International Monetary Fund

Republic of Serbia
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Press Release:
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December 22, 2010

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

December 9, 2010

The following item is a Letter of Intent of the government of the Republic of Serbia, which describes the policies that the 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 the 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.

ATTACHMENT I. REPUBLIC OF SERBIA: LETTER OF INTENT (LOI)

Mr. Dominique Strauss-Kahn   Belgrade, December 9, 2010
Managing Director
International Monetary Fund
Washington, D.C., 20431
U.S.A.

Dear Mr. Strauss-Kahn:

1. Our program has continued to perform satisfactorily. All end-September 2010 performance criteria were observed (Table 1). However, inflation was marginally above the inflation consultation clause's upper limit. While we have postponed the end-November structural benchmark on submitting to parliament draft laws to facilitate a more effective corporate debt collection and restructuring framework; the laws, as well as additional regulatory and legislative changes will be submitted in the next few weeks. We have revised the 2010 budget in line with our program targets and prepared the draft 2011 budget consistent with the fiscal balance rule in the recently revised Budget System Law. The submission of the 2011 budget to parliament is a prior action for the IMF Executive Board meeting in late-December (Table 2). We have recalled the draft pension law, which was submitted to parliament as a prior action in June, and re-submission of the law to parliament will be a prior action for the late-December Board meeting.

2. Recent economic developments leave little doubt that we continue to face significant challenges. On the one hand, the economy has continued to recover, and Serbia's growth performance in 2010 will compare favorably with regional peers. Growth is fuelled by an export recovery, supported by the dinar's sharp real depreciation. Reflecting the export-led recovery and a weak labor market, fiscal revenue growth remains, however, subdued. At the same time, inflation, driven by food price shocks and exchange-rate pass-through, has unexpectedly re-surfaced as a key policy concern. The recovery has been accompanied by an increase in the current account deficit. With capital inflows remaining well below pre-crisis levels as the corporate sector struggles to repair its balance sheets, this has put persistent depreciation pressures on the exchange rate.

3. We remain determined to respond to these challenges and tensions with appropriate policies. Foremost, we intend to implement the 2010 budget as previously agreed, and we will tighten fiscal policy in 2011 to counteract inflationary pressures and support needed external rebalancing. Monetary policy will likely have to tighten further to anchor medium-term inflation expectations. Our banking sector is well-capitalized and has built up large credit provisioning buffers, and corporate balance sheet repair will be facilitated by the

reformed corporate debt restructuring framework. Finally, comprehensive structural reforms will be needed to achieve faster productivity growth in a more export-based economy.

4. In consideration of our good implementation record and our continued commitment to the program's objectives, we request the completion of the sixth review under the Stand-By Arrangement (SBA) and that SDR 319.6 million be made available. However, in view of our limited balance-of-payments needs at present, we again intend to purchase only SDR 46.7 million at this time. The seventh and last program review, assessing performance relative to end-December 2010 performance criteria and benchmarks is envisaged for February 2011.

5. 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

6. Our real GDP projections for 2010 (1½ percent) and 2011 (3 percent) remain unchanged, but growth could well surprise on the upside. We have revised significantly upward our short-term inflation outlook given recent food price shocks and continued pass-through of dinar depreciation. Inflation is projected to remain temporarily at an elevated level for the next half year or so, and we now project that inflation will end-2010 above the upper bound of our tolerance band (6±2 percent), returning within the band (4½ percent±1.5 percent) only toward end-2011.

7. We continue to expect an external current account deficit of about 9 percent of GDP in 2010, and a gradual narrowing over the medium term, reflecting the significant competitiveness gains from depreciation, tight fiscal policies, and structural reform efforts, which include efforts to attract greenfield and brownfield FDI inflows to stimulate manufacturing exports.

8. We do not anticipate major challenges in covering our external financing requirements during 2011, in part reflecting expected inflows from Telekom Srbija privatization proceeds. As corporate restructuring and balance sheet repair restore investor confidence, private capital inflows to Serbia should resume over the medium term. However, given our still high external financing needs, the availability of sufficient sustainable inflows will need to be monitored carefully, and additional policy measures could be needed to ensure external balance. Conversely, we believe that we have adequate prudential and regulatory tools at our disposal to address possible risks emerging from a possible resurge of capital inflows in excess of our external financing requirements. The foreign exchange reserves remain at an adequate level, and should be sufficient to deal with challenging external scenarios.

Fiscal Policy

9. The fiscal program for 2010 is on track, and the deficit target for September was met by a comfortable margin. Total revenue collections have been in line with projections: while VAT collections were below expectations, higher excises have more than compensated for shortfalls. Apart from continued under execution of capital projects, spending programs have been implemented broadly in line with the fiscal program, although the one-off payment to pensioners in October (RSD 6½ billion) exceeded earlier plans significantly.

10. A supplementary budget for 2010 in line with the fiscal program has been submitted to parliament. The revised budget is consistent with the general government deficit target of RSD 148 billion (4.9 percent of GDP). The main upward revisions on the expenditure side reflect higher spending on public pensions and wages due to one-off payments to low-income employees and pensioners and additional social protection spending, mainly on targeted social assistance programs. The main compensating downward revisions on the expenditure side reflect lower execution of spending on capital and interest payments. We will execute the rebalanced budget transparently in line with approved allocations.

11. The 2011 budget will be in line with the adopted fiscal balance rule. Based on our macroeconomic framework, the fiscal balance rule prescribes to target a general government deficit that does not exceed 4.1 percent of GDP.

12. General government revenues in 2011 are projected to decline by 1⅓ percent of GDP relative to 2010. Revenue losses due to discretionary measures include lower customs collections (RSD 8 billion) reflecting the phasing in of the Stabilization and Association Agreement (SAA) with the EU and the elimination of the mobile phone tax (RSD 6 billion). Moreover, the 2011 budget will not be able to benefit from EU grants (RSD 5 billion in 2010). At the same time, we plan to request distributing the Telekom dividend for 2010 (RSD 6 billion), notwithstanding the expected sale of the company in 2011. We are considering a few smaller revenue measures, including a specific excise on cigarettes and a shift to a higher VAT rate on hotels, personal computers, and some high-end food products. We will also take measures to improve compliance on paying social contributions by integrating the collection of all wage-related taxes and contributions during 2011.

13. Given the targeted 2011 deficit and the projected revenue envelope, general government spending in 2011 will have to be contained to 42¾ percent of GDP, a decline by about 2 percent of GDP relative to 2010. To keep spending within the tight spending envelope, we have taken the following six main measures.

- First, we will cap the first indexation step for public pensions and wages in January 2011 at 2 percent. The two additional indexation steps in 2011 will be implemented in May (to the CPI inflation rate for the previous 3 months) and in November (to the CPI inflation rate for previous 6 months and half of 2010 GDP growth), respectively.

We do not plan an increase in the overall number of employees in the general government in 2011.

- Second, we will start to only gradually restore transfers to local governments to pre-crisis target levels. In particular, the level of transfers to municipalities is expected to increase by nearly 25 percent relative to what was originally budgeted for 2010.

- Third, we will freeze the amount of subsidies in 2011 at their nominal level of 2010, with exception of subsidies to ZTP (Railroad company) and Resavica (coal mine), which will grow in line with the indexation adopted for public wages.

- Fourth, the costs of the credit support programs in the 2011 budget will be considerably reduced, including by phasing out cash loans and curtailing the subsidy rate for liquidity loans.

- Fifth, Republican-level capital spending financed from domestic resources would be limited to RSD 27 billion, with priority given to the large infrastructure projects. Implementation of foreign-financed infrastructure projects will be substantially improved.

- And sixth, we plan to use most of the projected Telekom privatization proceeds for budget financing to reduce interest payments. In particular, we will pre-pay a portion of our high-interest debt, as well as use the Telekom proceeds to limit the issuance of Treasury bills for net financing purposes.

14. In executing the 2011 budget, we will faithfully implement the new fiscal rules included in the "fiscal responsibility" amendments to the Budget System Law. In particular, in line with the principles of a countercyclical fiscal policy implied by the fiscal balance rule, we will save any revenue overperformance. As regards spending, we will execute it strictly in line with budgeted allocations, with the exception of the "automatic stabilizers" operating on the expenditure side of the budget, such as unemployment benefits and targeted social assistance.

15. We plan to cover most of our 2011 general government gross financing needs of RSD 224 billion using Telekom Srbija privatization proceeds, domestic bank loans, and external sources, particularly the World Bank. We project that the level of gross public debt at end-2011 will be around 41 percent of GDP, leaving relatively little margin relative to the debt ceiling (45 percent of GDP) established by the revised Budget System Law.

16. We have revised the draft amendments to the law on pension and disability insurance. While we have retained most elements of the pension reform agreed during the fourth review of the SBA, we have introduced two changes aimed at strengthening protection for the most vulnerable and women. In particular, for non-farmer pensions, the law will

incorporate a clause whereby the minimum pension during 2011–15 would not fall below 27 percent of the net average wage. We have also postponed the gradual phasing out of the working credit for women by 2 years relative to the original schedule. At the same time, we have committed to setting up two working groups to: (i) study retirement arrangements for coal miners and other professions working under difficult conditions, and elaborate fair and efficient retirement options for these professions, taking into account best international practice; and (ii) assess options for introducing a protection clause for the old-age pension entitlement of a "standard pensioner" at the beginning of retirement, i.e., a pensioner who contributed for 40 years to the pension fund, also taking into account best international practice. Given the time needed to study these issues, we anticipate that further changes to the pension law will not be introduced before 2013, and will be combined with an updated assessment of the financial sustainability of the pension system.

17. While overall government arrears have declined during the program period, fresh arrears problems have emerged, especially in the health fund and at the local government level. To stop and reverse arrears accumulation, we have strengthened our planning procedures and ex-ante controls over commitments. In particular, we have upgraded our Treasury data management and control systems, whereby all budget beneficiaries will be required to submit their spending requests by the 5th day of each month for the following month. We will also strengthen the arrears monitoring system, extending it to local governments and increasing the quality and frequency of reporting.

18. Notwithstanding slow progress over the last two years, we remain committed to implementing structural reforms in the health and education sectors to lend more credibility to our medium-term fiscal targets, with support from the World Bank and other donors. Efforts to reform the pay-and-grading system in these sectors will need to be in line with our objective to reduce the public sector wage bill to below 8 percent of GDP over the medium term.

1. Monetary and Exchange Rate Policy

19. With inflation projected to remain above the pre-announced target tolerance band during most of 2011, the focus of monetary policy will remain to keep medium-term inflation expectations anchored. We have already raised the policy rate by a cumulative 250 basis points since August, and have continued to signal a possible tightening in our monetary stance. At the same time, we reckon that inflation risks remain tilted to the upside. Pressures in the foreign exchange market persist, and past depreciation of the dinar will continue to feed through into higher domestic prices for some time, which, together with the unfreezing of public sector wages and pensions in January, will likely dampen the disinflationary impact of still weak private demand. Looking ahead, we will use the full array of our policy tools available, if needed, including monetary reserve requirements, to maintain a monetary stance consistent with bringing inflation back into the tolerance band.

20. Effective communication of our inflation outlook and policy decisions with the public remains important to keep medium-term inflation expectations anchored. To increase the transparency of decision making and provide equal access to information to all actors in the financial markets, we have reduced the number of policy meetings, announced a firm meeting calendar, and will follow best practices regarding the timing of communications before and after policy meetings. We will also strive to further increase in our publications the information content on the policy options considered by the NBS's Executive Board.

21. In line with our inflation targeting framework, we will maintain the existing managed float exchange rate regime. FX interventions will continue to be used to smooth excessive exchange rate volatility or to provide liquidity to the market, as needed to ensure its orderly operation, without targeting a specific level or path for the exchange rate.

Financial Sector Policies

22. Our credit support programs have helped sustain the supply of credit and domestic demand during the height of the crisis. With credit markets now functioning more normally, we are phasing these programs out. In particular, we have already eliminated subsidies for cash loans to consumers and will substantially reduce the subsidy rate for liquidity loans in 2011.

23. We are strengthening the framework for dealing with the significant increase in payment problems, particularly in the corporate sector. The mandatory registration of promissory notes envisioned in the draft law on payments transactions will help make debtors' liabilities more transparent and gradually reduce the role of account blockages, thus facilitating debt restructuring. Despite recent improvements in court-mediated options, such as bankruptcy and pre-packaged re-organization procedures, their use has been constrained by the still slow and inefficient court system. Although there have been delays owing to the complex legal nature of the issues involved, we will soon submit to parliament a law on an out-of-court corporate debt restructuring mechanism. Participation in the mechanism would be voluntary and based on the parties' agreements, with mediation by the Chamber of Commerce. The law will be supplemented by tax and supervisory incentives to encourage expeditious agreements. In particular, supervisory incentives would include a shortening of the testing period for loan classification upgrades from 6 to 3 months. As regards tax-related incentives, the tax administration could be allowed to defer the tax liabilities up to 60 months on the basis of a debtor's request supplemented by an agreement with creditors on the restructuring. We are exploring options to introduce additional tax incentives, but this will need to be done in a deficit-neutral fashion, with one option being considered a gradual withdrawal of present corporate tax preferences.

24. Adoption of the Basel II framework remains a key priority in our strategy to strengthen further financial sector supervision. To that end, the NBS is finalizing the set of by-laws in line with Basel II framework. Also, together with the Ministry of Finance, the

NBS has prepared amendments to the law on banks that align the disclosure requirements with EU and Basel II standards, and also strengthen legal grounds for the NBS to issue relevant by-laws. However, given that adoption of amendments to the Banking Law has been delayed in order to reach agreement among stakeholders on amendments related to financial crisis resolution reforms, we have decided to extend the originally planned deadline for the implementation of the Basel II accord. The full implementation of the set of by-laws will be scheduled for December 31, 2011, with the test reporting period as of September 30, 2011. This decision is also consistent with the banks' proposals presented to the NBS.

25. As agreed in Vienna in March 2009, the commitments by foreign parent banks to maintain their exposures vis-à-vis Serbia, as well as related incentives to participating banks, will expire at end-2010. Observance of these commitments by nearly all banks has been a key ingredient for the successful stabilization of the financial sector after the global financial crisis spilled over into Serbia in late-2008. We will continue to use the cooperative framework under the Vienna initiative for dealing with key outstanding banking sector issues, particularly to coordinate the strategy for reducing financial stability risks from high euroization.

26. We remain committed to our de-euroization strategy. In particular, we have continued our campaign to increase the awareness of risks from unhedged foreign exchange borrowing through a series of foreign exchange hedging conferences. Developing a deeper dinar bond market also remains a priority, notwithstanding the present difficult environment. In this context, we are studying the option of allowing inclusion of T-bills with remaining maturity of more than one month in banks' regulatory liquidity ratio subject to a haircut.

27. To deal effectively with potential systemic banking crises in the future, parliament has adopted amendments to several financial sector laws—including on deposit insurance, banks, and bankruptcy and liquidation of banks and insurance companies. These will enable us to introduce temporary measures to improve the protection of depositors. In particular, the Deposit Insurance Agency (DIA) will have a larger toolkit for bank resolution, including through the establishment of the bridge banks or asset and liability purchase-and-assumption. The DIA will be empowered to introduce risk-based deposit insurance while the NBS will have the option of introducing temporary administration in a bank that is or is expected to become critically undercapitalized.

2. Structural Policies

28. We are making gradual progress on growth-oriented structural reforms. The restructuring of several key public enterprises, in particular JAT (airline) and ZTP (railways), and the privatization of Telekom Srbija is proceeding. During the remainder of the program, we will take steps to accelerate our structural reform agenda. In the energy sector, the current working group will propose recommendations on utility pricing and restructuring of public sector enterprises, including the sale of non-core assets and restraints on their wage bills,

which will be adopted by the government. We will further implement the "guillotine" project and step up our efforts to improve other aspects of the business environment. In particular, we will take steps to fully implement the laws on competition and submit to parliament the company and securities laws by end-2010. We are also reviewing recent charges and levies imposed by all levels of government and aim to discontinue many of such practices in 2011.

29. We have drafted a strategy of structural reforms for the 2011–20 period, and aim to adopt and implement its main elements as government acts. The strategy, initially produced by a group of Serbian economists, aims to anchor the transformation of the Serbian economy toward an export- and investment-based model. Among other steps, the strategy envisions an acceleration of reforms in labor and product markets, business environment, and the public enterprise sector.

/s/
Mirko Cvetkovic
Prime Minister

/s/
Dejan Soskic
Governor of the National Bank
of Serbia

/s/
Diana Dragutinovic
Minister of Finance

Attachment

Table 1. Serbia: Quantitative Conditionality Under the SBA, 2009–10 1/

	2009								2010							
	March		June		Sept.		Dec.		March		June			Sept.		Dec.
	Prog.	Act.	Prog.	Act.	Prog.	Act.	Prog.	Act.	Prog.	Act.	Prog.	Adj.	Act.	Prog.	Act	Prog.
Quantitative Performance Criteria																
Floor on net foreign assets of the NBS (in billions of euro)	5.1	6.0	4.4	5.9	3.6	6.5	4.3	6.6	4.0	6.2	4.9	4.9	5.4	4.6	5.0	4.0
Ceiling on consolidated general government overall deficit (in billions of dinars) 2/	15	12	34	55	58	79	134	121	23	24	72	69	55	109	84	148
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	10	0	10	2	10	2	20	0	20	20	18	20	18	20
Ceiling on contracting or guaranteeing by the public sector of new nonconcessional external debt (over one year, in millions of euro) 2/ 3/	200	0	550	100	550	100	550	100	200	0	550	550	140	600	170	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	0	0	0
Inflation Consultation Bands (in percent)																
Central point	9.2	9.4	8.0	8.3	9.5	7.3	7.5	6.6	5.4	4.7	4.0	4.0	4.2	5.3	7.7	6.0
Band, upper limit	11.2	n.a.	10.0	n.a.	11.5	n.a.	9.5	n.a.	7.4	n.a.	6.0	6.0	n.a.	7.3	n.a.	8.0
Band, lower limit	7.2	n.a.	6.0	n.a.	7.5	n.a.	5.5	n.a.	3.4	n.a.	2.0	2.0	n.a.	3.3	n.a.	4.0
Indicative Targets																
Ceiling on current expenditure of the Serbian Republican budget (in billions of dinars) 2/	190	152	335	331	520	506	695	689	182	165	354	354	353	548	543	750
Ceiling on gross accumulation of domestic guarantees by the Republican budget and the Development Fund and domestic borrowing by the Development Fund (in billions of dinars) 2/	n.a.	n.a.	50	7	50	15	50	15	13	16	50	50	32	50	19	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: Structural Conditionality, 2010

Measure	Target Date	Comment
Prior actions		
1. Government to submit to parliament a 2011 budget consistent with the program, including supporting legislation.	Before Board meeting	To support macroeconomic stability and bolster the credibility of fiscal policy.
2. Government to re-submit to parliament the pension law with only two changes (TMU ¶21).	Before Board meeting	To safeguard medium-term fiscal sustainability.
Structural benchmark		
1. Government to submit to parliament package of laws strengthening the corporate debt and restructuring framework (TMU ¶22).	End-February 2011	To foster out-of-court debt workouts to minimize unnecessary and costly bankruptcies and improve the allocation of resources in the economy.

ATTACHMENT II. 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 September 30, 2010 the NBS's net foreign assets, evaluated at program exchange rates, were €5,063 million; foreign reserve assets amounted to €9,842 million, and foreign reserve liabilities amounted to €4,839 million.

7. **Adjustors.** For program purposes, the NFA target will be adjusted upward *pari passu* to the extent that: (i) after September 30, 2010, 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 September 30, 2010. 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 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. 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. For program purposes, debt is classified as external when the residency of the creditor is not Serbian.

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), and the Development 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. 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

3.

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, Naftna Industrija Srbije (NIS), which is in majority private ownership, and Telekom Srbija, which competes with other telecommunication service providers.

20. **Ceiling on the accumulation of domestic loan guarantees (gross) extended by the Republican budget and the Development Fund.** The ceiling also includes the contracting

of any domestic loans by the Development Fund. It excludes any guarantees extended under the financial stability framework, unless such loans or guarantees are extended to entities other than financial sector institutions.

21. **Pension reform.** The revised amendments to the law on pension and disability insurance will be resubmitted to parliament. Changes compared to the version submitted to parliament in June 2010, apart from the modified indexation arrangements for 2011, would be strictly confined to the following two changes. First, the envisioned phasing out of the service credit for women from 15 to 6 percent—coupled with the corresponding increase in the years of service required for their full pension from 35 to 38—would be done over the period of 2013–2021, instead of 2011–19. Second, for pensions paid to former employees and the self-employed (but excluding pensions paid to farmers), a protection clause would be introduced, effective during 2011–15, whereby the minimum pension would not be allowed to fall below 27 percent of the economy-wide net average wage (prior action).

22. **Debt collection and restructuring. The Ministry of Economy, in consultation with the Ministry of Finance and the NBS, will submit draft legislation establishing a voluntary out-of-court restructuring mechanism for government approval by end-December 2010. The government will submit a package of the legislative changes, including legislation required to provide tax incentives, to parliament by end-February 2011 (structural benchmark).**

23. **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 45 days after the end of each quarter. 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.

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
Statistical Office and 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 and the Development Fund and domestic borrowing by the Development Fund	Within eight weeks of the end of the month