our prudential and supervisory framework to discourage unhedged currency risks. In addition, we will focus on market-based measures that would work through incentives, instead of coercive measures that could result in serious market distortions and increased costs of doing business. Specifically, we plan to: (i) introduce benchmark dinar securities, which may in part be issued by international financial institutions; (ii) foster a secondary market for T-bills; and (iii) encourage the development of hedging instruments.

21. The Financial Sector Support Program (FSSP) has proved a vital and innovative tool for safeguarding financial stability. As planned, we finished in December 2009 the onsite diagnostic studies and stress tests for all 31 banks. This comprehensive exercise confirmed that, following the recapitalization of one large domestic bank, our banking system is liquid and well capitalized, even after the most extreme scenario employed in the exercise. Given the easing of financial sector tensions since the peak of the crisis in early-2009, we have also agreed with participants in the Bank Coordination Imitative during a review meeting on February 26, 2010, to lower the exposure floor vis-à-vis Serbia of foreign parent banks from 100 to 80 percent, effective April 2010. Furthermore, we have amended our strict asset classification rules, and we are studying the scope for narrowing the provisioning ranges. Our cooperation with foreign home supervisors has strengthened appreciably, including through our participation in supervisory colleges, and we hope to finalize bilateral memoranda of understandings with Austria, France, and Germany in due course.

22. We have made progress on the framework for debt collection and restructuring. In December 2009, parliament approved the revised Bankruptcy Law. The new law stipulates the automatic initiation of bankruptcy procedures for companies whose accounts have been blocked for more than three years, and supports accelerated reorganizations using prepackaged plans. To address excessive blockages of bank accounts on the basis of promissory notes, the NBS has prepared draft amendments to the Law on Payment Transactions, including registration of all promissory notes in a single database—to increase transparency and reduce their excessive issuance—and modifications to the payout procedure from blocked accounts—to alleviate the rush-to-block problem. In response to feedback from market participants and government agencies, further changes are needed to facilitate the recording of promissory notes and to retain the high efficiency of the present blockage

procedure. Drawing on technical assistance, we have also started to explore options to introduce an out-of-court corporate loan workout framework.

23. Looking ahead, we plan to further improve the corporate debt restructuring framework. However, due to the legal complexities of this undertaking and resource constraints, we have to extend the deadline for submitting new legislation to parliament to end-September 2010 (structural benchmark). In this regard, we believe that blocked accounts and out-of-court restructuring mechanisms should be addressed in a coordinated and comprehensive manner, and incentives for restructuring should be tailored to facilitate consensual outcomes between creditors and borrowers.

Structural Policies

24. The following measures should help improve the business climate:

- Cutting red tape: A regulatory reform council is reviewing an estimated 7,500 laws, bylaws, and regulations, about 3,000 of which impact business. The ‘regulatory guillotine’ project, scheduled to be completed by June 2010, is estimated to cut Serbian companies’ costs by some 20 billion dinars annually.

- Adopting new legislation: With technical assistance from the international financial institutions, we will draft a new Company Law to strengthen corporate governance and eliminate all unnecessary requirements for the establishment and operation of entrepreneurs and companies.

- Ensuring property rights: We will strive to resolve, in line with our scarce fiscal resources, the still pending issues of land ownership and restitution of property seized from citizens and institutions after World War II. With regard to the latter, we have opted for compensation mainly in government bonds to avoid complications connected to restitution in kind, which has been limited by the adoption of the Law on Urban Development in 2009.

- Fighting corruption: A new anti-corruption agency with new expanded powers and responsibilities became operational as of January 1, 2010.

25. The following measures should increase the role of the private sector in the economy:

- Privatization: 169 companies are slated for privatization in 2010; additional sales of assets via forced liquidation and/or bankruptcy will be implemented in 201 existing cases, and new bankruptcy proceedings will be initiated for 336 nonviable state-owned companies. We hope to privatize the pharmaceutical company Galenika through a tender offer in 2010. We have recently agreed on the partial privatization of

Credy Bank. The new investor acquired more than half of the bank's stock and the government expects to divest its remaining shares within the next three years.

- Corporatization: All large state enterprises will be corporatized by end-2010**.** In several cases, this will be followed by either full or partial privatization, or the creation of joint ventures and private management contracts.

- Corporate restructuring: We have embarked on restructuring the airline company JAT. The overhaul of the state-owned railway company will also be accelerated with a view to reducing the need for large-scale subsidies over the medium term.

26. Following several recent important steps toward closer integration with the EU, and in line with the national plan for integration into the EU and the conditionality of EU budget support, we are committed to maintain and develop crucial administrative capacity. In particular, the Ministry of Finance will create conditions for the decentralized implementation system necessary to access EU structural funds.

/s/
Mirko Cvetković
Prime Minister

/s/
Radovan Jelašić
Governor of the National Bank
of Serbia

/s/
Diana Dragutinović
Minister of Finance

Attachment

Table 1. Serbia: Quantitative Conditionality Under the SBA, 2008–10 1/

	2008		2009								2010		
	Dec.		March		June		Sept.		Dec.		March	June	Dec.
	Prog.	Act.	Prog.	Act.	Prog.	Act.	Prog.	Act.	Prog.	Act.	Prog.	Prog.	Proj.
Quantitative Performance Criteria													
Floor on net foreign assets of the NBS (in billions of euro)	5.0	6.1	5.1	6.0	4.4	5.9	3.6	6.5	4.3	6.6	4.0	4.7	4.6
Ceiling on consolidated general government overall deficit (in billions of dinars) 2/	64	72	15	12	34	55	58	79	134	121	23	63	129
Ceiling on contracting or guaranteeing by the public sector of new short-term external debt (up to and including one year, in millions of euro) 2/	0	0	0	0	10	0	10	2	10	2	20	20	20
Ceiling on contracting or guaranteeing by the public sector of new nonconcessional external debt (over one year, in millions of euro) 2/ 3/	50	0	200	0	550	100	550	100	550	100	200	550	600
Ceiling on accumulation of government external payment arrears (continuous, in millions of euro)	0	0	0	0	0	0	0	0	0	0	0	0	0
Inflation Consultation Bands (in percent)													
Central point	10.0	8.6	9.2	9.4	8.0	8.3	9.5	7.3	7.5	6.6	5.4	4.0	6.0
Band, upper limit	12.0	n.a.	11.2	n.a.	10.0	n.a.	11.5	n.a.	9.5	n.a.	7.4	6.0	8.0
Band, lower limit	8.0	n.a.	7.2	n.a.	6.0	n.a.	7.5	n.a.	5.5	n.a.	3.4	2.0	4.0
Indicative Targets													
Ceiling on current expenditure of the Serbian Republican budget (in billions of dinars) 2/	635	633	190	152	335	331	520	506	695	689	182	370	729
Ceiling on gross accumulation of domestic guarantees by the Republican budget, the Guarantee Fund, and the Development Fund and domestic borrowing by the Guarantee and Development funds (in billions of dinars) 2/	n.a.	n.a.	n.a.	n.a.	50	7	50	15	50	15	13	25	50

1/ As defined in the Letter of Intent, the Memorandum on Economic and Financial Policies, and the Technical Memorandum of Understanding.
2/ Cumulative from January 1.
3/ Excluding loans from the IMF, EBRD, EIB, EU, IBRD, KfW, Eurofima, CEB, IFC, and bilateral government creditors, as well as debt contracted in the context of restructuring agreements.

Table 2. Serbia: Proposed Structural Conditionality for 4th and 5th SBA Reviews

Measure	Target Date	Comment
1. Authorities to adopt or submit to parliament amendments to relevant laws and regulations strengthening the corporate debt collection and restructuring framework (TMU ¶25).	September 2010	To address the issue of account blockages and foster out-of-court loan workouts to minimize unnecessary and costly bankruptcies and enhance banks' ability to deal with rising NPLs.
2. Government to submit to parliament a draft Budget System and Responsibility Law, including supporting legislation (TMU ¶21).	May 2010	To anchor authorities' medium-term fiscal adjustment plans and commitments to safeguard fiscal sustainability.
3. Government to submit to parliament a comprehensive pension law, incorporating both parametric reforms and a revised indexation formula, effective April 2011 (TMU ¶20).	May 2010	To support the medium-term fiscal consolidation strategy.
4. Risk management unit at tax administration to establish an integrated taxpayer compliance strategy (TMU ¶22).	July 2010	To address tax noncompliance and improve voluntary compliance.

Technical Memorandum of Understanding

REPUBLIC OF SERBIA

Technical Memorandum of Understanding

1. This memorandum sets out the understandings regarding the definition of indicators used to monitor developments under the program. To that effect, the authorities will provide the necessary data to the European Department of the IMF as soon as they are available. As a general principle, all indicators will be monitored on the basis of the methodologies and classifications of monetary, financial, and fiscal data in place on October 1, 2008, except as noted below.

A. Floor for Net Foreign Assets of the NBS

2. **Net foreign assets** (NFA) of the NBS consist of foreign reserve assets minus foreign reserve liabilities, measured at the end of the quarter.

3. 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: 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 Serbian 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 monetary gold.

4. For purposes of the program, all foreign currency-related assets will be evaluated in Euros at **program exchange rates** as specified below. For the remainder of 2010, the program exchange rates are those that prevailed on March 11, 2009. Monetary gold will be valued at the average London fixing market price that prevailed on March 11, 2009.

Cross Exchange Rates and Gold Price for Program Purposes 1/

	Valued in			
	RSD	euro	USD	SDR
Currency:				
RSD	1.0000	0.0106	0.0134	0.0093
euro	94.0972	1.0000	1.2647	0.8715
USD	74.4028	0.7907	1.0000	0.6891
SDR	107.9718	1.1475	1.4512	1.0000
Gold		727.35	919.875	633.88

1/ March 11, 2009.

5. For purposes of the program, **foreign reserve liabilities** are defined as any foreign-currency-denominated short-term loan or deposit (with a maturity of up to and including one year); NBS liabilities to residents and nonresidents associated with swaps (including any portion of the NBS gold that is collateralized) and forward contracts; 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 the SFRY are excluded. Also excluded are the amounts received under any SDR allocations received after August 20, 2009.

6. On December 31, 2009 the NBS's net foreign assets, evaluated at program exchange rates, were €6,597 million; foreign reserve assets amounted to €10,792 million, and foreign reserve liabilities amounted to €4,196 million.

7. **Adjustors.** For program purposes, the NFA target will be adjusted upward *pari passu* to the extent that: (i) after December 31, 2009, 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 Serbian commercial banks abroad; and (ii) the restructuring of the banking sector by the Deposit Insurance Agency involves a write-off of NBS foreign exchange-denominated liabilities to resident banks. The NFA floor will also be adjusted upward by any privatization revenue in foreign exchange received after December 31, 2009. Privatization receipts are defined in this context as the proceeds from sale or lease of all or portions of entities and properties held by the public sector that are deposited in foreign exchange at the NBS, either directly, or through the Treasury.

B. Inflation Consultation Mechanism

8. Inflation is defined as the change over 12 months of the end-of-period consumer price index (CPI), as measured and published by the Serbian Statistics Office.

9. Breaching the inflation consultation band limits at the end of a quarter would trigger discussions with IMF staff on the reasons for the deviation and the proposed policy response. A deviation of more than 1 percentage point from either the upper or the lower band specified in Table 1 would trigger a consultation with the IMF's Executive Board on the reasons for the deviation and the proposed policy response before further purchases could be requested under the SBA.

C. Ceiling on External Debt Service Arrears

10. **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. The authorities are committed to continuing negotiations with creditors to settle all remaining official external debt-service arrears.

11. **Reporting.** The accounting of non-reschedulable 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. Data on other arrears, which can be rescheduled, will be provided separately.

D. Ceilings on External Debt

12. **Definitions.** The ceilings on contracting or guaranteeing of new nonconcessional external debt by the public sector with original maturity of more than one year and short term external debt (with maturities up to 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)) but also to commitments contracted or guaranteed for which value has not been received. Excluded from this performance criterion are normal short-term import credits.

13. Excluded from the ceilings are loans from the IMF, EBRD, EIB, EU, IBRD, KfW, CEB, Eurofima, IFC, and bilateral government creditors, as well as debt contracted in the context of restructuring agreements. For the purpose of this performance criterion, the public sector comprises the consolidated general government, the Export Credit and Insurance Agency (AOFI), the Development Fund, and the Guarantee Fund.

14. For new debt to budgetary users, the day the debt is contracted will be the relevant date for program purposes. For new debt to non-budgetary users, the day the first guarantee is signed will be the relevant date. Contracting or guaranteeing of new debt will be converted into Euros for program purposes at the program cross exchange rates described in this TMU. 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.

15. **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.

E. Fiscal Conditionality

16. **The general government fiscal balance,** on a cash basis, is defined as the difference between total general government revenue (including grants) and total general government expenditure (irrespective of the source of financing) as presented in the "GFS classification table" and including expenditure financed from foreign project loans. For program purposes, the consolidated general government comprises the Serbian Republican budget (on-budget and own revenue), local governments, the pension fund (employees, self-employed, and farmers), the health fund, the National Agency for Employment, and the Road Company (JP Putevi Srbije) and any of its subsidiaries. Any new extrabudgetary fund or subsidiary established over the duration of the program would be consolidated into the general government. Revenues of the Republican budget exclude profit transfers from the NBS. Expenditures exclude the clearance of arrears of the Road Company accumulated up to end-2008.

17. **Adjusters.** The deficit ceiling will be adjusted upward for the additional expenditure that may be needed for potential lender-of-last-resort operations under the financial stability framework, following consultation with IMF staff. It will be increased (respectively reduced) in 2010 by the amount of project loans disbursed by foreign creditors listed in TMU ¶13 above to the general government in excess of (respectively, lower than) the program projections indicated in the table below, in consultation with IMF staff, on the basis of actual disbursements as jointly reported by the Ministry of Finance and the NBS. This adjustment does not apply to program loans and general budget support.

Disbursements of project loans by foreign creditors

From January 1, 2010 to:	Program projections (billions of dinars)
March 31, 2010	4.3
June 30, 2010	8.5
September 30, 2010	12.8
December 31, 2010	17.0

18. **Government current expenditure of the Republican budget** (excluding expenditure financed by own sources) includes wages, subsidies, goods and services, interest payments, transfers to local governments and social security funds, social benefits from the budget, other current expenditure, and net lending. It does not include capital spending. The ceiling will be adjusted for the additional expenditure that may be needed for potential lender-of-last-resort operations under the financial stability framework.

19. The **large public enterprises** monitored under the program include the following 10 enterprises or their successors: JP Elektroprivreda Srbije (EPS), JP Elektromreza Srbije

(EMS), JP Transnafta, JP Srbijagas, JP PTT Srbije, JP Jugoslovenski Aerotransport, JP Zeleznice Srbije, JP Srbijasume, JP Aerodrom Nikola Tesla Beograd, JVP Srbijavode. This list excludes JP Putevi Srbije (the Road Company), which is considered part of general government, JP Naftna Industrija Srbije (NIS), which is in majority private ownership, and JP Srbija Telekom, which competes with other telecommunication service providers. Going forward, the program will include monitoring of the aggregate wage bill of local utilities.

20. **Pension law**. The new pension draft law should be submitted to Parliament by end-May 2010. This draft law should tighten early retirement rules, including by (i) gradually increasing the minimum early retirement age from currently 53 years to 58 years for both men and women by 2020, (ii) restricting retirement before the minimum early retirement age to only a limited number of occupations; (iii) increasing the minimum service requirement for retirement for women from 35 to 38 years and gradually phasing out more than a half extra service credit for women; and (iv) raising the eligibility age for survivor's pensions to 58 years for men and to 53 for women. Further, the draft law will impose strict limits on extra service credits to a limited number of eligible professions. Contribution collection efficiency would also be strengthened, including by registering of all social security payers in a single central registry. The draft law will also contain a revised pension indexation rule, to take effect in April 2011. Any revised rule will be in line with the medium-term objective of reducing net spending of pension funds to about 10 percent of GDP by 2015. Two alternatives are under consideration. Under one, the current semi-annual CPI-based indexation formula would be augmented to include a growth premium if the previous year's GDP growth rate exceeded a threshold of 4 percent. The growth premium will be calculated as the difference between the actual growth rate in the previous year and the 4 percent threshold. Under the second, pensions would be temporarily—during the 18-month period starting in April 2011—linked to public wages. Thereafter, pensions would be indexed to the CPI (end-May 2010).

21. **Fiscal responsibility legislation**. The present Budget System Law (BSL) will be amended to further strengthen fiscal discipline. Amendments should be adopted by the government and submitted to parliament that: (i) establish a simple and transparent rule that strengthens control over the medium-term fiscal framework; (ii) strengthen fiscal procedures of the current BSL; and (iii) establish effective fiscal monitoring and enforcement mechanisms, potentially including by setting up an independent fiscal council. Further, binding ceilings on pension and general government wage spending for 2010-12 should be included in the fiscal responsibility framework (end-May 2010).

22. **Tax administration reform**. The risk management unit at the tax administration agency should adopt a fully integrated taxpayer compliance strategy that is based on the identification of the major risks to revenue and appropriate resource allocation to ensure the highest impact on collections. The strategy should focus on improving voluntary compliance and reducing noncompliance (end-July 2010).

23. **Ceiling on the accumulation of domestic loan guarantees (gross) extended by the Republican budget, the Guarantee Fund, and the Development Fund.** The ceiling also includes the contracting of any domestic loans by the Development and the Guarantee Funds. It excludes any guarantees extended under the financial stability framework, unless such loans or guarantees are extended to entities other than financial sector institutions.

24. **Reporting.** General government revenue data and the Treasury cash situation table will be submitted weekly on Wednesday; updated cash flow projections for the Republican budget for the remainder of the year five days after the end of each month; and the stock of spending arrears of the Republican budget, the Road company, and the social security funds 15 days after the end of each month. General government comprehensive fiscal data (including social security funds) would be submitted by the 25th of each month. The large state-owned enterprises listed in paragraph 19 will submit quarterly accounts and the wage bill data 45 days after the end of the quarter.

F. Financial Sector Conditionality

25. Improvements to the framework for debt collection and restructuring will focus on two areas: account blockages based on promissory notes and out-of-court loan workouts. As regards the first area, the NBS, in consultation with the government, will finalize amending the law on payments transactions to introduce registration of promissory notes using a uniform format—containing essential loan details and blockage conditions—in a single registry. The Ministry of Economy, together with the NBS, will explore alternatives to the first-mover advantage in account blockages. As regards out-of-court loan workouts, the Ministry of Economy and the NBS, in consultation with the Ministry of Finance and banks, shall (i) establish an out-of-court restructuring mechanism working group comprising representatives of the Ministries of Finance and Economy, NBS, tax authorities and selective bank representatives by mid-March, 2010; (ii) draft a corporate debt restructuring strategy note proposing the main features of an out-of-court restructuring mechanism (such as the form of the framework, coverage of debtors, and role of the NBS) and identify the legal changes needed to support such a mechanism by end-April 2010; (iii) submit draft legislative changes for government approval by end-June 2010; and (iv) submit the package of the legislative changes to Parliament by end-September 2010 (structural benchmark).

Data Reporting for Quantitative Performance Criteria

Reporting Agency	Type of Data	Timing
NBS	Net foreign assets of the NBS (including adjustors)	Within one week of the end of the month
Ministry of Finance	Consolidated government overall deficit	Within 25 days of the end of the month
NBS and Ministry of Finance	New short-term external debt contracted or guaranteed by the public sector	Within four weeks of the end of the quarter
NBS and Ministry of Finance	New nonconcessional external debt contracted or guaranteed by the public sector	Within four weeks of the end of the quarter
Ministry of Finance	Government external payment arrears	Within two weeks of the end of the month
NBS	CPI inflation	Within four weeks of the end of the month
Ministry of Finance	Current expenditure of the Serbian Republican budget	Within 25 days of the end of the month
Ministry of Finance	Gross accumulation of domestic guarantees by the Republican budget, the Guarantee Fund, and the Development Fund and domestic borrowing by the Guarantee and Development Funds	Within eight weeks of the end of the month