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January 2002
IMF Country Report No. 02/12

Federal Republic of Yugoslavia: Second Review Under the Stand-By Arrangement and Modification of Performance Criteria; Staff Supplement; News Brief on the Executive Board Discussion; and Statement by the Executive Director for the Federal Republic of Yugoslavia

In the context of the Second Review Under the Stand-By Arrangement with the Federal Republic of Yugoslavia and Modification of Performance Criteria, the following documents have been released and are included in this package:

- the staff report for the Second Review Under the Stand-By Arrangement and Modification of Performance Criteria, prepared by a staff team of the IMF, following discussions that ended on **November 9, 2001** with the officials of Federal Republic of Yugoslavia on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on December 28, 2001.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a supplement to the staff report of **January 10, 2002** updating information on recent economic developments.

- a News Brief summarizing the **views of the Executive Board as expressed during its January 11, 2002 discussion** of the staff report that completed the review.

- a statement by the Executive Director for the Federal Republic of Yugoslavia.

The documents listed below have been or will be separately released.

Letter of Intent by the authorities of the Federal Republic of Yugoslavia of December 28, 2001*
Memorandum of Economic and Financial Policies by the authorities of the Federal Republic of Yugoslavia*
Supplementary Letter of Intent by the authorities of January 4, 2002

*May also be included in Staff Report.

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

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International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

FEDERAL REPUBLIC OF YUGOSLAVIA

Second Review Under the Stand-By Arrangement and Modification of Performance Criteria

Prepared by the European I and Policy Development and Review Departments

(In consultation with other Departments)

Approved by Susan Schadler and Shigeo Kashiwagi

December 28, 2001

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Executive Summary

Background: Economic and policy performance has been impressive since the overthrow of the Milosevic regime and the initiation of reforms in late 2000. Inflation has declined by two-thirds to 40 percent, and the foreign exchange reserves of the central bank have doubled. Real GDP is estimated to grow by 5½ percent in 2001, but remains less than one-half of its 1989 level. This reflects capacity constraints after years of disinvestment; the ongoing economic restructuring; and a shortfall in government spending on investment and restructuring in 2001 because of delays in foreign assistance and privatization proceeds. For the FRY as a whole, macroeconomic policy implementation has remained firmly on track and—with a single exception pertaining to Montenegro—all quantitative performance criteria at end-September were observed. Montenegro, which accounts for about 7 percent of the FRY economy, has experienced problems in fiscal policy implementation and transparency, which are being addressed. Following the liberalization of the price, foreign exchange, and trade regimes in early 2001, new institutional frameworks for bank and enterprise restructuring have been implemented beginning in mid-2001 in line with Fund and World Bank recommendations. Meanwhile, prospects for external sustainability were enhanced by the Paris Club decision to reduce the NPV of debt to official creditors by 66 percent; discussions with London Club creditors are underway.

Policy discussions: The discussions on the second review in November highlighted a challenging policy agenda for the period ahead, especially in the area of bank and enterprise restructuring. With macroeconomic policies firmly on track, the policy targets for the remainder of 2001 were revised mainly to lock in overperformance. For 2002, the authorities envisage a policy framework that aims to promote economic restructuring and recovery, while halving inflation to 20 percent. The fiscal deficit in FRY is projected to rise by about 3.8 percentage points, to 6.2 percent of GDP in 2002, reflecting mainly a shift forward in financing and associated spending originally planned for 2001. The increased deficit will be financed mostly through grants, concessional borrowing, and privatization proceeds. Excluding increased spending on restructuring costs, reconstruction investment, and external debt service, the 'underlying' deficit would decline significantly in relation to GDP. On the structural front, recently adopted legislation has considerably liberalized the labor market, raised the retirement age by three years as of January 2002, and modified the pension indexation formula with a view to putting the pension fund on a sustainable path. Building on the progress in 2001, the authorities are committed to important bank resolution measures and an acceleration of the privatization process.

I. Introduction

1. On June 11, 2001, the Executive Board approved a 10-month stand-by arrangement for the Federal Republic of Yugoslavia (FRY) in the amount of SDR 200 million, or 43 percent of quota, to be made available in four purchases of SDR 50 million each (Appendix I). FRY has made two purchases, the first one upon Board approval of the arrangement and the second one upon completion of the first review on September 19. The third purchase depends on observance of performance criteria as of end-September 2001 and completion of the second review under the arrangement.

2. **Discussions for the second review under the stand-by arrangement were held in Belgrade and Podgorica during October 29–November 9, 2001.**[1] In the attached letter to the Managing Director of December 26, 2001, and the accompanying Memorandum on Economic and Financial Policies, the federal and republican authorities outline policies for the period ahead, proposing modified performance criteria, indicative targets and structural benchmarks for the remainder of the program period (Appendix V). On this basis, the authorities request completion of the second review under the stand-by arrangement and a waiver of applicability of end-December 2001 performance criteria.[2]

3. **Upon completing the first review under the stand-by arrangement, Executive Directors commended the authorities for the progress in stabilization and structural reform, while cautioning that the tasks ahead would be extremely difficult.** Directors noted that firm policy implementation had lowered core inflation and strengthened foreign

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

The staff team included Mr. E. Zervoudakis (head), Mr. J. Herderschee, Ms. X. Li, Ms. E. Ribakova (all EU1), Ms. Q. Kong (FAD), Mr. H. Tadesse (PDR), and Ms. C. Strayer (assistant, EU1). The team was assisted by Mr. J. Charap, the Fund's resident representative.

[2] The second review under the SBA has been slightly delayed, owing mainly to the need to reach understandings on fiscal policy for 2002. The need for a waiver of applicability arises because completing the second review beyond December 31, 2001 means that purchases under the SBA are "legally controlled" by the end-December (rather than end-September) 2001 performance criteria. Since final data are not expected to be available at the time of the Board meeting, the Board would need to waive the applicability of end-December 2001 performance criteria and complete the review to allow purchases that were originally scheduled to become available on the basis of the end-September 2001 performance criteria. Furthermore, as the end-September 2001 performance criteria would no longer be legally controlling, no waiver is needed for the nonobservance of one end-September 2001 performance criterion (see Box 1). The purchase related to the end-December 2001 performance criteria will be conditional on observance of end-December 2001 performance criteria and completion of the third review under the stand-by arrangement.

reserves, while supporting a sustainable economic recovery. They also welcomed the speedy adoption of an institutional and legal framework to guide economic transformation. Directors cautioned that sustainability of the overall reform effort would hinge upon progress in restructuring the banking and enterprise sectors as well as strong support from creditors and donors. As regards Montenegro, Directors called upon the authorities to address problems in fiscal policy implementation and transparency.

4. **The World Bank has been closely involved in FRY's reconstruction efforts** (Appendix II). World Bank lending operations are expected to start in the coming months, following the settlement of the arrears of US$1.8 billion to the Bank through the extension of a 30-year consolidation loan at market-related interest rates. Lending of up to US$540 million (depending on policy performance) is envisaged for FY 2002–04 under "hardened" (shorter grace and maturity periods) IDA terms, which would generate a positive net resource transfer to FRY. A total of US$200 million in IDA resources could be provided as credits to FRY in FY 2002, with up to US$160 million in support of fiscal management, private sector development and banking reform, and up to US$40 million in support of investment operations. The World Bank strategy also provides for advisory activities, including a Public Expenditure and Institutional Review now underway.

5. **The status of Montenegro remains uncertain.** Negotiations are underway between the authorities in Belgrade and the pro-independence government in Podgorica, and a referendum offering a choice between independence and a new federal constitutional framework is expected in April 2002. Meanwhile, Montenegro (which accounts for about 7 percent of the FRY economy) effectively pursues independent economic policies, with the DM (euro) as its sole legal tender, its own customs, and no fiscal transfers to or from the federal government.

6. **The quality of statistics, albeit much improved, remains weak** (Appendix III). With technical assistance from the Fund and others since late 2000, progress has been made toward ensuring that the monetary, external and fiscal accounts comply with internationally accepted norms. Nevertheless, considerable weaknesses remain, including in the national accounts. At the authorities' request and as a basis for further technical assistance, a ROSC mission will undertake a comprehensive data quality assessment around mid-2002.

II. BACKGROUND

7. **Economic activity is recovering from very low levels, while progress has been made in lowering inflation.**[3] Real GDP is estimated to rise by 5½ percent in 2001 but would remain less than one half of its 1989 level (Table 1 and Figure 1). With stagnant industrial production, the real GDP growth is attributed to a rebound (by 25 percent) in agricultural output after the previous year's severe drought, and increasing activity in services (especially transportation and, in Montenegro, tourism). Headline inflation (retail prices) declined to 40 percent in November 2001 (year-on-year), compared with 113 percent in December 2000

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

(Figure 2). Adjusting for large increases in administered prices and indirect taxes, core inflation is tentatively estimated at about 15–20 percent. Average wages in the state sector (accounting for one quarter of total employment) have remained broadly unchanged in real terms from the previous year, as envisaged under the program.[4] In Montenegro, inflation was 25 percent in October 2001 (year-on-year), reflecting large administered price increases as well as the lagged effects of substantial wage increases in 2000.

8. **The balance of payments features a widening trade deficit and robust invisible receipts.** Recorded exports in January–September 2001 were 3.4 percent higher in U.S. dollar terms (8.5 percent in euro terms) than in the corresponding period of the previous year but remained 20 percent below their real level in 1998. Recorded imports in the same period were 20.7 percent higher in U.S. dollar terms (27.0 percent higher in euro terms), reflecting in large part the counterpart to in-kind foreign assistance. Despite the worsening trade balance, large inflows of remittances and service receipts have helped contain the size of the current account deficit and—together with unrecorded inflows probably attributable to remonetization—enabled a continued accumulation of foreign reserves. As of end-November, gross official reserves amounted to about US$1.1 billion (2.4 months of projected 2002 imports), having more than doubled from end-2000.

9. **Confidence in the dinar is recovering, owing to stabilization of price and exchange rate expectations.** The strong growth in real reserve money (by about 30 percent during January–November 2001) has stemmed entirely from net NBY purchases of foreign exchange from the market—rather than net NBY credit operations or official foreign exchange inflows—in an environment of declining inflation and nominal market interest rates (Figure 3).[5] The BOP surplus has permitted the NBY to maintain a relatively stable exchange rate for the dinar against the DM (euro) since the adoption of a managed float at the beginning of this year. The resulting significant real appreciation of the dinar (by about 30 percent over the past 12 months) appears to have partly compensated for the sharp effective devaluation of the dinar in late 2000, when the official and gray market exchange rates were unified.

10. **Budget performance has been very good but the underlying fiscal position remains difficult**. Based on preliminary data, the overall deficit of the consolidated general government in FRY in January–October 2001 is estimated at the equivalent of about 1.0 percent of annual GDP, compared with an original annual program target of 6.1 percent of GDP and a revised target of 4.0 percent of GDP in 2001. This fiscal overperformance

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[4] Real wages economy-wide increased by 7 percent in January–October 2001 (compared to the corresponding period of the previous year) but remain relatively low in DM terms (about DM 200 per month). A June 2001 shift in the definition of wages to include fringe benefits has probably caused some overestimation of wage growth.

[5] Along with greater price and exchange rate stability, the introduction of new, higher-denomination banknotes has probably contributed to the increased demand for dinar money. Until last May, the highest denomination had been 100 dinars (equivalent to US$1½); by end-October, newly issued notes of 200 dinars and 1000 dinars accounted for almost half of currency in circulation.

reflects higher-than-programmed revenue at all levels of government and, in Serbia, a containment of spending below programmed levels in light of delays in foreign financing and privatization receipts, which were expected to concentrate toward the end of 2001. In Montenegro, the fiscal position has improved somewhat since mid-2001, owing to better revenue performance.

11. **Important progress has been made in recent months in normalizing relations with Paris Club and multilateral creditors.** In November 2001, agreement was reached on the restructuring of US$4.5 billion of Paris Club debt (roughly 40 percent of total external debt), involving a phased NPV reduction of 66 percent (Appendix IV). An initial reduction of 51 percent would come into force upon Board approval of a 3-year arrangement, which could succeed the current stand-by arrangement that expires on March 31, 2002. The second phase of the debt reduction, by 15 percent, could come into force upon successful completion of the prospective 3-year arrangement and a satisfactory track record of payment to Paris Club creditors. This treatment will lead to the write-off by Paris Club creditors of about US$3 billion of FRY's commercial (non-ODA) debt owed to Paris Club creditors; a further US$2 billion in external debt to other bilateral creditors would be written off on the assumption of comparable treatment by other creditors. In addition to the restructuring of US$1.8 billion of World Bank debt (¶4 above), arrears of US$210 million to the European Investment Bank were cleared in October 2001 with financial support from the European Union.[6] Negotiations to secure a debt restructuring agreement with London Club creditors are underway, with the authorities reportedly aiming for terms broadly similar to those in the Paris Club agreement. In light of these efforts, the Fund could continue to provide resources under its lending into arrears policy.

III. Policy Discussions

12. **The discussions in Belgrade highlighted some impressive policy achievements over the past year**—following the overthrow of the Milosevic regime in October 2000 and the formation of a reformist government in Serbia in January 2001—**as well as persisting economic difficulties and a challenging policy agenda for the period ahead.** Specifically:

- Rapid progress has been made in stabilizing the economy and strengthening the external position, with the program firmly on track. Credit, external, fiscal, and wage targets pertaining to Serbia were observed at end-September with a comfortable margin (see Box 1 on program implementation); the new institutional frameworks for bank and enterprise restructuring have begun to be implemented in line with Fund and World Bank recommendations; and relations with multilateral and Paris Club creditors have been normalized, consistent with external sustainability. These achievements follow the liberalization of the price, foreign exchange, and trade regimes in the first half of 2001.

[6] Efforts are continuing toward settlement of arrears to two other multilateral creditors accounting for a very small share of debt (Appendix IV).

- The economic situation remains difficult—with only a relatively small increase in output and living standards in 2001—owing to capacity constraints after years of disinvestment and war destruction; the ongoing economic restructuring; and lower than originally programmed spending on investment and restructuring in 2001 as a fiscally prudent response to delays in foreign assistance and privatization proceeds.

- Looking ahead to 2002 and beyond, there is a need to consolidate the gains in stabilization, advance the increasingly difficult task of bank and enterprise restructuring, and complete the normalization of relations with foreign creditors, so as to attract investment and achieve sustainable growth.

Box 1. Program Implementation

Program implementation has been generally good, despite fiscal slippage in Montenegro which accounts for less than 10 percent of government spending and GDP in FRY. (Annexes A and B to Appendix V).

Quantitative performance criteria were met as of end-September 2001, with a single exception pertaining to Montenegro. The NFA floor and the NDA ceiling were comfortably observed. The ceiling on bank credit to the government was also met, notwithstanding a higher-than-targeted fiscal deficit in Montenegro. The four debt-related performance criteria were also observed, with the exception of the ceiling on the extension of new guarantees and the assumption of enterprise debt to banks by the public sector (set at zero under the program). The Montenegrin government extended two guarantees in the total amount of DM 200,000 to a majority state-owned agro-industrial company. The authorities attributed this to lax procedures, confirmed by the external audit of the budget financing, which were being addressed.

Out of 11 *structural benchmarks* for the period through end-September—in the fiscal, financial, and privatization sectors—eight were met on time and two were met with some delay (the introduction of a drug list in Serbia and the adoption of an organic budget law in Montenegro). The only benchmark that has not yet been met relates to decisions on resolution of all banks in Montenegro, which will be based on the envisaged parliamentary approval of a law amendment on bank rehabilitation.

Of the three *indicative targets,* two—relating to the NDA of the banking system and the wage bills of the largest state enterprises in Serbia—were met. Notwithstanding a good overall fiscal performance so far, the ceiling on the government expenditure arrears was missed on account of a delay in pension payments in Serbia. These arrears are expected to be eliminated by end-March 2002.

13. **The discussions in Podgorica dealt with the difficult budgetary situation, fiscal transparency, and structural reform.** Policy formulation and implementation were complicated by political uncertainty surrounding Montenegro's status within FRY. The Montenegrin authorities nevertheless stressed their commitment to the program, as evidenced by improved fiscal policy implementation after the April parliamentary elections, and further progress with fiscal reform, bank restructuring, and enterprise privatization. The mission

team expressed concern about the lack of fiscal transparency, as corroborated by an external audit of the budget financing commissioned by the authorities as agreed under the program.

A. Macroeconomic Objectives and Policies for the Remainder of 2001 and 2002

14. **The macroeconomic objectives for 2001 were estimated to be broadly achievable despite a worsening of the external environment, thus setting the basis for further economic recovery, disinflation, and external adjustment in 2002.**

- **Real GDP** is estimated to grow by 5½ percent in 2001, compared with a program target of 5 percent, reflecting a stronger-than-expected rebound in agricultural output. Real GDP is projected to grow by 4 percent in 2002, on the expectation that normal agricultural output will be largely offset by nonagricultural growth of 4 to 5 percent (as compared with an estimated 1½ percent in 2001), reflecting increased foreign assistance, inflows of FDI, and the response of the economy to improved incentives.

- **Inflation** in Serbia is estimated to be around 40 percent by end-2001—somewhat higher than programmed, owing to an underestimation of the effects of increases in administered prices and indirect taxes—and is targeted to decline to 20 percent by end-2002. In light of further large adjustments in administered prices, this would correspond to a core inflation rate of about 10 percent, compared with 15–20 percent in 2001. In Montenegro, inflation is estimated to amount to 24 percent by end-2001, significantly higher than targeted, and is projected to decline to 8 percent during 2002.

- The **current account deficit** on a cash basis (before official grants), estimated at US$1.1 billion (10.2 percent of GDP) in 2001, would be lower than targeted, owing mainly to higher private remittances. For 2002, the current account deficit is projected to rise to US$1.5 billion (12.6 percent of GDP), reflecting an increase in debt service payments and foreign-financed project-related imports. The 'underlying' current account deficit (adjusted for interest payments and project-related imports) is expected to decline slightly in relation to GDP.

15. **With macroeconomic policies firmly on track, the policy targets for the remainder of 2001 were revised mainly to lock in overperformance.** The fiscal deficit in the whole of FRY is now estimated at 2.4 percent of GDP in 2001, compared with an original program target of 6.1 percent. This overperformance reflected a combination of revenue overperformance (2.0 percent of GDP) and a fiscally prudent containment of spending in response to a shortfall in foreign financing and privatization receipts (1.8 percent of GDP). In the area of monetary policy, the NBY has revised NDA and NFA targets for end-December 2001, to lock in and sterilize some foreign exchange inflows. The targets for nominal wage bills in state enterprises for end-December 2001 were left unchanged.

Text Table 1. Key Macroeconomic Objectives and Policies, 2000–2002

	2000	2001			2002
		Original Program	1st Review	2nd Review (proposed)	Prel. Proj.
		(Percentage change)			
Real GDP growth	5	5	5	5½	4
Inflation (end period)	113.5	30–35	35	40	20
Of which: Montenegro	...	6.5	15	24	8
Current account deficit (before grants)					
US$ million	610	1,493	1,258	1.075	1,526
In percent of GDP	7.6	14.6	12.5	10.2	12.6
Excl. interest payments (in percent of GDP)	7.0	12.2	11.2	9.7	9.5
		(In percent of GDP)			
Fiscal deficit	0.9	6.1	4.0	2.4	6.2
Government credit from the banking system	0.2	0.6	0.8	0.8	0.6
		(In percent of year-beginning reserve money)			
NFA growth	147.7	8.2	20.5	65.5	...
NDA growth	-56.6	18.0	25.1	10.1	...
Reserve money growth	91.1	26.1	45.6	75.6	...

Sources: Yugoslav authorities; and IMF staff estimates.

16. **For 2002, the authorities envisage a policy framework that aims to promote economic restructuring and recovery, while supporting further disinflation.** The overall fiscal deficit in FRY is projected to rise substantially—according to preliminary estimates, by about 3.8 percentage points, to 6.2 percent of GDP in 2002. The authorities noted that this higher deficit will reflect mainly a shift forward in foreign financing, privatization receipts, and corresponding spending originally planned for 2001. This higher deficit should not compromise the achievement of the inflation objective or jeopardize fiscal sustainability, in part because it will be financed largely through grants, concessional borrowing, and privatization proceeds. Moreover, the additional spending—mostly in the form of restructuring costs, reconstruction investment, and external debt service—will either raise potential output, utilize idle resources in the construction sector, or (in the case of interest payments) not add to claims on domestic resources. Adjusted for such spending, the underlying fiscal position would improve by the equivalent of 1.6 percent of GDP. Tight credit policy and wage restraint in the state sector would be geared to further disinflation. If progress in stabilization were to be slower than envisaged, macroeconomic policies would be tightened to ensure achievement of the program objectives. Building on the progress in 2001, bank and enterprise restructuring would accelerate in 2002.

B. Fiscal Policy

17. **The discussions on fiscal policy in 2001 highlighted the overall good budget implementation and wide-ranging reforms.** Fiscal policy has remained on track in FRY as a whole—notwithstanding the large shortfall in foreign financing and privatization receipts for the Serbian budget—reflecting a cautious authorization of spending commitments and revenue overperformance. Meanwhile, wide-ranging tax and expenditure reforms have improved the efficiency of the fiscal system.

- At the **federal** level, favorable collections from sales taxes and custom duties, in conjunction with spending (especially wage) restraint, have allowed a reduction in expenditure arrears of 0.5 percent of GDP as well as an estimated cash balance in 2001 (¶10).[7]

- At the **Serbian** government level, a deficit (before grants) of 1.9 percent of GDP is expected in 2001, compared with a target of 5.7 percent under the original program. This is explained by revenue overperformance of 1½ percent of GDP on account of strong sales tax, excises, and the personal income tax collections; and lower-than-programmed expenditure on foreign-financed projects and interest payments on foreign debt in line with debt restructuring agreements. Larger-than-budgeted transfers to the social security funds—due in part to delays in adjusting the pension indexation formula—will be offset by savings in other current expenditure, including wages.

- At the **Montenegrin** government level, the fiscal slippage in 2001H1 will be only partly corrected by year-end. Notwithstanding a strong revenue performance since mid-2001—reflecting an exceptionally strong tourist season and measures to curtail tax evasion—the government will not be able to repay a credit to the central bank (of about 1½ percent of GDP) that had been contracted in early 2001, contrary to the program. This was due to the effects of higher-than-projected inflation on spending across most categories other than wages.

- Fiscal reforms have continued. At the federal level, the transfer of responsibility for defense spending from the General Staff to the Defense Ministry as of end-August 2001 improved fiscal transparency and expenditure management. In Serbia, following the wide-ranging tax and budgetary reforms in the first half of 2001, further progress has been made in improving expenditure management (¶15), while draft systemic legislation (including an Organic Budget Law) legislation would be submitted to parliament. The authorities committed to intensify their efforts toward the establishment of a Treasury and Large Taxpayer Offices, notwithstanding staffing constraints that had already caused some delays. In Montenegro, in addition to the recent adoption of new Organic Budget and Public Procurement Laws, a Treasury is expected to operate fully from the beginning of 2002 (¶18). Furthermore, new tax

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[7] Henceforth, unless otherwise noted, references to paragraphs pertain to the MEFP of December 26, 2001 (Appendix V to this report).

codes (covering personal income tax, corporate income tax, excises, property tax, the VAT and tax administration) are expected to be approved by parliament by end-2001.

Text Table 2. Consolidated General Government Fiscal Operations, 2000–2002 1/
(In percent of GDP) 2/

	2000	2001			2002
	Est.	Original Program	First Review	Second Review	Projected
Total revenue	38.8	39.9	39.5	41.9	43.5
Tax revenue	35.0	36.6	36.5	38.7	40.4
Nontax revenue	3.8	3.1	2.8	3.0	3.0
Capital revenue	0.0	0.2	0.2	0.2	0.1
Total expenditure and net lending	39.7	46.0	43.5	44.2	49.7
Purchases of goods and services	18.5	19.3	19.6	18.6	18.4
Of which: Wages and salaries	10.0	10.3	9.9	10.0	10.1
Interest payment	0.6	1.0	0.4	0.8	2.6
Subsidies	2.2	3.3	3.4	3.3	3.3
Transfers to households	15.1	17.8	17.1	18.7	20.7
Capital expenditure	3.3	3.6	1.6	1.4	3.4
Other	0.0	0.9	1.4	1.4	1.2
Overall balance	-0.9	-6.1	-4.0	-2.4	-6.2
Financing	0.9	6.1	4.0	2.4	6.2
Domestic financing	0.1	0.6	0.8	0.5	0.6
Foreign grants	0.8	1.2	1.5	0.9	1.2
Foreign debt financing	0.0	2.9	1.2	0.9	3.0
Project financing	...	0.0	0.0	0.2	1.3
Budgetary support	...	2.9	1.2	0.7	1.6
Privatization receipts	0.0	1.4	0.4	0.0	1.4
Accumulation of expenditure arrears	2.1	0.0	0.0	0.0	0.0
Overall commitment balance	-3.0	-6.1	-4.0	-2.4	-6.2
Memorandum items:					
Overall cash balance of:					
Serbian general government	-0.2	-5.7	-3.6	-1.9	-5.6
Montenegro general government	-0.7	-0.4	-0.4	-0.4	-0.6
Overall cash balance of general government In Montenegro (in percent of Montenegro GDP)	-10.4	-6.1	-6.1	-5.8	-6.6

Sources: Ministries of Finance of the Federal Republic of Yugoslavia, Republic of Serbia, and Republic of Montenegro; and IMF staff estimates.

1/ Consolidated general government includes the federal, the republican and local governments, the social security funds and the extrabudgetary programs. Local governments in Montenegro are, however, excluded.

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

18. **The discussions on fiscal policy in 2002 focused on the burdens imposed by new expenditure demands.** (Table 7A; ¶11, 14, and 17). The new burdens stem from (a) a resumption of external debt servicing (1.8 percent of GDP); (b) spending on bank and enterprise restructuring in Serbia in the form of severance payments to redundant bank and

enterprise workers and limited compensation to depositors at banks undergoing liquidation (1.6 percent of GDP); and (c) increased foreign-financed capital spending (2.0 percent of GDP). Other spending (including wages), which was compressed in 2001 compared to programmed levels, would remain broadly constant or rise slightly in relation to GDP. Defense spending is expected to remain unchanged at 3.8 percent of GDP, as measures to restructure the military, including shortening the compulsory military service will be offset by increased security spending in southern Serbia (¶11). Overall, the expenditure/GDP ratio (including a contingency reserve) would rise by the equivalent of 5.5 percent of GDP. The revenue/GDP ratio would rise by about 1.6 percentage points, reflecting the full-year effect of the tax reform measures in 2001 and large increases in excises, partly offset by a reduction in the financial transactions tax and sales tax exemptions for selected basic food items and medicines in Serbia.

19. **On this basis, the fiscal deficit in FRY is projected to reach 6.2 percent of GDP in 2002, to be financed largely by grants, concessional loans, and privatization revenue; borrowing from the domestic banking system will be limited to 0.6 percent of GDP.** Privatization receipts in excess of the budgeted amount will be used, in the first instance, to reduce the government's net indebtedness and, in consultation with the Fund and the World Bank, for the restructuring of enterprises with a view to facilitating their privatization and the further lowering of the distortionary tax on financial transactions.

20. **To help limit the size of budgetary transfers to the social security funds and put them on a more sustainable fiscal path, the pension system in Serbia is expected to undergo a bold reform.** On the basis of legislation that was adopted in late December 2001 and is to come into force in January 2002, the retirement age was raised by 3 years (to 63 years for men and 58 for women) and the indexation scheme for pensions was modified, along the lines of the Swiss model (arithmetic average of wage and price increases).

21. **An external audit of the budget financing in Montenegro revealed significant weaknesses in budgetary practices.** In line with undertakings in the program, a reputable foreign accounting firm audited the stocks and flows of government borrowing and the granting of guarantees. The auditor's report highlighted major weaknesses in internal controls over budget borrowing and issuance of government guarantees. The authorities indicated that, to a large extent, these problems would be addressed by the newly established Treasury within the Ministry of Finance, which was set up with Technical Assistance from USAID. The authorities also provided information on government guarantees issued in August 2001 for two loans (totaling DM 200,000) from a commercial bank to an enterprise with mixed state/social ownership, in violation of a performance criterion (Annex A to Appendix V). The authorities attributed this to lax procedures, confirmed by the external audit of the budget financing, which were being addressed.

C. Wage and Pricing Policies

22. **Wage restraint in the state sector will be geared to lowering inflation.** Wage bills in the federal and republican governments as well as in the large state-owned enterprises are estimated to remain constant in real terms in 2001, in line with the program target. For 2002, the authorities saw the need for continued wage restraint in the state sector, to lower inflation and make room for investment and reform-related spending. Accordingly, the wage bills in the federal government and state enterprises will be targeted to remain constant in real terms, while the wage bills in the republican governments (where average wages are somewhat lower) will be targeted to remain broadly unchanged in relation to GDP (¶19). To create a more efficient labor market, the authorities are encouraging wage differentiation in the eight large state enterprises, allowing pay raises for some workers while encouraging retrenchments for others, thus continuing to observe the agreed limits on the wage bill specified in the program. A new labor law in Serbia—adopted in mid-December 2001—has liberalized employment contracts and the wage determination process in line with World Bank recommendations.

23. **Further increases in the administered prices of electricity, community heating, and other products are necessary to bring them closer to cost recovery levels.** In Serbia, electricity prices were increased during 2001 by a cumulative 120 percent. Nevertheless, the current electricity price of US¢ 2.03 per kWh is less than half the US¢ 4.5 per kWh that World Bank experts have estimated to be the economic costs. Price increases to US¢ 3 per kWh are envisaged to take place during 2002 and will allow the electric power company (EPS) to cover most current costs. However, the phasing of the price increases during 2002 will necessitate some budgetary support (about ½ percent of GDP) and donor assistance (¶20). Communal heating prices, which are regulated at the local level, are expected to be raised by approximately 50 percent during the 2001/02 winter. In Montenegro, most administrative price controls have been removed with the exception of electricity and other utility prices. Electricity prices were increased effectively by 50 percent in November 2001 to about US¢ 2.7 per kWh and will be increased further in 2002.

D. Monetary and Exchange Rate Policies

24. **The financial program targets for end-December 2001 were further revised in line with recent developments.** As shown in Text Table 3, NFA and reserve money targets for end-December 2001 were raised further to take account of the larger-than-programmed foreign exchange inflows and remonetization of the economy, while the NDA target was lowered to ensure continued sterilization of the NFA overperformance. The imminent conversion of DMs into euros could further boost the remonetization process, in light of efforts to attract deposits into the banking system.[8]

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[8] Official estimates are that approximately DM 3–5 billion in foreign banknotes are circulating in FRY. To recover the cost of conversion of DMs into euros, commercial banks will charge 0.9 percent for cash transactions but will waive the fee for deposits of at least 31 days.

Text Table 3. Monetary Indicators, 2000–2001

	2000	2001									
	Dec.	June		September			Oct.	December		
		Orig. Prog.	Actual	Orig. Prog.	First Review	Actual	Actual	Orig. Prog.	First Review	Second Review
	(Cumulative change as percent of reserve money at year-beginning)									
NFA	147.7	8.0	44.1	1.8	17.0	67.1	82.0	8.2	20.5	65.5
NDA	-56.6	-1.3	-18.0	12.2	19.3	-10.2	-10.8	18.0	25.1	10.1
Reserve money	91.1	6.8	26.1	14.0	36.3	59.9	71.2	26.1	45.6	75.6
	(Cumulative percentage change from year-beginning)									
Currency in circulation	64.1	10.7	31.0	19.8	45.0	61.4	73.0	36.0	60.0	90.0
	(Cumulative change in millions of U.S. dollars from year-beginning; end-Dec. 2000 exchange rates)									
NFA 1/	...	25.2	138.5	5.2	53.4	210.7	257.7	25.2	64.4	205.8
Gross official reserves 2/	...	88.3	386.4	132.3	365.3	514.6	563.6	216.3	440.3	509.7
	(End-period cumulative percentage change from year-beginning)									
Memorandum item:										
Retail prices (end period)	113.5	21.7	23.1	26.4	28.0	31.2	34.4	35.0	35.0	40.0

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

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

25. **The discussion on exchange rate policy focused on the trade off between safeguarding external competitiveness and stabilizing inflation expectations.** The monetary authorities and the staff agreed that the current level of the exchange rate remained broadly appropriate, especially in light of the persisting BOP surpluses. However, the mission cautioned about the risks to the external position from a continued real appreciation of the dinar, especially since a loss of competitiveness is reflected in trade flows with a considerable lag. For their part, the monetary authorities reiterated their concerns about the effects on market confidence of even a gradual depreciation before reforms have taken hold. Moreover, it was noted that, given the relatively low level of average wages (DM 200 per month), efforts to enhance the profitability of the traded goods sector should concentrate on increasing productivity through enterprise restructuring rather than on exchange rate depreciation that was likely to be eroded through higher wage and price inflation. In the event, it was agreed that the NBY will continue to monitor the underlying movements in NFA (i.e., adjusted for net autonomous inflows) and stand ready to adjust the exchange rate as needed to safeguard the external position.

26. **In line with MAE recommendations, the authorities have undertaken to further liberalize the foreign exchange market, reform monetary policy instruments, and develop a financial market.** A new foreign exchange law—to be adopted by end-March 2002—and a number of interim measures would allow commercial banks to operate more actively in the foreign exchange market (¶23). The reserve requirements system will be reformed by end-January 2002, through a widening of the deposit base to include foreign currency as well as dinar deposits, the adoption of a lower unified reserve requirement ratio, and the introduction of an averaging system. The authorities also committed to develop the nascent financial market, which will facilitate the privatization process, open an alternative source for budget financing, and provide instruments for monetary operations (¶24). In the area of payments reform, following considerable delays, the authorities have undertaken to intensify their efforts with a view to introducing a modern payments system by January 1, 2003.

27. **The NBY has undertaken to improve its accounting, audit, and control systems.** Under the Fund's safeguards assessment policy, an on-site assessment of the NBY was conducted during October 2001. The assessment identified vulnerabilities and proposed remedies that have been endorsed by the authorities (Box 2). Specifically, the NBY will take measures to improve the accounting treatment of unresolved issues of succession to the former Yugoslavia; prepare financial statements on the basis of International Accounting Standards on an expeditious basis; strengthen the functioning of the Internal Audit Department; and improve the organizational structure of the NBY (¶25).

Box 2. Safeguards Assessment—Summary of Conclusions

Safeguards assessment

An on-site assessment of the NBY was conducted during October 2001. The assessment received full cooperation from the authorities, and the Governor of the central bank agreed to all the remedies proposed for vulnerabilities by the staff. The vulnerabilities and remedies are as follows:

Vulnerabilities

The vulnerabilities identified include: (i) preparation of two sets of financial statements, one based on local accounting standards, and a second broadly based on, but not fully compliant with, International Accounting Standards (IAS), of which neither is currently published;
(ii) contradictory results of the two accounting frameworks that reflect a series of unresolved succession issues among the five republics of the former Socialist Federal Republic of Yugoslavia (SFRY); (iii) unreconciled balances of audited financial statements and Net Foreign Assets (NFA) data for end-December 2000 submitted to the IMF under program conditionality; (iv) inability of the external auditors to express an opinion on the financial statements; (v) lack of a decision-making authority above the Governor and an oversight body for the external and internal audit functions, such as an audit committee; and (vi) lack of a properly functioning Internal Audit Department (IAD).

Remedies under program conditionality

The NBY agreed to: (i) prepare financial statements based on IAS; (ii) adopt IAS as its permanent accounting framework, effective with the 2003 financial year; (iii) publish the IAS-based 2001 financial statements, and (iv) commit to address the accounting treatment of unresolved succession issues.

The NBY also committed to amend the Law to: (i) adopt IAS as the permanent accounting framework; and (ii) provide for a Supervisory Board (the By-laws of the NBY will define the establishment of an Audit Committee).

The NBY committed to organize a properly functioning IAD by: (i) defining its role with the development of a charter and ensuring an appropriate degree of independence and objectivity; (ii) continuing to recruit additional staff with skill levels necessary to successfully conduct financial and information system risk-based audits; and (iii) commissioning an independent assessment of the IAD. The NBY's Internal Audit Department will review the reconciliation of the accounting records and the NFA data submitted to the Fund for program purposes on a monthly basis, as part of its regular audit cycle.

E. Bank Restructuring

28. **The NBY has made important progress in bank restructuring in line with its Bank Restructuring Strategy.** Starting in late 2000, the new NBY management undertook a comprehensive evaluation of the financial position of the commercial banks in Serbia with a view to redressing deficiencies in the largely insolvent and illiquid banking system. In May 2001, the NBY adopted a bank restructuring strategy, in line with Fund and World Bank

recommendations, and immediately began its implementation. As of end-November 2001, out of 71 banks on the territory of Serbia, some 45 banks accounting for about 30 percent of the book value of total banking assets had been categorized either as healthy (category A, Text Table 4) or as solvent but undercapitalized and placed under enhanced NBY supervision (category B). The remaining 26 banks, accounting for 70 percent of the book value of banking assets, had been categorized as insolvent and had been either placed under the control of the Bank Rehabilitation Agency (BRA), pending their rehabilitation or liquidation (category C), or put in liquidation (category D).

Text Table 4. Republic of Serbia: Status of Commercial Banks
(In millions of DM)

		Book Value of Assets		Deposits		
	No. of Banks	DM Million	% of Total Assets	Total Deposits	% of Total Deposits	No. of Employees
A (healthy)	29	3,062	13	1,096	30	4,617
of which: Foreign 2/	5	128	0.5	63	2	210
B (solvent but under-capitalized; under enhanced NBY supervision)	16	4,415	19	784	21	8,803
Subtotal (A+B)	45	7,477	32	1,780	51	13,420
C (insolvent; under BRA control)	7	14,277	60	1,632	44	10,460
D (insolvent; in liquidation)	19	2,073	9	174	5	2,490
Total (A+B+C+D)	71	23,827	100	3,687	100	26,370
(in percent of GDP)		108		17		

Sources: Yugoslav authorities; and IMF staff estimates.
Note: Banks in Kosovo are not included.
1/ Financial data as of June 2001; excluding a small number of banks under liquidation, of which data is as of December 31, 2001. Around 90 percent of the assets of banks in categories C and D are nonperforming.
2/ Data is provided only for three foreign banks actively operating in June 2001.

29. **The Bank Rehabilitation Agency (BRA) has assessed the financial position and viability of the five large banks under its supervision.** The BRA Board, on the recommendations of the NBY, has appointed new managers, recognized the losses on bad loans, written off the equity capital, and established the BRA as the exclusive owner of these five banks. A balance-sheet analysis confirmed that the banks are deeply insolvent. In addition the BRA compiled detailed information on income, expenses, and cash flow of these banks and their liquidity positions, confirming unsustainable operating losses and liquidity difficulties. Based on this analysis, the authorities have decided to resolve the problems in these banks in an expeditious and fiscally prudent manner. Meanwhile, bank liquidation and

supervision procedures are being strengthened through amendments to federal legislation and the adoption of regulations and other measures by the NBY (¶35).

30. **The Central Bank of Montenegro (CBM) is also making progress in restructuring banks and strengthening its supervision capacity** (¶28-29). Assisted by bilateral donors, diagnostic reports of all 11 banks in Montenegro have been completed. On this basis, four banks have been re-licensed and decisions are pending on the remaining banks.

F. Enterprise Restructuring and Privatization

31. **The privatization process in Serbia is picking up momentum.** Following the adoption in mid-2001 of a new privatization law—which mandated sales to strategic investors through transparent tender and auction procedures and abolished the privileged treatment of employees and management—the Privatization Agency has proceeded with preparations for privatization through international tenders of some 30 large socially-owned enterprises, including three cement companies, albeit with some delays (¶30).[9] Another 30 medium-sized companies will be offered for sale through auctions during 2002. The Privatization Ministry expects to generate receipts of some US$200–400 million (1.7–3.4 percent of GDP) from privatization sales in 2002. The remaining 4,000 small and medium-sized socially-owned companies are expected to conduct their own privatization under the supervision of the Privatization Agency; the authorities intend to foster interest in the process by publishing basic information on some 500 of these companies in 2002. In addition, some 30 economic conglomerates—employing over 200,000 people or 9½ percent of total employment—will be restructured over the next two years prior to their privatization.

32. **Montenegro is pursuing a dual approach to privatization.** Under the mass privatization plan that is envisaged to apply to minority stakes in over 200 enterprises, vouchers were distributed to the public in September, privatization investment funds have been licensed, and shareholder meetings are expected to be held in January to appoint new company directors (¶32). Investor interest in sales of majority interest to strategic investors on the basis of international tenders is mainly concentrated in the telecommunications and other service sectors, especially tourism.

IV. Staff Appraisal

33. **Excellent policy implementation under the Fund-supported program has started to yield positive economic results.** However, the reconstruction of FRY's devastated

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[9] Under the previous privatization law of 1997, about 800 socially-owned enterprises, employing 200,000 workers, were privatized through management/employee buyouts. Still to be privatized are 8 large state-owned enterprises (mainly public utilities) employing another 200,000 workers and over 4,000 socially-owned enterprises employing 1.1 million workers. (This compares with total employment of 2.1 million in Serbia, of which 0.4 million is accounted for by the government, 0.4 million by the private sector, and the remainder by state and socially-owned enterprises.)

economy will be a lengthy and difficult process, requiring strong resolve from the authorities and continued support from the international community.

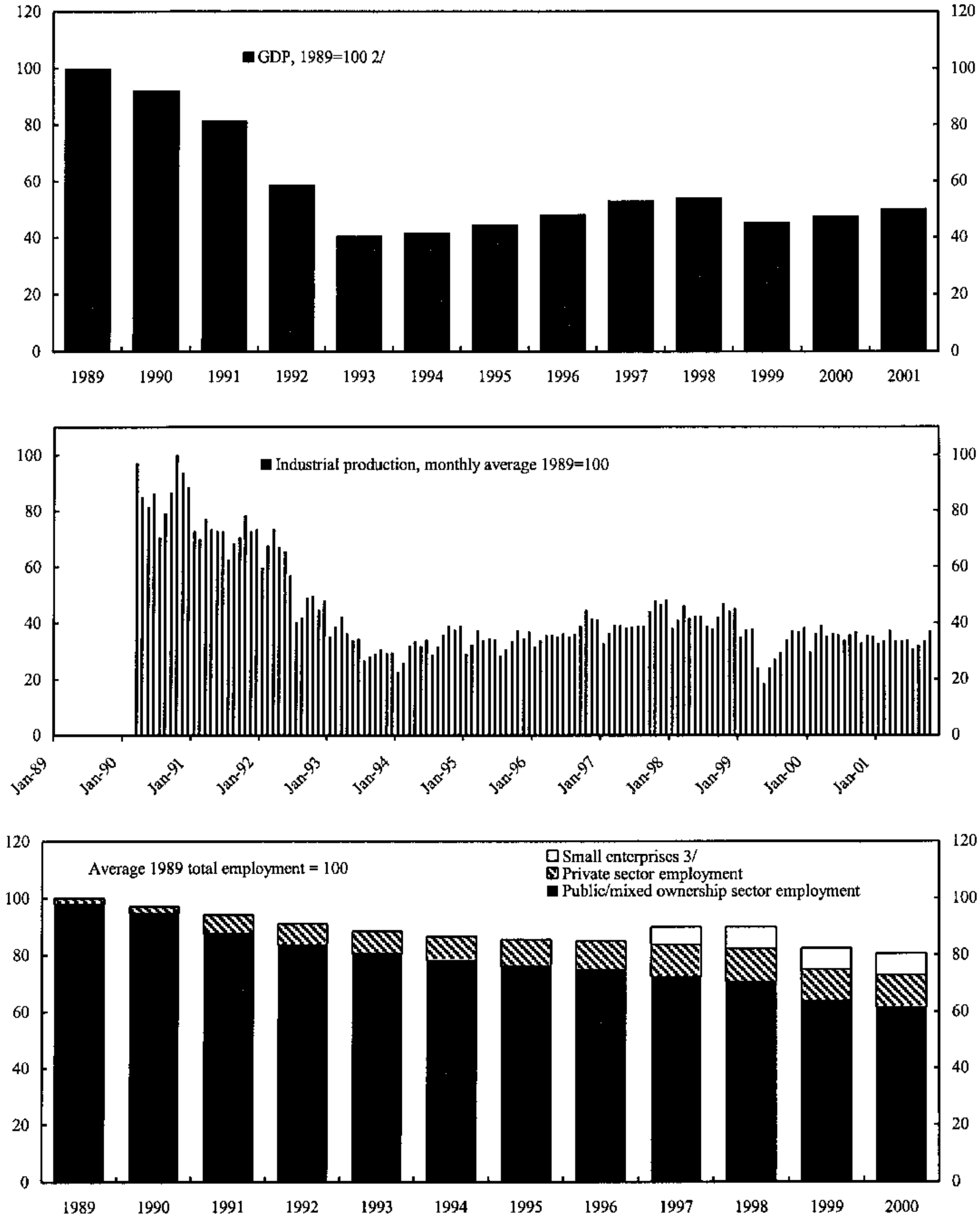
34. **Important progress has been made in stabilization and structural reform over the past year.** Inflation has declined sharply; confidence in the dinar has strengthened; and output is rising. Good economic performance has been made possible by the firm implementation of policies, as evidenced by overperformance with respect to the programmed policy targets for FRY as a whole. In Montenegro, which accounts for a small share of the FRY economy, the fiscal position has improved somewhat since mid-year, but fiscal discipline and transparency remain weak. On the structural policy front, a legal and institutional framework is now in place in FRY to guide bank restructuring and enterprise privatization.

35. **While the authorities' record of policy implementation has been impressive, the risks to FRY's economic reform effort are considerable.** Owing to the extremely difficult initial conditions—especially the largely insolvent banking and enterprise sectors and a dilapidated infrastructure—bold policies, as well strong donor and creditor support, will be needed to ensure sustainable growth and external viability. In particular, economic restructuring will increasingly require decisions on closures and redundancies in banks and enterprises, with difficult social and political implications. Against this background, donor and creditor support will be essential to mitigate the burden of transition and permit the authorities to maintain broad support for their reform policies.

36. **The authorities have adopted an economic policy framework for 2002 that is supportive of further progress in stabilization and reform.** The fiscal program is designed to support economic recovery and reconstruction through reliance on foreign assistance and privatization proceeds, while containing inflationary pressures and crowding out by limiting domestic borrowing. Along with firm credit policies, wage restraint in the state sector will help lower inflation, in part through its demonstration effect in the rest of the economy. The fiscal program will be supported by a bold pension reform to put the financing of the pensions on a more sustainable basis, through a significant and immediate increase in the retirement age and a change in the indexation method. In light of the continuing real appreciation of the dinar, the NBY will need to monitor closely developments in the foreign exchange market and adjust the exchange rate as needed to protect the external position and avoid exit problems. On the basis of foundations set in 2001, bank restructuring and enterprise privatization should accelerate in 2002.

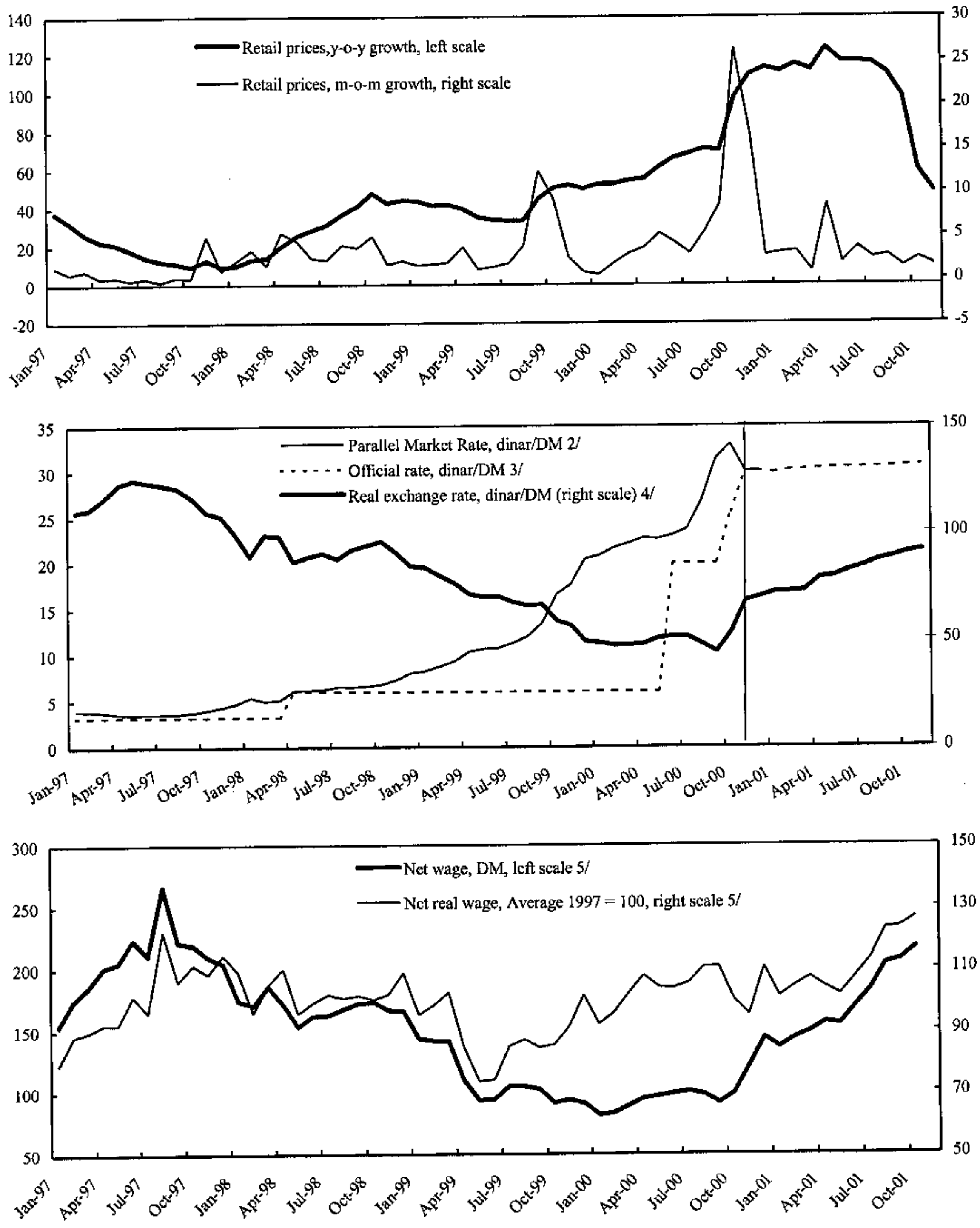
37. **The staff recommends completion of the second review and waiver of applicability of end-December 2001 performance criteria.** The FRY authorities have adhered firmly to implementation of the program and have made remarkable progress in stabilization and reform over the past year. Moreover, they have adopted a policy framework for 2002, including key parameters of budgetary policy, that are consistent with further progress toward sustainable growth and a viable external position. While fiscal policy implementation and transparency problems in Montenegro remain a source of concern, the staff notes that the Montenegrin authorities have undertaken to address these concerns through a newly-introduced Treasury within the Finance Ministry and other organizational measures.

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



Sources: Federal Institute of Statistics and National Bank of Yugoslavia.
1/ Data before 1991 refer to the territory of the Republics of Serbia and Montenegro; after February 1999 indicators refer to the territory excluding Kosovo.
2/ Growth rates for 1990-94 refer to Gross Social Product (GSP), which is about 15-20 percent smaller than GDP as it excludes public and other services.
3/ In 1997 the official statistics begun to track employment in small enterprises excluded from other surveys.

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



Sources: Federal Institute of Statistics; National Bank of Yugoslavia; and Fund staff calculations.

1/ Data after February 1999 exclude Kosovo.

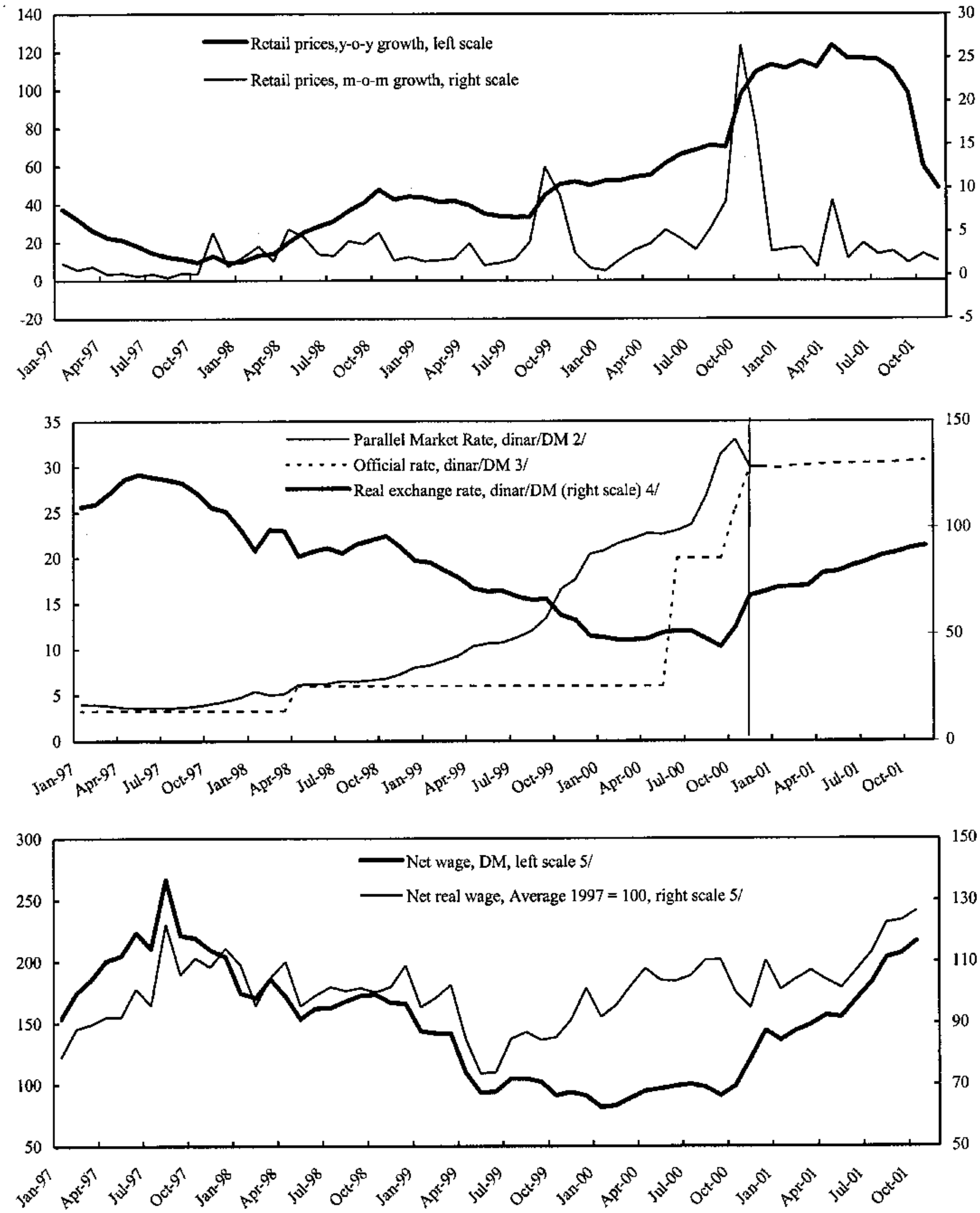
2/ Difference between official and parallel market rates are negligible in December 2000.

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

4/ Real index obtained by applying the FRY retail price index and the German CPI to the average parallel market rate, and since December 2000 the official exchange rate. Increase denotes appreciation.

5/ Owing to a change in the definition of wages to include fringe benefits, the level of wages may be overestimated from June 2001.

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



Sources: Federal Institute of Statistics; National Bank of Yugoslavia; and Fund staff calculations.

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5/ Owing to a change in the definition of wages to include fringe benefits, the level of wages may be overestimated from June 2001.

Table 1. Federal Republic of Yugoslavia (Serbia/Montenegro): Selected Economic and Financial Indicators, 1998-2002 1/

	1998	1999	2000	2001 Prog. Orig. Prog.	2001 Prog. First Review	2001 Prog. Second Review	2002 Prel. Proj.
Real economy							
GDP, in billions of YUD	146.3	192.9	358.1	678.5	693.3	699.6	909.5
GDP, in millions of US dollars	13,889	10,155	8,071	10,231	10,045	10,537	12,078
Average net real wage, 1997 =100	102	88	103	103	104 2/	113 2/	...
Average net wage in DM, at gray market exchange rates	169	109	99	149	161 2/	179 2/	...
				(Percent change)			
Real GDP	1.9	-15.7	5.0	5.0	5.0	5.5	4.0
Industrial production	3.6	-22.5	10.9	0.0	0.0	0.0	2.2
Retail prices (annual average)	29.8	42.4	71.8	86-89	89.0	91.3	25.9
Retail prices (end of period)	...	49.9	113.5	30-35	35.0	40.0	20.0
Unemployment rate (in percent) 3/	25.1	26.5	27.3	...	...	27.8	...
				(Percent of GDP)			
General government finances 4/							
Revenue	...	...	38.8	39.9	39.8	41.9	43.5
Expenditure	...	...	39.7	46.0	43.8	44.2	49.7
Cash balance	...	...	-0.9	-6.1	-4.0	-2.4	-6.2
Foreign grants	...	...	0.8	1.2	1.2	0.9	1.2
Foreign loans	...	...	0.0	2.9	1.6	0.9	3.0
Privatization receipts	...	...	0.0	1.4	0.4	0.0	1.4
Domestic financing	...	...	0.2	0.6	0.8	0.5	0.6
Commitment balance 5/	...	...	-3.0	-6.1	-4.0	-2.4	-6.2
				(Percent change)			
Money supply (end-of-period) 6/							
M1	...	47.3	85.1	36.0	60.2	97.5	...
M2	...	67.6	61.4	20.4	29.3	58.7	...
Balance of payments				(In billions of U.S. dollars)			
Merchandise exports	3.0	1.7	1.9	2.1	2.0	2.0	2.2
Merchandise imports	-4.8	-3.3	-3.7	-4.5	-4.5	-4.5	-4.9
Trade balance	-1.9	-1.6	-1.8	-2.4	-2.5	-2.5	-2.7
Current account balance, after grants	-0.7	-0.8	-0.3	-0.8	-0.7	-0.5	-1.0
(In percent of GDP)	-5.0	-7.5	-4.2	-8.2	-7.0	-5.0	-8.1
Current account balance, before grants	-0.7	-0.8	-0.6	-1.5	-1.3	-1.1	-1.5
(In percent of GDP)	-5.0	-7.5	-7.6	-14.6	-12.5	-10.2	-12.6
Foreign debt (year-end)	...	...	11.3	12.5	12.2	11.7	8.3
Gross official reserves	...	0.3	0.5	0.7	0.9	1.0	1.4
(In months of imports of goods and services)	...	1.1	1.3	1.7	2.1	2.3	2.8

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

1/ With the exception of foreign debt, data for 1999-2002 exclude Kosovo. GDP excludes Kosovo throughout.
2/ The latest data for 2001 may not be comparable to historical data and program targets for 2001, owing to changes in statistical definitions.
3/ Excludes workers on "forced holiday" (about 20-25 percent of the labor force in recent years).
4/ Fiscal operations of all levels of government, except for Montenegro where it excludes local governments.
5/ Excludes arrears of local governments and most interest payments on foreign debt due but not paid.
6/ From 1999 onwards excludes Montenegro.

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

	1997	1998	1999	2000 Revised	2001 Original Program	2001 Revised Proj.	2002 Proj.
Trade balance	**-2,070**	**-1,736**	**-1,619**	**-1,788**	**-2,441**	**-2,517**	**-2,710**
Exports f.o.b.	2,758	2,996	1,676	1,923	2,064	1,989	2,234
(percent growth)		8.6	-44.1	14.7	7.3	3.4	12.3
Recorded	2,679	2,821	1,497	1,723	1,964	1,889	2,234
Unrecorded	79	175	179	200	100	100	0
Imports f.o.b.	-4,828	-4,732	-3,295	-3,711	-4,506	-4,506	-4,944
(percent growth)		-2.0	-30.4	12.6	21.4	21.4	9.7
Services, net	**456**	**493**	**228**	**331**	**210**	**353**	**404**
Receipts	818	914	471	624	775	725	831
Expenditure	-362	-421	-243	-293	-565	-372	-426
Net factor income	**25**	**8**	**-41**	**-1**	**-152**	**4**	**-314**
of which: Net interest	25	8	-41	11	-152	4	-314
Earnings	59	57	43	53	52	52	66
Payments 1/	-34	-49	-84	-42	-204	-48	-381
Private remittances, net	**310**	**655**	**668**	**848**	**890**	**1,085**	**1,094**
Inflows	662	1,033	948	1,132	1,190	1,520	1,537
Recorded	465	688	501	632	980	1,378	
Unrecorded	197	345	447	500	210	142	
Outflows	-352	-378	-280	-284	-300	-434	-443
Current account balance, before grants	**-1,279**	**-580**	**-764**	**-610**	**-1,493**	**-1,075**	**-1,526**
(In percent of GDP)	-7.7	-4.2	-7.5	-7.6	-14.6	-10.2	-12.6
Official grants	0	0	0	271	650	550	550
Foreign direct investment	740	113	112	25	160	120	300
Foreign loans, net	283	-10	-25	180	588	496	435
Medium and long term, net	54	25	12	213	588	486	417
Disbursements	128	50	29	227	599	497	457
of which: official creditors 2/					529	427	375
Amortization 1/	-74	-25	-17	-14	-11	-11	-40
Short term, net	229	-35	-37	-33	0	10	18
Other capital inflows	139	78	30	49	50	50	50
Capital account balance	**1,162**	**181**	**117**	**255**	**798**	**666**	**785**
Errors and omissions	-103	198	410	267	290	290	290
Overall balance	**-220**	**-201**	**-237**	**183**	**245**	**431**	**99**
Financing	**220**	**201**	**237**	**-183**	**-9,614**	**-9,888**	**-187**
Net foreign assets (increase, -)	18	115	111	-246	-25	-221	-187
Central Bank, net					-25	-221	-187
Gross foreign reserves (increase, -) 3/	18	115	111	-227	-217	-349	-315
of which: IMF purchases				152	128	128	128
Gross foreign liabilities	0	0	0	-19	192	128	128
Commercial banks, net					0	0	0
Arrears (reduction, -) 4/	202	86	126	63	-9,589	-9,667	0
Financing expected						-	-
Official grants						-	-
Official borrowing						-	-
Residual gap					9,369	9,457	88
Arrears settlement with creditors (for 2001) 4/					9,369	9,457	0
Debt relief from creditors (2002 onwards) 5/					0	0	88
Memorandum items:							
Current account balance, after grants	-1,279	-580	-764	-339	-843	-525	-976
(In percent of GDP)	-7.7	-4.2	-7.5	-4.2	-8.2	-5.0	-8.1
Gross international reserves, USD mn (end period) 6/			289	516	733	1,012	1,361
in months of prospective imports of goods & services			0.9	1.3	1.6	2.3	2.8
Debt service, cash	108	74	101	56	215	59	333
(In percent of GDP)	0.7	0.5	1.0	0.7	2.1	0.6	2.8
Principal	74	25	17	14	11	11	40
Interest	34	49	84	42	204	48	293

Sources: National Bank of Yugoslavia and IMF staff estimates.

1/ Up to 2001, figures indicate debt service actually paid. For 2002, 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).

2/ Official disbursements recorded above-the-line are amounts based on already secured commitments.

3/ Reserve accumulation at fixed (Dec. 2000) exchange rates and excluding US$161.5 mn on account of the distribution of BIS-related inflows.

4/ Of the US$9667 million arrears total, US$9457 million is expected to be cleared through arrears settlement agreements with external creditors; around US$210 million of arrears (owed to the EIB) were paid fully in 2001 from official financing funds.

5/ Represents a 60 percent capitalization of moratorium interest due to bilateral and commercial creditors, as per Nov. 2001 Paris Club agreement.

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

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

	Creditor	Total Debt	*Of which:* Arrears			
			Principal	Interest	Late Interest	Total Arrears
I.	Total stock of outstanding debt	11,304	5,436	1,519	2,462	9,667
	Of which : Medium and long-term debt	10,088	4,935	1,519	2,462	9,166
II.	Multilateral creditors	2,488	1,157	354	557	2,068
	IMF	152	0	0	0	0
	IBRD	1,781	1,004 1/	263	436	1,703
	Eurofima	126	0	0	0	0
	IFC	132	71	9	52	132
	EIB	257	54	74	65	193
	Other	40	28	8	4	40
III.	Official bilateral creditors	4,736	2,408	393	1,528	4,329
	Paris Club	4,540	2,372	393	1,528	4,293
	Pre-cutoff (1982) debt	3,420	1,880	304	1,206	3,390
	Previously rescheduled	2,386	1,299	269	818	2,386
	Previously not rescheduled	1,034	581	35	388	1,004
	Post-cutoff (1982) debt	1,004	492	89	322	903
	Other bilateral creditors (largely post-1992)	196	36	0	0	36
IV.	Commercial creditors	2,864	1,370	772	377	2,518
	London Club 2/	1,997	811	745	124	1,679
	Other commercial creditors: convertible currencies	682	350	27	253	630
	Other commercial creditors: non-convertible currencies	185	209	0	0	209
V.	Short-term debt	1,216	501	0	0	501
	Trade arrears related to oil and gas imports 3/	553	501	0	0	501
	Other short-term debt	663	0	0	0	0

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

1/ Including exchange rate adjustments.

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

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

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

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

	1999	2000				2001									
	Dec.	Mar.	June	Sep.	Dec.	Mar.	June		Sep.			Oct.	Dec.		
							Original Program	Actual	Original Program	First Review	Actual		Original Program	First Review	Second Review
Net foreign assets of the NBY 1/	163	125	238	239	364	457	389	525	369	440	589	638	389	451	584
Net foreign assets of the NBY for program purposes	-552	-567	-451	-406	-309	-231	-283	-170 2/	-303	-255 2/	-98	-51	-283	-244	-103 2/
Gross foreign assets	293	255	369	368	516	608	605	741	649	720	869	918	733	795	864
Gold	139	134	141	135	125	126	...	127	...	...	128	128	...	...	...
Foreign currencies	100	93	108	145	240	178	...	236	...	...	247	268	...	...	...
Foreign exchange accounts abroad	55	29	120	88	151	404	...	378	...	...	494	522	...	...	...
Reserve-related liabilities (-)	130	130	131	129	152	152	216	216	280	280	280	280	344	344	280
Gross reserve liabilities for program purposes (-)	844	822	820	774	825	840	888	911	952	975	967	969	1,016	1,039	967
IMF	130	130	131	129	152	152	216	216	280	280	280	280	344	344	280
Other	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Adjustments for program purposes	714	693	689	645	672	688	672	695	672	695	687	689	672	695	687
Foreign currency liabilities to domestic banks	714	693	689	645	672	688	...	695	...	...	687	689	...	...	...
Loan from China deposited by Yugoslav bank	...	...	...	99	100	100	...	100	...	...	100	100	...	...	...
Forex deposits from commercial banks	...	...	...	63	61	66	...	57	...	...	54	57	...	...	...
Unpaid interest	...	...	...	68	70	70	...	70	...	...	70	70	...	...	...
Short-term loan from commercial banks	...	...	...	0	11	12	...	10	...	...	0	0	...	...	...
Minimum reserve and other deposits	...	...	...	96	105	115	...	133	...	...	138	137	...	...	...
Old obligations commercial banks	...	...	...	319	325	325	...	325	...	...	325	325	...	...	...
Foreign currency liabilities to nonbank non-government residents	0	0	0	0	0	0	...	0	...	...	0	0	...	...	...
Net foreign assets of commercial banks of Serbia	366	333	373	384	366	351	366	371	366	371	467	512	366	371	530

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

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

2/ Program floor.

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

(In millions of dinars; end of period)

	1999	2000				2001													
	Dec.	Mar.	June	Sep.	Dec.	Mar.	June		Sep.				Oct.		Nov		Dec.		
							Original Program	Actual	Original Program	First Review	Actual EoP	Actual Avg.	Actual EoP	Actual Avg.	EoP	Avg	Original Program	First Review	Second Review
Net foreign assets	-22,549	-26,135	-21,231	-27,167	-19,501	-14,618	-17,879	-10,751 2/	-19,142	-16,127 2/	-6,190	-6,228	-3,221	-1,535	-2,959	-2,944	-17,879	-15,433	-6,502 2/
Net foreign assets in DM million	-1,074	-1,162	-923	-906	-650	-487	-596	-358	-638	-538	-206	-208	-107	-51	-99	-98	-596	-514	-217
Gross foreign assets 3/	11,975	11,751	17,375	24,628	32,587	38,430	38,197	46,793	40,977	45,459	54,891	51,758	57,986	58,725	58,249	58,264	46,282	50,197	54,579
Gross reserve liabilities (-) 4/	-34,524	-37,886	-38,606	-51,795	-52,088	-53,048	-56,076	-57,544	-60,119	61,587	-61,081	-57,986	-61,208	-60,260	-61,208	-61,208	-64,161	65,629	61,081
Net domestic assets	32,016	36,085	32,085	41,389	39,347	34,289	39,064	35,770 5/	41,766	43,185 5/	37,329	35,508	37,202	33,487	36,427	36,614	42,909	44,328	41,351 5/
Domestic credit	107,968	120,412	124,285	167,691	153,611	147,955	...	147,616	...	...	149,664	...	150,644	...	...	...	...	...	...
Net claims on government	5,096	6,415	6,344	8,781	5,480	1,644	...	2,628	...	...	6,072	...	5,334	...	...	...	...	...	...
Claims	6,713	8,083	8,675	11,162	11,424	11,433	...	11,433	...	...	14,715	...	15,307	...	...	...	...	...	...
Dinar credits	1,652	2,364	2,685	2,691	3,071	3,187	...	3,103	...	...	6,299	...	6,833	...	...	...	...	...	...
Foreign currency credits	5,060	5,720	5,990	8,472	8,353	8,246	...	8,330	...	...	8,416	...	8,474	...	...	...	...	...	...
Liabilities (-)	-1,617	-1,668	-2,331	-2,381	-5,944	-9,789	...	-8,805	...	...	-8,643	...	-9,973	...	...	...	...	...	...
Dinar liabilities	-547	-498	-1,145	-702	-1,462	-3,608	...	-3,591	...	...	-2,528	...	-2,363	...	...	...	...	...	...
Foreign currency liabilities	-1,070	-1,170	-1,186	-1,680	-4,482	-6,181	...	-5,214	...	...	-6,115	...	-7,610	...	...	...	...	...	...
Net claims on banks	100,214	111,013	115,110	154,894	144,932	143,171	...	142,085	...	...	140,887	...	142,414	...	...	...	...	...	...
Claims	100,677	111,488	115,404	155,964	145,603	144,423	...	144,293	...	...	143,985	...	145,073	...	...	...	...	...	...
Recourse to required reserves	866	859	1,023	1,521	1,174	882	...	1,017	...	...	847	...	1,821	...	...	...	...	...	...
Other dinar credits	4,120	3,357	3,224	3,322	3,364	3,401	...	3,346	...	...	3,144	...	3,163	...	...	...	...	...	...
Foreign currency credits	95,690	107,271	111,157	151,121	141,065	140,140	...	139,930	...	...	139,994	...	140,089	...	...	...	...	...	...
Foreign currency credits in DM million	4,557	4,768	4,833	5,037	4,702	4,671	...	4,664	...	...	4,666	...	4,670	...	...	...	...	...	...
Liabilities (-)	-463	-475	-294	-1,070	-671	-1,252	...	-2,208	...	...	-3,098	...	-2,659	...	...	...	...	...	...
of which: stock of NBY bills	0	0	0	0	-86	-343	...	-1,372	...	...	-2,700	-2,761	-2,578	-2,888	-2,387	-2,864	...	...	...
Net claims on the rest of the economy	2,658	2,984	2,832	4,016	3,199	3,140	...	2,903	...	...	2,705	...	2,896	...	...	...	...	...	...
Claims	2,785	3,095	3,106	4,178	3,660	3,559	...	3,702	...	...	3,493	...	3,454	...	...	...	...	...	...
Dinar credits	2,663	2,957	2,963	3,981	3,457	3,358	...	3,503	...	...	3,291	...	3,252	...	...	...	...	...	...
Foreign currency credits	123	137	143	197	203	201	...	199	...	...	202	...	202	...	...	...	...	...	...
Liabilities (-)	-127	-111	-274	-161	-461	-419	...	-799	...	...	-788	...	-558	...	...	...	...	...	...
Dinar deposits	-127	-111	-274	-161	-461	-419	...	-799	...	...	-788	...	-558	...	...	...	...	...	...
Other assets, net	-75,951	-84,327	-92,200	-126,302	-114,264	-113,666	...	-111,846	...	...	-112,335	...	-113,441	...	...	...	...	...	...
Reserve money	9,467	9,950	10,854	14,222	19,846	19,907	21,186	25,019	22,624	27,057	31,139	29,279	33,981	31,952	*33,468*	*33,670*	25,030	28,895	34,849
Currency in circulation	6,688	6,203	7,159	9,026	10,933	11,258	12,100	14,318	13,100	15,853	17,563	16,258	18,911	18,267	*20,471*	*19,010*	14,869	17,493	20,773
Reserve deposits	2,779	3,747	3,695	5,196	8,912	8,649	9,086	10,701	9,524	11,204	13,576	13,022	15,070	13,685	12,997	14,661	10,160	11,402	14,075
Required reserves held 6/	1,217	1,656	1,723	2,569	3,650	4,730	5,886	6,041	6,124	7,727	7,988	7,566	8,073	7,998	*8,111*	*8,378*	6,560	8,030	11,596
Shortfall in required reserves 6/	866	859	1,023	1,521	1,174	882	0	1,017	0	0	847	811	1,821	1,112	*1,481*	*1,499*	0	0	0
Excess reserves 7/	696	1,231	948	1,106	4,088	3,037	3,200	3,643	3,400	3,477	4,741	4,645	5,176	4,576	*3,405*	*4,785*	3,600	3,371	2,479
Memorandum items: (12-months growth rates, unless otherwise indicated)																			
Reserve money, nominal 8/	26.0	28.0	27.9	66.9	109.6	78.9	95.6	104.6	59.1	90.7	119.4	111.9	138.2	123.6	112.9	132.2	26.1	45.6	75.6
Reserve money, real 8/	-15.9	-14.6	-20.1	5.2	-1.8	-19.1	-11.6	-42.6	-17.5	-2.1	10.1	6.4	47.6	38.6	51.8	65.6	-4.8	7.9	25.4
Currency in circulation, nominal	32.3	23.8	30.6	57.5	63.5	81.5	69.0	100.0	45.1	75.6	94.9	89.3	131.5	106.6	124.5	135.1	36.0	60.0	90.0
Currency in circulation, real	-11.8	-17.4	-18.4	-0.7	-23.4	-17.9	-23.5	-9.0	-24.7	-8.2	-2.1	-5.0	43.5	28.0	60.1	67.7	7.0	18.5	35.7
Currency in circulation, monthly average, nominal	...	46.5	28.4	50.6	41.5	76.6	...	90.8	...	...	89.3	...	106.6	...	135.1	...			
Currency in circulation, monthly average, real	...	-2.2	-19.8	-5.0	-33.7	-18.8	...	-13.2	...	...	-5.0	...	28.0	...	67.7	...	...	...	...
Required reserves, including shortfall, nominal 8/	2.7	12.7	33.1	130.4	131.6	45.0	51.9	82.1	49.7	88.9	137.0	...	134.2	...	158.1	...	36.0	66.5	140.4
Required reserves, including shortfall, real 8/	-31.5	-24.8	-16.8	45.3	8.5	-34.4	-3.0	-17.1	-24.7	-2.7	19.0	...	45.1	...	84.0	...	6.1	23.3	71.7
Excess reserves, nominal	62.4	131.4	1.1	8.8	487.4	146.6	237.5	284.2	207.5	214.5	343.6	...	158.9	...	126.3	...	-11.9	-17.5	-39.4
Excess reserves, real	8.4	54.5	-36.8	-31.4	175.1	11.6	52.8	74.8	59.5	61.9	122.7	...	60.5	...	61.4	...	-31.3	-38.9	-56.7
Excess reserves as a share of quarterly GDP (percent)	1.18	1.87	1.27	1.27	3.04	2.00	1.9	2.2	1.91	2.0	3.1	...	3.0	...	2.0	...	1.9	1.8	1.3
Cash in circulation as share of quarterly GDP (percent)	11.37	9.41	9.60	10.40	8.14	7.41	7.0	8.6	7.38	8.9	11.4	...	10.8	...	12.2	...	7.8	9.1	10.8
Stock of NBY bills as share of reserve money (percent)	0.00	0.00	0.00	0.00	0.43	1.72	...	5.49	...	...	8.67	9.43	7.59	9.04	7.13	8.50	...	...	...

Sources: National Bank of Yugoslavia; 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 end-2000 (program) exchange rates thereafter.
2/ Program floor.
3/ Exclude frozen assets and liabilities of FRY; undivided assets of SFRY; and BIS gold and foreign currency deposits allocated to FRY in June 2001.
4/ Exclude long-term liabilities and undivided liabilities of the SFRY. Including foreign-currency denominated liabilities to resident banks and non-government residents.
5/ Program ceiling. It will be monitored as a monthly average as defined in the Technical Memorandum of Understanding from September 2001 onwards.
6/ Reserves that banks are required to hold in NBY account 201 to satisfy the standard 24.5 percent reserve requirement.
7/ Comprises balances in Giro accounts and cash in commercial bank vaults.
8/ Figures in 2001 are adjusted for lower reserve requirements and exemptions in early 2000.

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

(In millions of dinars; end of period)

	1999	2000				2001									
	Dec.	Mar.	June	Sep.	Dec.	Mar.	June		Sep.			Oct	Dec.		
							Original Program	Actual	Original Program	First Review	Second Review		Original Program	First Review	Second Review
Net Foreign Assets 1/	21,596	21,093	28,765	41,663	46,058	51,015	47,675	56,571	46,411	51,195	66,703	72,641	47,675	51,889	70,371
(NFA in DM m.)	1,028	937	1,251	1,389	1,535	1,701	1,589	1,886	1,547	1,706	2,223	2,421	1,589	1,730	2,346
Assets	26,921	27,068	34,916	50,300	55,681	60,601	61,303	70,215	64,083	68,881	84,390	90,327	69,389	73,618	88,057
NBY	11,975	11,751	17,375	24,628	32,587	38,430	38,197	46,793	40,977	45,459	54,891	57,986	46,282	50,197	54,579
Commercial banks	14,947	15,317	17,540	25,672	23,093	22,171	23,106	23,422	23,106	23,422	29,498	32,341	23,106	23,422	33,478
Liabilities (-) 2/	-5,325	-5,975	-6,151	-8,636	-9,623	-9,586	-13,628	-13,644	-17,671	-17,686	-17,686	-17,686	-21,714	-21,729	-17,686
NBY	-5,325	-5,975	-6,151	-8,636	-9,623	-9,586	-13,628	-13,644	-17,671	-17,686	-17,686	-17,686	-21,714	-21,729	-17,686
Net Domestic Assets	18,991	21,675	17,765	18,306	19,464	16,317	24,604	18,513 3/	28,226	29,198 3/	22,969	24,634	31,226	32,831	33,602 3/
Domestic credit	133,017	152,501	159,805	210,846	218,642	215,620	...	216,785	...	...	223,527	225,288	...	...	...
Net credit to government	6,869	7,627	6,962	10,066	5,917	1,583	7,917	1,382 3/	9,917	11,336 3/	3,302	2,269	9,917	11,336	11,336 3/
Credit	10,521	11,645	12,363	15,347	15,367	14,710	...	15,056	...	...	18,242	18,824	...	...	...
Dinar credit	4,573	4,926	5,339	5,446	5,521	5,052	...	4,750	...	...	8,225	8,767	...	...	...
NBY	1,652	2,364	2,685	2,691	3,071	3,187	...	3,103	...	...	6,299	6,833	...	...	...
Commercial banks	2,921	2,562	2,654	2,756	2,450	1,865	...	1,647	...	...	1,926	1,934	...	...	...
Foreign currency credits	5,948	6,719	7,024	9,901	9,846	9,658	...	10,306	...	...	10,017	10,057	...	...	...
NBY	5,060	5,720	5,990	8,472	8,353	8,246	...	8,330	...	...	8,416	8,474	...	...	...
Commercial banks	887	999	1,034	1,429	1,493	1,412	...	1,976	...	...	1,601	1,583	...	...	...
Deposits	-3,652	-4,018	-5,402	-5,281	-9,450	-13,127	...	-13,674	...	...	-14,940	-16,555	...	...	...
Dinar credit	-2,448	-2,625	-3,854	-3,324	-4,745	-6,771	...	-8,271	...	...	-8,512	-8,620	...	...	...
NBY	-547	-498	-1,145	-702	-1,462	-3,608	...	-3,591	...	...	-2,528	-2,363	...	...	...
Commercial banks	-1,901	-2,127	-2,709	-2,622	-3,282	-3,163	...	-4,680	...	...	-5,984	-6,257	...	...	...
Foreign currency deposits	-1,204	-1,393	-1,548	-1,958	-4,705	-6,356	...	-5,403	...	...	-6,428	-7,935	...	...	...
NBY	-1,070	-1,170	-1,186	-1,680	-4,482	-6,181	...	-5,214	...	...	-6,115	-7,610	...	...	...
Commercial banks	-134	-223	-361	-278	-223	-175	...	-189	...	...	-313	-325	...	...	...
Credit to the non-government sector	126,148	144,874	152,844	200,780	212,725	214,037	...	215,403	...		220,225	223,019	...	...	...
Households	1,663	2,063	2,687	3,178	2,684	2,344	...	3,494	...	...	4,581	4,914	...	...	...
Non-profit and other sectors	3,662	7,130	7,037	8,184	24,409	24,828	...	26,280	...	...	27,267	28,054	...	...	...
Enterprises in dinar	20,719	23,118	25,334	28,674	31,189	34,468	...	37,593	...	...	39,405	41,631	...	...	...
Enterprises in foreign currency	100,104	112,563	117,786	160,744	154,444	152,397	...	148,036	...	...	148,972	148,420	...	...	...
Enterprises in foreign currency (DM million)	4,767	5,003	5,121	5,358	5,148	5,080	...	4,935	...	...	4,966	4,947	...	...	...
Other items, net	-114,026	-130,826	-142,041	-192,539	-199,177	-199,303	...	-198,272	...	...	-200,558	-200,654	...	...	...
Broad Money (M2)	40,587	42,768	46,530	59,970	65,522	67,538	72,279	75,084	74,637	80,393	89,672	97,275	78,901	84,720	103,973
Dinar-denominated M2	18,229	19,277	21,054	25,752	32,588	35,244	38,521	43,543	40,591	48,236	54,485	59,341	44,319	51,497	63,288
M1	14,552	15,476	17,208	21,078	26,954	28,875	31,648	36,591	33,440	40,579	45,995	49,979	36,658	43,191	53,242
Currency outside banks	6,688	6,203	7,159	9,026	10,932	11,257	12,100	14,318	13,100	15,853	17,563	18,911	14,869	17,493	20,773
Demand deposit	7,864	9,273	10,049	12,051	16,022	17,618	19,548	22,273	20,340	24,726	28,432	31,068	21,789	25,697	32,469
Time and savings deposits	3,677	3,801	3,846	4,675	5,633	6,369	6,873	6,952	7,152	7,656	8,490	9,362	7,661	8,306	10,046
Foreign currency deposit (non-frozen)	22,358	23,491	25,476	34,218	32,935	32,294	33,758	31,541	34,046	32,157	35,187	37,934	34,581	33,224	40,685
Foreign currency deposit (not-frozen), (DM million)	1,065	1,044	1,108	1,141	1,098	1,076	1,125	1,051	1,135	1,072	1,173	1,264	1,153	1,107	1,356
Memorandum items:															
12-months growth rates (in percent)															
Broad Money (M2)	...	...	...	...	61.4	57.9	55.3	61.4	24.5	34.1	49.5	64.5	20.4	29.3	58.7
Dinar-denominated M2	...	...	...	...	78.8	82.8	83.0	106.8	57.6	87.3	111.6	140.6	36.0	58.0	94.2
M1	...	...	...	...	85.2	86.6	83.9	112.6	58.7	92.5	118.2	145.7	36.0	60.2	97.5
Currency outside banks	...	...	...	...	63.5	81.5	69.0	100.0	45.1	75.6	94.6	131.3	36.0	60.0	90.0
Velocity (M1)	12.9	15.0	16.0	15.1	13.4	15.4	16.8	14.5	18.4	15.0	13.4	12.9	19.1	16.0	13.1
Multiplier (M2/Reserve money)	4.3	4.3	4.3	4.2	3.3	3.4	3.4	3.0	3.3	3.0	3.3	2.9	3.2	2.9	3.0
Demand deposits/Required reserves	3.8	3.7	3.7	2.9	3.3	3.1	3.3	3.2	3.3	3.2	3.7	3.1	3.3	3.2	2.8
M1/Time and Saving Deposits	4.0	4.1	4.5	4.5	4.8	4.5	4.6	5.3	4.7	5.3	5.4	5.3	4.8	5.2	5.3
Foreign exchange deposit/Time deposit	6.1	6.2	6.6	7.3	5.8	5.1	4.9	4.5	4.8	4.2	4.1	4.1	4.5	4.0	4.1
Frozen foreign currency deposit (dinar million)	143,956	156,258	159,790	210,102	211,431	...	...	...	...	...	...	...	...	...	...
Frozen foreign currency deposit (DM million))	6,855	6,945	6,947	7,003	7,048	...	...	...	...	...	...	...	...	...	...

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

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

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

3/ Program ceiling.

Table 7A. Federal Republic of Yugoslavia: Consolidated General Government Fiscal Operations in 2000-2002

	Consolidated General Government Excluding Montenegro										Consolidated General Government Including Montenegro									
	2000	2001			2002	2000	2001			2002	2000	2001			2002	2000	2001			2002
		Prog.	1st Rev.	2nd Rev.	Proj.		Prog.	1st Rev.	2nd Rev.	Proj.		Prog.	1st Rev.	2nd Rev.	Proj.		Prog.	1st Rev.	2nd Rev.	Proj.
	(Billion dinars)					(Percent of GDP) 2/					(Billion dinars)					(Percent of GDP) 2/				
Total revenue	128.8	250.6	250.6	265.8	361.7	36.0	36.9	36.2	38.3	39.8	140.2	273.8	273.9	290.3	395.6	39.2	40.4	39.5	41.9	43.5
Current revenue	128.8	250.1	250.1	264.7	360.7	36.0	36.9	36.1	38.2	39.7	140.2	272.7	272.8	289.2	394.7	39.2	40.2	39.3	41.7	43.4
Tax revenue	115.7	229.7	231.7	245.6	335.6	32.3	33.9	33.4	35.4	36.9	126.4	251.1	253.1	268.4	367.4	35.3	37.0	36.5	38.7	40.4
Personal income tax	12.4	25.5	26.6	29.9	44.4	3.5	3.8	3.8	4.3	4.9	12.7	26.2	27.3	30.7	48.2	3.5	3.9	3.9	4.4	5.3
Social security contributions	39.7	73.2	70.5	74.7	93.4	11.1	10.8	10.2	10.8	10.3	44.8	83.8	81.1	85.3	107.3	12.5	12.3	11.7	12.3	11.8
Corporate income tax	1.1	2.1	3.1	3.1	3.6	0.3	0.3	0.4	0.4	0.4	1.1	2.1	3.1	3.1	3.6	0.3	0.3	0.4	0.4	0.4
Retail sales tax	29.4	57.5	63.3	69.5	97.2	8.2	8.5	9.1	10.0	10.7	32.9	63.8	69.5	76.6	106.4	9.2	9.4	10.0	11.0	11.7
Excises	10.7	26.7	23.9	25.8	38.2	3.0	3.9	3.4	3.7	4.2	10.7	26.7	23.9	25.8	38.2	3.0	3.9	3.4	3.7	4.2
Taxes on international trade and operations	8.5	14.1	14.1	12.9	20.0	2.4	2.1	2.0	1.9	2.2	10.3	17.8	17.8	17.0	24.6	2.9	2.6	2.6	2.5	2.7
Other taxes	13.8	30.6	30.2	29.8	38.9	3.8	4.5	4.4	4.3	4.3	13.9	30.8	30.4	30.0	39.1	3.9	4.5	4.4	4.3	4.3
Extrabudgetary taxes	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Nontax revenue	13.1	20.4	18.5	19.1	25.1	3.7	3.0	2.7	2.8	2.8	13.8	21.6	19.7	20.7	27.3	3.8	3.2	2.8	3.0	3.0
Capital revenue	0.0	0.5	0.5	1.1	0.9	0.0	0.1	0.1	0.2	0.1	0.0	1.1	1.1	1.1	0.9	0.0	0.2	0.2	0.2	0.1
Total expenditure and net lending	129.6	289.3	275.3	279.0	412.3	36.2	42.6	39.7	40.2	45.5	143.6	315.4	301.6	306.5	451.9	40.1	46.5	43.5	44.2	49.7
Current expenditure	118.6	261.3	257.7	261.5	373.2	33.1	38.5	37.2	37.7	41.2	131.2	284.4	281.0	287.2	409.7	36.6	41.9	40.5	41.4	45.0
Expenditure on goods and services	61.6	123.6	126.4	118.3	153.1	17.2	18.2	18.2	17.1	17.0	66.4	132.9	135.7	129.1	167.3	18.5	19.6	19.6	18.6	18.4
Wages and salaries	33.4	64.5	62.1	62.0	81.9	9.3	9.5	9.0	8.9	9.1	36.0	71.0	68.6	69.3	91.9	10.1	10.5	9.9	10.0	10.1
Other purchases of goods and services	28.2	59.0	64.2	56.3	71.1	7.9	8.7	9.3	8.1	7.9	30.4	61.9	67.2	59.8	75.5	8.5	9.1	9.7	8.6	8.3
Interest payment	2.2	6.7	2.9	5.2	21.7	0.6	1.0	0.4	0.8	2.4	2.2	6.7	2.9	5.2	23.6	0.6	1.0	0.4	0.8	2.6
Subsidies and other current transfers	54.8	131.1	128.4	137.9	198.4	15.3	19.3	18.5	19.9	21.9	62.5	144.8	142.3	152.9	218.8	17.5	21.3	20.5	22.1	24.1
Subsidies	7.1	21.7	22.7	22.0	28.1	2.0	3.2	3.3	3.2	3.2	8.1	22.5	23.6	22.9	30.1	2.3	3.3	3.4	3.3	3.3
Transfers to households	47.7	109.3	105.7	116.0	170.3	13.3	16.1	15.2	16.7	18.7	54.5	122.3	118.8	130.0	188.7	15.2	18.0	17.1	18.7	20.7
Capital expenditure	11.0	23.5	10.0	8.5	29.0	3.1	3.5	1.4	1.2	3.2	11.8	24.7	11.2	9.7	31.2	3.3	3.6	1.6	1.4	3.4
General reserves	0.0	2.9	2.2	0.0	10.0	0.0	0.4	0.3	0.0	1.1	0.3	4.1	3.4	0.0	10.0	0.1	0.6	0.5	0.0	1.1
Lending minus repayment	0.0	1.7	5.6	9.0	0.1	0.0	0.2	0.8	1.3	0.0	0.3	2.1	6.0	9.6	0.9	0.1	0.3	0.9	1.4	0.1
Net transfer to other levels of government	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.2	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-0.8	-38.7	-24.7	-13.4	-50.6	-0.2	-5.7	-3.6	-1.9	-5.6	-3.4	-41.7	-27.7	-16.3	-56.2	-0.9	-6.2	-4.0	-2.4	-6.2
Foreign grants	0.1	5.2	7.7	4.2	8.7	0.0	0.8	1.1	0.6	1.0	2.8	8.0	10.6	6.4	10.9	0.8	1.2	1.5	0.9	1.2
Overall balance including grants	-0.7	-33.6	-17.0	-9.1	-41.9	-0.2	-4.9	-2.4	-1.3	-4.6	-0.6	-33.7	-17.1	-10.0	-45.4	-0.2	-5.0	-2.5	-1.4	-5.0
Statistical discrepancy	0.0	0.0	-0.2	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.2	-0.2	0.0	0.0	0.0	0.0	0.0	0.0
Financing	0.7	33.6	16.8	8.9	41.8	0.2	4.9	2.4	1.3	4.6	0.6	33.7	16.9	9.8	45.3	0.2	5.0	2.4	1.4	5.0
Domestic financing	0.7	4.0	5.4	2.7	5.4	0.2	0.6	0.8	0.4	0.6	0.6	4.1	5.5	3.6	5.5	0.2	0.6	0.8	0.5	0.6
Bank financing	0.3	4.0	5.4	2.7	5.4	0.1	0.6	0.8	0.4	0.6	0.3	4.1	5.5	3.6	5.5	0.1	0.6	0.8	0.5	0.6
NBY	0.3	4.0	5.4	3.1	5.4	0.1	0.6	0.8	0.4	0.6	0.3	4.0	5.4	3.8	5.5	0.1	0.0	0.8	0.6	0.6
Commercial banks	0.0	0.0	0.0	-0.4	0.0	0.0	0.0	0.0	-0.1	0.0	-0.1	0.2	0.2	-0.2	0.0	0.0	0.0	0.0	0.0	0.0
Non-bank financing	0.4	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.4	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0
Foreign Financing	0.0	19.6	8.2	6.2	25.2	0.0	2.9	1.2	0.9	2.8	0.0	19.6	8.2	6.2	27.0	0.0	2.9	1.2	0.9	3.0
Privatization receipts	0.0	9.7	3.0	0.0	11.3	0.0	1.4	0.4	0.0	1.2	0.0	9.7	3.0	0.0	12.9	0.0	1.4	0.4	0.0	1.4

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

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

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

Table 7B. Federal Republic of Yugoslavia: Federal Government Fiscal Operations, 1997-2002
(In percent of GDP) 1/

	1997	1998	1999	2000	2001					2002
					Budget	Prog.	Prog. 1st Rev	Prog. 2nd Rev	Prel. Jan.-Sep.	Proj. Jan.-Dec.
A Total revenue and grants (1+2)	6.6	6.4	6.8	7.6	7.6	6.8	6.6	6.9	4.7	6.9
1 Total revenue (1.1+1.2)	6.6	6.4	6.8	7.6	7.6	6.8	6.6	6.9	4.7	6.9
1.1 Current revenue (1.1.1+1.1.2)	6.6	6.4	6.8	7.6	7.6	6.8	6.6	6.9	4.7	6.9
1.1.1 Tax revenue (1.1.1.1+1.1.1.2+1.1.1.3)	5.3	5.4	5.6	6.8	6.3	5.8	5.7	6.0	4.0	6.0
1.1.1.1 Turnover (retail sales) tax	2.1	2.6	2.4	4.2	3.7	3.5	3.4	3.9	2.6	3.9
1.1.1.2 Taxes on international trade and operations	2.7	2.4	2.3	2.4	2.4	2.1	2.0	1.9	1.3	1.9
1.1.1.3 Other taxes	0.5	0.4	0.3	0.2	0.3	0.2	0.2	0.2	0.2	0.2
1.1.1.4 Extrabudgetary taxes	0.0	0.0	0.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0
1.1.2 Nontax revenue	1.4	1.0	1.2	0.8	1.3	0.9	0.9	0.9	0.7	0.9
1.2 Capital revenue	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
2 Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
B Total expenditure and net lending (1+2)	6.6	6.4	6.8	7.6	7.6	6.5	6.6	6.9	4.7	6.9
1 Total expenditure (1.1+1.2)	6.6	6.4	6.8	7.5	7.4	6.3	6.4	6.9	4.6	6.9
1.1 Current expenditure (1.1.1+1.1.2)	6.6	6.4	6.8	7.5	7.3	6.2	6.4	6.7	4.6	6.7
1.1.1 Interest	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.2	0.0	0.2
1.1.2 Non-interest (1.1.2.1+1.1.2.2+1.1.2.3+1.1.2.4)	6.6	6.4	6.8	7.4	7.2	6.1	6.3	6.5	4.5	6.5
1.1.2.1 General Government Services	0.8	1.0	0.8	0.8	1.2	1.0	0.7	1.0	0.5	1.0
1.1.2.2 Defense	4.8	4.5	5.1	5.1	4.7	4.0	3.8	3.9	2.6	3.8
1.1.2.3 Social Insurance and Social Security Transfers	0.6	0.6	0.5	1.2	1.1	1.2	1.3	1.5	1.0	1.7
1.1.2.5 Other non-interest expenditure	0.4	0.4	0.4	0.3	0.1	0.0	0.5	0.0	0.4	0.0
1.2 Capital expenditure	0.0	0.0	0.0	0.0	0.1	0.1	0.0	0.2	0.0	0.2
2 Net lending	0.0	0.0	0.0	0.1	0.2	0.3	0.2	0.0	0.1	0.0
Overall budget balance (cash) (A-B)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing (1+2+3)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
1 Domestic financing (net) (1.1+1.2)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
1.1 Banking system (1.1.1+1.1.2)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
1.1.1 National Bank of Yugoslavia	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
1.1.2 Commercial banks	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
1.2 Nonbank	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
2 Foreign financing (net) (2.1-2.2)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
2.1 Disbursements	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
2.2 Amortization	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
3 Privatization receipts	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:										
Nominal GDP (billion Dinars)	112.4	146.3	192.9	358.1	604.0	678.5	693.3	693.3	693.3	909.5
Modified overall balance including newly accumulated arrears	...	...	...	-1.1	...	...	...	...	...	...

Sources: Ministry of Finance of the FRY; and IMF staff estimates.
1/ Expressed in terms of GDP of the FRY excluding Kosovo.

Table 7C. Serbia: Republican Government Fiscal Operations, 1997-2002
(In percent of GDP) 1/

	1997	1998	1999	2000 Actual	2001 Budget	2001 Program	2001 Prog. 1st Rev.	2001 Prog. 2nd Rev.	2001 Prel. Jan.-Sep.	2002 Budget
A Total revenue and grants (1+2)	**12.3**	**11.5**	**9.1**	**13.8**	**16.2**	**16.0**	**16.4**	**17.7**	**11.6**	**20.8**
1 Total revenue (1.1+1.2)	12.3	11.5	9.1	13.8	15.7	15.4	15.5	17.1	11.5	19.9
1.1 Current revenue (1.1.1+1.1.2)	12.3	11.5	9.1	13.8	15.7	15.4	15.5	16.9	11.4	19.9
1.1.1 Tax revenue (1.1.1.1+...+1.1.1.6)	12.3	11.5	9.1	12.4	15.5	14.6	15.0	16.4	11.2	18.8
1.1.1.1 Personal income tax	6.4	5.0	3.6	3.5	3.7	3.7	3.7	4.3	2.9	4.9
1.1.1.2 Corporate income tax	0.3	0.4	0.5	0.3	0.3	0.3	0.4	0.4	0.3	0.5
1.1.1.3 Turnover (retail sales) tax	3.6	3.3	3.1	3.4	4.3	4.1	4.8	5.3	3.6	7.5
1.1.1.4 Excises	1.0	0.8	0.5	2.2	3.7	3.7	3.2	3.5	2.3	4.2
1.1.1.5 Property taxes	0.3	0.4	0.4	0.2	0.0	0.0	1.2	1.3	0.9	0.9
1.1.1.6 Other taxes	0.7	1.6	1.1	2.7	3.5	2.9	1.6	1.6	1.2	0.8
1.1.2 Nontax revenue	0.0	0.0	0.0	1.4	0.2	0.8	0.5	0.5	0.2	1.1
1.2 Capital revenue	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.2	0.1	0.0
2 Grants	0.0	0.0	0.0	0.0	0.5	0.6	0.9	0.6	0.1	1.0
Of which: Grants for the budget for recovery and restructuring	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
B. Total expenditure and net lending (1+5)	**12.3**	**11.5**	**9.1**	**14.1**	**18.9**	**20.9**	**18.8**	**19.0**	**11.8**	**25.4**
1. Total expenditure (2+3+4)	12.3	11.5	9.1	14.1	18.9	20.9	18.0	17.7	10.9	25.4
2 Current expenditure (2.1+2.2+2.3)	12.0	11.4	8.7	12.3	17.0	17.5	16.8	17.2	10.5	21.7
2.1. Expenditure on goods and services (2.1.1+...+2.1.4)	9.8	9.6	7.8	6.8	7.6	7.9	7.3	6.8	4.6	7.2
2.1.1 Wages and salaries	4.5	3.8	3.7	3.7	4.0	4.0	3.6	3.9	2.6	4.2
2.1.2 Employer contribution	1.4	1.2	1.2	0.9	0.9	0.9	0.9	0.8	0.6	0.8
2.1.2.1 Contribution	0.0	0.0	0.0	0.0	0.0	0.0	0.7	0.2	0.0	0.0
2.1.2.2 Tax	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.0
2.1.3 Severance payments	0.0	0.0	0.0	0.0	0.2	0.2	0.1	0.1	0.0	0.0
2.1.4 Other purchases of goods and services	3.9	4.6	2.9	2.2	2.6	2.8	2.7	2.0	1.4	2.2
2.2. Interest payment	0.1	0.3	0.2	0.1	0.8	0.7	0.1	0.1	0.1	1.7
2.3. Subsidies and other current transfers	2.1	1.5	0.8	5.3	8.6	9.0	9.4	10.3	5.8	12.8
2.3.1 Subsidies	0.0	0.0	0.0	2.0	2.4	2.4	2.7	2.6	1.8	2.2
2.3.2 Transfers to households	2.0	1.4	0.7	1.4	3.2	3.2	2.8	2.8	1.9	4.4
Of which: Repayment for frozen foreign currey deposit	0.0	0.0	0.0	0.0	0.8	0.7	0.6	0.6	0.4	0.7
2.3.3 Current transfers to other levels of government	0.1	0.1	0.0	1.9	3.0	3.4	3.8	4.8	2.1	6.1
Federal budget	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Republican budget	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Local Budgets	0.1	0.1	0.0	0.5	0.1	0.1	0.1	0.1	0.1	0.2
Pension Funds	0.0	0.0	0.0	1.5	2.4	2.6	2.6	3.7	1.7	4.8
Health Fund	0.0	0.0	0.0	0.0	0.3	0.3	0.6	0.6	0.2	0.5
Labor Market Fund	0.0	0.0	0.0	0.0	0.2	0.4	0.4	0.3	0.0	0.3
3. Capital expenditure	0.3	0.1	0.4	1.8	0.7	3.0	0.9	0.5	0.4	2.6
Of which: Budget for recovery and reconstruction	0.0	0.0	0.0	0.0	0.0	2.3	0.5	0.0	0.0	1.3
4. General reserves	0.0	0.0	0.0	0.0	1.2	0.4	0.3	0.0	0.0	1.1
5. Lending minus repayment	0.0	0.0	0.0	0.0	0.0	0.0	0.8	1.3	1.0	0.0
Overall budget balance (cash) (A-B)	**0.0**	**0.0**	**0.0**	**-0.3**	**-2.6**	**-4.9**	**-2.4**	**-1.3**	**-0.3**	**-4.6**
Core balance 2/	0.0	0.0	0.0	-0.3	-2.6	-2.6	-2.4	-1.3	-0.3	-3.3
Balance of the budget for recovery and reconstruction 3/	0.0	0.0	0.0	0.0	0.0	-2.3	0.0	0.0	0.0	-1.3
Statistical Discrepancy	0.0	0.5	0.2	0.0	3.0	3.4	3.8	4.8	2.1	0.0
Financing (1+2+3+4)	0.0	0.5	0.2	0.3	2.6	4.9	2.4	1.3	0.3	4.6
1 Domestic financing (net) (1.1+1.2)	0.0	0.5	0.2	0.3	0.6	0.6	0.8	0.4	0.3	0.6
1.1 Banking system (1.1.1+1.1.2)	0.0	0.5	0.2	0.2	0.6	0.6	0.8	0.4	0.3	0.6
1.1.1 National Bank of Yugoslavia	0.0	0.1	0.2	0.2	0.6	0.6	0.8	0.4	0.5	0.6
1.1.2 Commercial banks	0.0	0.4	0.0	0.0	0.0	0.0	0.0	-0.1	-0.2	0.0
1.2 Nonbank	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0
2 Foreign financing (net) (2.1-2.2)	0.0	0.0	0.0	0.0	0.6	2.9	1.2	0.9	0.0	2.8
2.1 Program	0.0	0.0	0.0	0.0	0.6	2.9	0.7	0.9	0.0	1.5
2.2 Project	0.0	0.0	0.0	0.0	0.0	0.0	0.5	0.0	0.0	1.3
3 Privatization receipts	0.0	0.0	0.0	0.0	1.4	1.4	0.4	0.0	0.0	1.2
Memorandum items:										
Nominal GDP (billion dinars)	112.4	146.3	192.9	358.1	685.0	678.5	693.3	693.3	693.3	909.5

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

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

Table 7D. Montenegro: Republican Government Fiscal Operations, 2000-2002
(In percent of GDP)

	2000	2001					2002
		Budget	Jan.-Dec. Rev.Prog.	Jan.-.Mar. Prelim	Jan.-June Prel.	Jan-Sep Prelim	Jan-Dec Projections
A Total revenue and grants (1+2)	**37.2**	**27.3**	**30.9**	**6.2**	**12.1**	**20.8**	**31.9**
1 Total revenue (1.1+1.2)	28.8	23.5	27.6	5.7	11.0	19.7	28.8
1.1 Current revenue (1.1.1+1.1.2)	28.8	23.5	27.6	5.7	11.0	19.7	28.8
1.1.1 Tax revenue (1.1.1.1+1.1.1.2+1.1.1.3+1.1.1.4)	23.4	21.3	24.3	4.6	9.4	17.2	25.4
1.1.1.1 Personal income	6.8	6.9	7.0	1.5	3.1	5.0	0.0
1.1.1.2 Turnover (retail sales) tax	4.8	6.9	7.6	1.2	2.7	5.1	#REF!
1.1.1.3 Excises	7.4	4.2	4.1	0.7	1.7	3.0	0.0
1.1.1.4 Other taxes	4.4	3.2	5.5	1.2	1.9	4.2	0.0
1.1.2 Nontax revenue	5.4	2.2	3.3	1.1	1.6	2.5	3.4
1.2 Capital revenue	0.0	0.0	0.0	0.0	0.0	0.0	0.0
2 Grants	8.3	3.8	3.3	0.4	1.1	1.1	3.1
B Total expenditure and net lending (1+2)	**37.0**	**28.6**	**32.7**	**7.6**	**14.7**	**23.2**	**35.3**
1 Total expenditure (1.1+1.2)	37.0	28.2	32.2	7.7	14.5	22.7	34.1
1.1 Current expenditure (1.1.1+1.1.2)	32.4	26.0	29.8	7.0	13.3	21.0	31.8
1.1.1 Interest	0.2	0.1	0.1	0.0	0.0	0.0	2.4
1.1.2 Non-interest (1.1.2.1+1.1.2.2+1.1.2.3+1.1.2.4)	32.2	25.9	29.8	7.0	13.2	20.9	29.3
1.1.2.1 wages and salaries	15.6	14.7	14.5	2.6	5.2	9.2	14.6
1.1.2.2 goods and services	0.0	4.9	6.9	1.7	3.1	5.0	6.0
1.1.2.3 Social Insurance and Social Security Transfers	3.9	3.9	5.8	1.8	3.2	4.5	4.8
1.1.2.4 Other non-interest expenditure	12.8	1.0	1.2	0.3	0.8	1.1	1.3
1.2 Capital expenditure	4.6	2.3	2.3	0.7	1.2	1.7	2.3
2 Net lending	0.0	0.3	0.6	-0.1	0.3	0.5	1.3
C Net transfer to other levels of government (1+3-2-4)	**0.1**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
1 Transfers to lower levels of government	0.1	0.0	0.0	0.0	0.0	0.0	0.0
2 Transfers from lower levels of government	0.0	0.0	0.0	0.0	0.0	0.0	0.0
3 Transfers to extra-budgetary social security funds	0.0	0.0	0.0	0.0	0.0	0.0	0.0
4 Transfers from extra-budgetary funds	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall budget balance excluding grants (cash) (A-B-C-2)	**-8.3**	**-5.1**	**-5.1**	**-1.9**	**-3.8**	**-3.5**	**-6.6**
Overall budget balance (cash) (A-B-C)	0.0	-1.2	-1.8	-1.4	-2.7	-2.4	-3.4
Financing (1+2+3)	0.0	1.2	1.8	1.4	2.7	2.4	#REF!
1 Domestic financing (net) (1.1+1.2)	0.0	0.0	1.8	1.4	2.7	2.4	#REF!
1.1 Banking system (1.1.1+1.1.2)	0.0	0.0	1.8	1.4	2.7	2.4	#REF!
1.1.1 National Bank of Yugoslavia	0.0	0.0	1.5	1.9	1.6	1.5	-1.6
1.1.2 Commercial banks	0.0	0.0	0.4	-0.4	1.2	1.0	#REF!
1.2 Nonbank	0.0	0.0	0.0	0.0	0.0	0.0	0.0
2 Foreign financing (net) (2.1-2.2)	0.0	0.0	0.0	0.0	0.0	0.0	2.4
2.1 Disbursements	0.0	0.0	0.0	0.0	0.0	0.0	2.4
2.2 Amortization	0.0	0.0	0.0	0.0	0.0	0.0	0.0
3 Privatization receipts	0.0	1.2	0.0	0.0	0.0	0.0	2.6
Memorandum items:							
Nominal GDP (million DM)	1300.0	1570.0	1570.0	1570.0	1570.0	1570.0	1817.7

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

Table 8. Federal Republic of Yugoslavia: Indicators of External Vulnerability 1998-2001 1/

(In percent of GDP, unless otherwise indicated)

	1998	1999	2000 Est.	2001 Rev. prog.
Financial indicators				
Public sector debt	...	...	178.2	151.2
Broad money (percent change, 12-month basis)	69.4	67.6	61.4	28.6
Private sector credit (percent change, 12 month basis)	...	128.4	68.6	...
Weighted interest rates (percent per month, December) 2/	7.0	3.9	6.8	...
Retail prices (percent per annum, e.o.p.)	...	49.9	113.5	40
External Indicators				
Exports (percent change, 12-month basis in US$)	24.0	-44.7	14.7	3.4
Imports (percent change, 12-month basis in US$)	1.0	-32.0	14.4	21.4
Terms of Trade (percent change, 12 month basis)	-2.6	-4.4	0.0	1.0
Current account balance, before grants	-4.8	-7.5	-8.3	-10.2
Current account balance after grants and FDI	-3.9	-6.4	-4.6	-3.8
Errors and omissions	2.0	4.0	3.6	2.8
Gross official reserves (in US$ millions)	326	293	516	1,012
(in months of imports GS of the following year)	1.1	0.9	1.3	2.3
Central Bank short-term foreign liabilities (in US$ millions) 3/	0	0	0	0
Gross reserves of the banking system (in US$ millions)	774	659	882	1,359
(in months of imports GS of the following year)	2.6	1.9	2.2	3.0
Short term foreign liabilities of the commercial banks (in US$)	...	...	663	663
Foreign currency liabilities of the commercial banks (in US $)	...	...	4,345	4,371
Official reserves/Broad money (M2) (percent)	18	30	50	60
Official reserves/Narrow money (M0) (percent)	59	126	164	174
Total short term external debt by original maturity (in US$ millions)	...	...	1,216	1,216
Total short term external debt by remaining maturity (in US$ millions)	...	...	1,417	1,469
Total short term external debt to reserves by original maturity (in percent)	...	...	235.7	120.1
Total short term external debt to total debt by original maturity (in percent)	...	...	10.8	10.2
Total short term external debt to total debts by remaining maturity (in percent)	...	...	12.5	12.3
Total short term external debt to reserves by remaining maturity (in percent)	...	...	137.9	89.5
Total external debt (in US$ millions)	...	...	11,304	11,980
Of which: Public and Publicly guaranteed debt 4/	...	...	10,088	10,764
Total external debt (in percent of exports of G&S)	...	...	443.8	441.4
External interest payments, cash basis (in percent of exports of G&S)	...	...	1.6	1.8
External amortization payments, cash basis (in percent of exports of G&S)	...	...	0.0	0.4
Exchange rate, official (per DM, end of period)	6	6	30	...
Exchange rate, parallel (per DM, end of period)	8	21	30	...
REER (annual average, February-December 1994 = 100) 5/	91.5	68.0	52.2	81.7

Sources: Yugoslav authorities; and IMF staff estimates.

1/ All stocks are measured end-of-period.

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

3/ Excluding IMF.

4/ Assuming all long- and medium-term external bank debt to official creditors is government guaranteed.

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

	1998	1999	2000	2001 Rev. prog.
1. Gross financing requirements	-720	-818	-1,074	-11,102
External current account deficit (excluding official transfers)	-660	-764	-671	-1,075
Debt amortization	-60	-54	-47	-11
Medium- and long-term debt	-25	-17	-14	-11
Public sector	...	...	...	-11
Multilateral 1/	...	...	...	-11
Bonds and notes	...	...	...	0
Other	...	...	...	0
Commercial banks and corporate private sector	...	...	...	0
Short-term debt 2/	-35	-37	-33	0
Repayment of arrears	0	0	0	-9,667
Gross reserve accumulation	0	0	-227	-349
IMF repurchases and repayments	0	0	-129	0
2. Available financing	720	818	1,074	1,090
Official grants	0	0	271	550
Foreign direct investment (net)	113	112	25	120
Debt financing from private creditors	78	30	49	130
Medium and long-term financing	78	30	49	70
To public sector	0	0	0	0
Of which: Balance of payments financing 3/	0	0	0	0
To commercial banks	26	19	8	0
To corporate private sector	52	11	41	0
Short-term financing and other capital inflows	0	0	0	60
Official creditors (recorded under financing gap for 2001)	50	29	227	0
Multilateral 1/	...	...	...	...
Of which: Balance of payments financing	...	...	...	...
Bilateral	...	...	...	...
To public sector	...	...	...	...
Of which: Balance of payments financing	...	...	...	...
To private sector	...	...	...	...
IMF (for 2001, presented as part of exceptional financing)	0	0	150	
Accumulation of arrears (exceptional)	86	126	62	0
Other flows 4/	393	521	290	290
3. Financing gap	0	0	0	10,012
Program and project assistance	0	0	0	555
World Bank	0	0	0	70
IMF	0	0	0	128
EBRD	0	0	0	30
EU	0	0	0	237
Other bilateral support	0	0	0	90
Project assistance				0
Debt relief	0	0	0	9,457
4. Residual Financing Gap				0

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

1/ Including IMF for 2001.

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

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

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

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

	2000	2001	2002	2003	2004	2005	2006	2007
		Projections 1/						
Fund repurchases and charges 2/								
In millions of SDRs	...	7.3	15.4	16.3	92.7	163.2	85.9	8.1
In millions of U.S. dollars	...	9.4	19.3	20.4	116.5	205.5	108.3	10.2
In percent of exports of goods and NFS	...	0.3	0.6	0.6	2.9	4.5	2.1	0.2
In percent of debt service	...	15.9	4.6	3.9	18.9	30.6	10.0	0.8
In percent of quota	...	1.6	3.3	3.5	19.8	34.9	18.4	1.7
In percent of gross official reserves	...	0.9	1.5	1.3	6.3	9.7	4.5	0.4
Fund credit outstanding								
In millions of SDRs	116.9	216.9	316.9	316.9	239.7	87.5	6.3	0.0
In millions of U.S. dollars	154.2	280.2	396.8	397.4	301.3	110.2	7.9	0.0
In percent of quota	25.0	46.4	67.8	67.8	51.3	18.7	1.3	0.0
In percent of GDP	1.9	2.7	3.3	3.1	2.1	0.7	0.0	0.0
In percent of gross official reserves	29.9	27.7	29.9	25.2	16.3	5.2	0.3	0.0
Memorandum items:								
Exports of goods and NFS (millions of US$)	2,547	2,714	3,065	3,494	4,000	4,528	5,062	5,578
Debt service (millions of US$)	56	59	421	530	618	672	1,086	1,233
Quota (millions of SDRs)	468	468	468	468	468	468	468	468
Quota (millions of US$)	617	604	586	586	588	589	590	590
Gross official reserves (millions of US$)	516	1,012	1,327	1,577	1,852	2,127	2,423	2,624
GDP (millions of US$)	8,071	10,537	12,078	12,994	14,158	15,221	16,410	17,624
U.S. dollar per SDR	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3

Sources: Yugoslav authorities; and IMF staff estimates.

1/ As of end-November, 2001.

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

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

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

1/ The quota is SDR 467.7 million.

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

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

II. **General Resources Account:**	SDR Million	%Quota
Quota	467.70	100.0
Fund Holdings of Currency	684.64	146.4

III. **SDR Department:**	SDR Million	%Allocation
Net cumulative allocation	56.66	100.0
Holdings	6.81	12.0

IV. **Outstanding Purchases and Loans:**	SDR Million	%Quota
First Credit Tranche	216.93	46.4
Stand-by arrangement	216.93	46.4

V. **Financial Arrangements:**

Type	Approval Date	Expiration Date	Amount Approved	Amount Drawn
Emergency Post Conflict Assistance	12/20/00	...	SDR 116.9 million	SDR 116.9 million
Stand-by	6/11/01	3/31/02	SDR 200.0 million	SDR 100.0 million

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

	Overdue	Forthcoming				
	11/30/2001	2001	2002	2003	2004	2005
Principal				18.8	108.5	89.7
Charges/Interest			7.4	7.3	6.0	3.0
Total			7.4	26.1	114.5	92.7

VII. **Safeguards Assessments:**

Under the Fund's safeguards assessment policy, the National Bank of Yugoslavia is subject to a full Stage One safeguards assessment with respect to the Stand-By Arrangement approved on June 11, 2001, which is scheduled to expire on March 31, 2002. An on-site assessment of the NBY, conducted during October 2001, identified vulnerabilities and proposed remedies that have been agreed to by the central bank (Box 2).

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

VIII. **Exchange Arrangement**

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

IX. **Last Article IV Consultation**

No consultation discussions have yet been held with FRY.
The authorities have requested a ROSC Data Module mission that is scheduled to take place in mid-2002.

X. **Technical Assistance**

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

XI. **Resident Representative**

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

Federal Republic of Yugoslavia: Relations with the World Bank Group

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

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

3. As of December 31, 2000, the stock of arrears of the FRY to the IBRD amounted to US$1.7 billion. The plan for arrears resolution agreed to as a condition of membership provides for the exceptional consolidation of FRY's arrears into a new package of IBRD loans. As part of the membership package the Bank's Board of Directors approved temporary exceptional IDA eligibility for FRY, allowing up to US$540 million in new IDA loans over the next three years, once arrears have actually been cleared. Negotiations on the package of consolidation loans have been successfully completed and the package has been submitted for final Board approval.

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

5. In the context of the membership package the Bank's Board of Directors also endorsed a Transitional Support Strategy (TSS) that provides the framework for World Bank assistance to FRY in FY02. A total of up to US$200 million in IDA resources could be provided as credits to FRY in FY02, with up to US$160 million as quick-disbursing assistance in support of priority reforms in the areas of fiscal management, private sector development and banking reform. Negotiations have been successfully completed for a first Structural Adjustment Credit of US$70 million. Up to US$40 million would also be provided in support of investment operations in FY02. Advisory activities already commenced under the TSS include a Public Expenditure and Institutional Review (PEIR), a Country Procurement Assessment Report (CPAR), A Country Financial Accountability Assessment (CFAA), household survey work preparatory to a Poverty Assessment (and to the government's planned Interim Poverty Reduction Strategy Paper), and a Private Sector Development Strategy (in conjunction with the IFC and EBRD).

Federal Republic of Yugoslavia: Statistical Issues

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

A. Real Sector

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

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

B. Balance of Payments

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

foreign exchange transactions carried outside official channels and underreporting of external trade. During 2001, the NBY expended commendable efforts to improve its estimation of actual flows based on existing data.

C. Government Finance

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

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

Federal Republic of Yugoslavia: Core Statistical Indicators
(As of December 12, 2001)

	Exchange rates	International Reserves	Central Bank Balance Sheet	Reserve Money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Government Balance	Gross Social Product	External Debt/ Debt Service
Date of Latest Observation	Nov. 30, 2001	Nov. 30, 2001	Oct. 31, 2001	Nov. 13, 2001	Oct. 31, 2001	Oct. 31, 2001	Nov. 31, 2001	Sep, 30, 2001	Sep. 30, 2001	Sep. 30, 2001	Dec. 31, 1999	July 31, 2001
Date Received	Dec. 5, 2001	Dec. 12, 2001	Nov. 11, 2001	Nov. 22, 2001	Nov. 22, 2001	Nov. 7, 2001	Dec. 3, 2001	Nov., 2001	Nov., 2001	Nov., 2001	Dec., 2000	Nov., 2001
Frequency of Data	Daily	Daily	Monthly	Daily	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Annually	Monthly
Frequency of Reporting	Weekly	Weekly	Monthly	Weekly	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Annually	Monthly
Source of Update	NBY	NBY	NBY	NBY	NBY	NBY	FBS	FBS	FBS	Ministries of Finance of the FRY, Serbia, and Montenegro	FBS	NBY
Mode of Reporting	Report to the Fund	Report to the Fund	Report to the Fund	Report to the Fund	Report to the Fund	Report to the Fund	Website	Website	Website	Report to the Fund	Website	NBY
Confidentiality	Public	Confi-Dential	Confi-dential	Confi-dential	Confi-dential	Public	Public	Public	Public	Public	Public	Confiden-tial
Frequency of Publication	Daily	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Annually	Annually	Monthly

Federal Republic of Yugoslavia: External Debt Issues

1. **Significant progress has been made in the restructuring of FRY's more than US$11 billion of external debt, around 85 percent of which had been in arrears** (see Table 3). As of December 2001, multilateral creditors (accounting for roughly 22 percent of total debt) had nearly all concluded restructuring agreements with FRY on the repayment of outstanding obligations. Arrears to the IMF were cleared in December 2000, as a condition for FRY's membership in the Fund. A restructuring agreement was also concluded in December 2000 with Eurofima, involving principal repayments over a ten-year period. A restructuring agreement with the World Bank, involving US$1.8 billion of debt (almost entirely in arrears), was concluded in November 2001, with a repayment of 30 years, at market interest rates and a five-year grace period. US$210 million of arrears to the EIB were settled in October with the help of an EU macrofinancial loan. A ten-year restructuring of arrears to the Eurofund is expected to be agreed soon, following discussions in early October. Efforts are continuing toward settlement of arrears to two remaining multilateral creditors holding a very small share of debt, the International Bank for Economic Cooperation and the IFC.

2. **Paris Club creditors, with about US$4.5 billion (or 40 percent) of total external debt, reached a debt restructuring agreement with FRY in November 2001, involving a phased 66 percent NPV reduction on commercial debt.** The agreement will be implemented in three phases. In the first phase, 100 percent of FRY debt contracted before December 20, 2000 (the cut-off date) will be deferred until end-March 2002 (when the current stand-by arrangement expires). In the second phase, upon approval of a successor three-year arrangement with the IMF, 51 percent of commercial debt as of end-March 2002 will be cancelled and the remaining amounts rescheduled over 22 years (with 6 years grace); moreover, 60 percent of the interest charged on the rescheduling until end-March 2005 will be capitalized. In the third phase, with the successful completion of the three-year arrangement and a satisfactory track record of payment to Paris Club creditors, FRY will obtain an additional 15 percent commercial debt reduction , bringing the total debt reduction to 66 percent. The very small amount of ODA debt owed to Paris Club creditors will be repaid over 39 years, with a 16-year grace period.[1] The agreement implies substantial cashflow relief over the next three years (2002–04), limiting annual cash debt service during this period to around US$45 million.

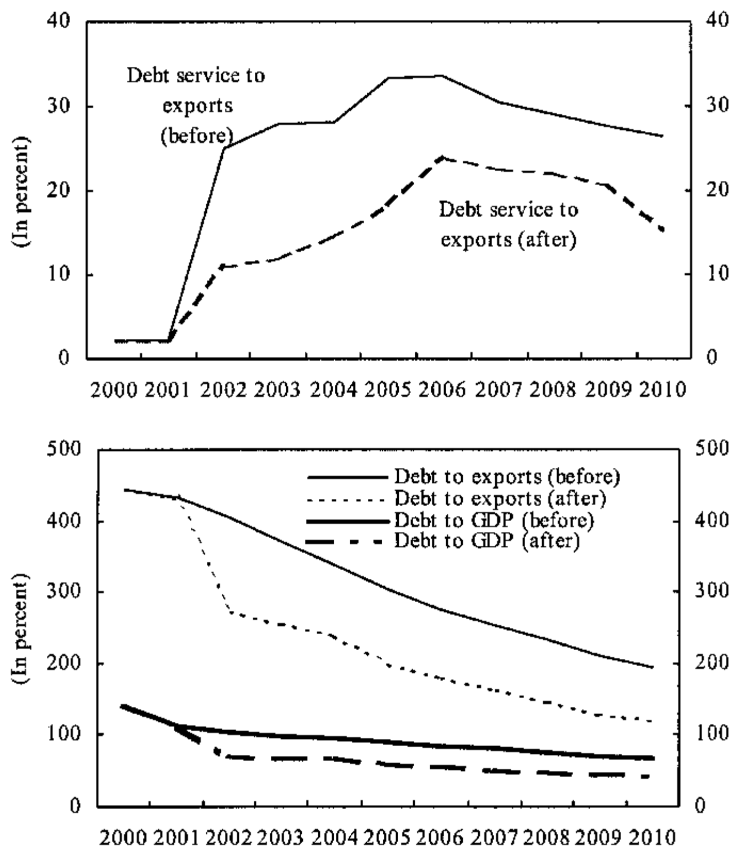
3. **Negotiations between FRY and its other bilateral creditor groups are underway.** With respect to the London Club group of creditors, a Bank Advisory Committee has been officially constituted and discussions were held in October and November. Treatment

[1] Other key elements of the agreement included: (i) a March 20, 2002 deadline for the signing of bilateral agreements; (ii) a *de minimus* clause excluding debts of less than SDR 100,000; and (iii) an option for voluntary swap agreements between FRY and its bilateral creditors.

comparable to the Paris Club restructuring agreement is being sought from London Club creditors as well as other bilateral creditors with government-guaranteed claims.

4. **The restructuring agreements with multilateral and Paris Club creditors (in conjunction with comparable treatment from other bilateral creditors) have considerably enhanced FRY's prospects for external sustainability, and rendered its debt servicing manageable over the next few years. This is conditional on a continuation of the good policy record and a strong recovery of exports and output.**[2] On this basis, debt service payments to 2005 would average around 14 percent of exports of goods and services, rising from an estimated US$335 million in 2002 to US$814 million by 2005. The debt-service ratio would rise in the latter half of the decade to 21 percent as grace periods on bilateral and multilateral restructuring agreements come to an end and given the start of principal repayments on new borrowing. Debt ratios have a favorable profile over the decade, showing a steady decline from around 200 percent of exports of goods and services in 2005 to 120 percent by 2010. In percent of GDP, debt would decline to around 69 percent in 2002 (from 112 percent in 2001) and to around 40 percent by the end of the decade.

External Debt Indicators, Before and After Bilateral Debt Reduction, 2000-2010



Sources: Data provided by the FRY authorities; and IMF staff estimates.

[2] Average growth in exports of goods and services is projected at 10.8 percent for 2001–10 (given an expected recovery from a low base), while U.S. dollar nominal GDP growth over the same period is forecast to average 8.1 percent, reflecting in part the U.S. dollar appreciation in the early part of the decade.

Profile of Principal Repayments Under the Paris Club Agreement

(Debt Reduction Option)

Year	Percent
2001	0
2002	0
2003	0
2004	0
2005	0
2006	0
2007	0
2008	1.88
2009	2.15
2010	2.46
2011	2.82
2012	3.23
2013	3.69
2014	4.23
2015	4.84
2016	5.54
2017	6.35
2018	7.27
2019	8.32
2020	9.53
2021	10.91
2022	12.49
2023	14.31

December 26, 2001

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

Dear Mr. Köhler:

The implementation of policies under our stabilization and reform program for 2001, which is supported by a stand-by arrangement approved on June 11 and reviewed on September 19, has been firm, setting the basis for continued reforms and a sustained improvement in the living standards of our citizens. The attached Memorandum of Economic and Financial Policies—which updates and supplements the Memoranda attached to our letters of May 25, 2001 and September 4, 2001—describes our economic objectives and policies for the remainder of the program period. On this basis, we request: (a) completion of the second review under the stand-by arrangement and (b) a waiver of applicability of end-December 2001 performance criteria.

We believe that the policies and measures described in the attached memorandum are sufficient to achieve the program objectives, but we stand ready to take additional measures and seek new understandings with the Fund, if necessary, to keep the program on track. We will remain in close consultation with the Fund in accordance with the Fund's policies on such consultations, and will provide the Fund with all information that it requests to assess the implementation of the program. We propose to combine the last review under the current stand-by arrangement that is scheduled to expire at end-March 2002 with the start of an extended arrangement in support of a medium-term program of adjustment and reform.

Yours sincerely,

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

Mladjan Dinkic /s/
Governor
National Bank of Yugoslavia

Bozidar Djelic /s/
Minister of Finance
Republic of Serbia

Miroslav Ivanisevic /s/
Minister of Finance
Republic of Montenegro

FEDERAL REPUBLIC OF YUGOSLAVIA

REVISED MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

Belgrade, December 26, 2001

I. Introduction

1. This memorandum updates and supplements the Memorandum of Economic and Financial Policies (MEFP) attached to the Letter of Intent of May 25, 2001, as subsequently revised by the MEFP attached to the Letter of Intent of September 4, 2001. It reports on economic performance and policy implementation under the Fund-supported program for 2001, updates the economic objectives and policy agenda under the program for the remainder of this year, and outlines the key economic and policy objectives for 2002. Annex A to this memorandum describes the quantitative performance criteria and indicative limits for the remainder of the program; and Annex B lists the preconditions for consideration of the second review by the IMF Executive Board, and the structural performance criteria and benchmarks for the remainder of the program.

2. **With macroeconomic and structural policies on track, rapid progress is being made in stabilizing and reconstructing the economy.** In FRY as a whole, the fiscal, credit, wage and external targets of the program were achieved by a comfortable margin at end-September 2001. In Serbia, important decisions have been taken regarding reform of the banking system and, despite some initial delays, the privatization process remains on track. Meanwhile, retail price inflation declined to an annualized rate of 42 percent during the first 10 months of the year, from 113 percent last year, the foreign exchange reserves of the National Bank of Yugoslavia (NBY) have more than doubled since the beginning of the year, confidence in the dinar is being steadily restored, and output is on the rise—albeit from low levels. In Montenegro, fiscal pressures have eased somewhat. Further progress has been made in the areas of budget reform and privatization, while important decisions are pending in the area of bank restructuring. Inflation remains relatively high (an annualized rate of 26 percent in DM terms during January–September 2001) reflecting administered price increases as well as the lagged effects of large wage increases until late 2000.

II. Economic and Policy Objectives for the Remainder of 2001 and for 2002

3. **Achievement of the broad macroeconomic objectives for this year has set the basis for further progress in 2002.**

- *Real GDP* in FRY is expected to grow by 5½ percent in 2001, somewhat faster than programmed, with strong output growth in agriculture and some services (including tourism in Montenegro) more than offsetting the lackluster performance of industry; in Montenegro, output growth was lower (3½ percent) than in the rest of FRY. Looking ahead, a worsening of economic conditions abroad will affect the FRY economy adversely, by limiting prospects for export growth and inflows of foreign direct investment. According to preliminary projections, GDP in FRY will grow by about 4 percent in 2002, with a resumption of growth in industry from a low level broadly compensating for normal agricultural performance.

- *Inflation* in Serbia is expected to decline by almost two-thirds to 40 percent during 2001, compared to a program target of 35 percent. Adjusting for the effects of administered price increases and higher indirect taxes, core inflation is estimated at about 15–20 percent. For 2002, inflation is targeted to be halved to 20 percent; in light of further adjustments in administered prices, this would imply a core inflation rate of about 10 percent. In Montenegro, inflation is projected to decline by two-thirds to 8 percent during 2002.

- Recent developments in the external accounts are consistent with the program target for the *current account deficit* in 2001. For 2002, the 'underlying' current account deficit (adjusted for interest payments and project-related imports) is expected to decline slightly in relation to GDP.

4. **The updated policy targets for 2001 and the key policy parameters for 2002 are consistent with a strengthening of stabilization and reform.** The fiscal deficit in the whole of FRY is now estimated at 2.4 percent of GDP in 2001, compared with a revised program target of 4.0 percent, reflecting revenue overperformance and some spending compression in response to delays in foreign financing and privatization receipts that had been programmed for late 2001. In the area of monetary policy, the NBY has revised the NFA and NDA targets for the remainder of 2001 to lock in and sterilize some of the continued external overperformance. Looking ahead, the fiscal program for 2002 will emphasize reliance on foreign assistance and privatization receipts to meet the new burdens on the budget, and—as a key fiscal objective—will strictly limit recourse to borrowing from the banking system to 0.6 percent of GDP. This should create some room for the restructured banking sector to support expansion of private sector economic activity. The overall fiscal deficit in FRY is tentatively projected to rise by 3.8 percentage points, to 6.2 percent of GDP in 2002. The increase in the deficit is entirely explained by a projected rise in interest payments on external debt, bank and enterprise restructuring costs, and investment spending. Adjusted for these categories of spending, the underlying fiscal deficit would decline by the equivalent of 1.6 percent of GDP in 2002. If progress in stabilization is slower than envisaged, macroeconomic policies will be tightened as needed to ensure achievement of the program objectives.

A. External Debt Management

5. **Progress toward normalizing relations with external creditors has gained momentum in the past few months.** An agreement was reached with Paris Club creditors on November 16, involving inter alia a phased 66 percent reduction in the net present value of commercial obligations and a rescheduling of the remaining stock over 22 years with a 6-year grace period. A Bank Advisory Committee for Yugoslavia's London Club creditors has been officially constituted and discussions were initiated in October. Treatment comparable to the Paris Club restructuring agreement will be sought from London Club as

well as other bilateral creditors with government-guaranteed claims. As regards multilateral creditors, the regularization of arrears is nearly complete. EIB arrears of US$209 million were cleared on October 17, 2001 with the assistance of an EU macro-financial loan. Agreement was also reached in November 2001 on the restructuring of around US$1.8 billion in arrears to the World Bank, which involves a repayment of obligations over 30 years and paves the way for the commencement of lending operations. Discussions with the Eurofund were held in early October and agreement is expected on a restructuring of arrears over a ten year period. Efforts toward settlement with the two remaining multilateral creditors, the International Bank for Economic Cooperation in Moscow and the IFC, are continuing.

6. **The federal and republican authorities remain committed to observing the limits on non-concessional borrowing specified under the program.** In this regard, a disbursement that shall not exceed US$50 million is planned from the KfW by mid-December to be used to assist the electricity generating company to carry out critical investment and repairs.

B. Fiscal Policy

Overview

7. **Notwithstanding a difficult and uncertain environment, fiscal policy has remained on track in FRY as a whole in 2001, while important reforms have enhanced the efficiency of the tax and expenditure systems.** The deficit of the consolidated general government in FRY is now envisaged to amount to 2.4 percent of GDP in 2001, compared with an original target of 6.1 percent and a revised target of 4.0 percent of GDP, while the limit on net government borrowing from the banking system (of up to 0.8 percent of GDP) will be observed. In Montenegro, the budget remained under pressure, contributing to arrears accumulation by the health fund. Meanwhile, a wide-ranging tax reform in Serbia, as well as improvements in tax administration in Montenegro, contributed significantly to buoyant tax revenue.

8. **Fiscal policy will continue to support economic stabilization and recovery.** The preparation of the budgets for the next year, now underway, is subject to considerable uncertainty—related in large part to the amounts of foreign budgetary assistance and privatization receipts as well as tax revenues. Based on preliminary estimates, the fiscal deficit in FRY is expected to reach 6.2 percent of GDP in 2002 and to be financed largely by grants (1.2 percent of GDP), foreign loans (3.0 percent of GDP), and privatization proceeds (1.4 percent of GDP). Borrowing from the banking system will be limited to the equivalent of 0.6 percent of GDP. On current policies, the revenue/GDP ratio in FRY would rise by 1.6 percentage points, reflecting the full-year effect of tax reform measures introduced since last April and increases in excises, partly offset by a substantial reduction in the distortionary tax on financial transactions and sales tax exemptions for selected basic food items and medicines in Serbia. The expenditure/GDP ratio in FRY would rise by about 5.5 percentage points, accommodating an increase in (a) interest payments associated with the resumption of debt service to bilateral creditors and the World Bank (1.8 percentage points), (b) bank and

enterprise restructuring costs (1.6 percentage points), and (c) investment spending (2.0 percentage points). Other spending, including wages, would remain broadly unchanged in relation to GDP. This appropriate fiscal policy stance will be accompanied by continued reforms of the budget system supported by a World Bank Public Expenditure and Institutional Review (PEIR).

9. **The repayment of frozen foreign currency deposits (FFCDs) will continue as envisaged under the program** (MEFP of May 25, 2001, ¶15). Bonds have already been issued to repay deposits up to DM 10,000 per account. A decision on the issuance of bonds to repay amounts in excess of DM 10,000 per account will be taken in 2002 in the context of the formulation of a medium-term program, consistent with limiting repayments to no more than 0.9 percent of projected GDP in 2005 and subsequent years.

Federation

10. **The execution of the federal budget in 2001 is expected to be in line with the program.** Strong revenue performance on account of the sales tax and the customs duties, coupled with a prudent wage policy, have created room for clearance of outstanding arrears to military suppliers, full payment of military pensions, and additional spending related to the security zone in southern Serbia, in line with international agreements. A salary freeze through September at the level of November 2000 generated considerable savings from the budgeted amounts, which were only partly used to pay for the 15 percent wage raise granted in the last quarter. The introduction of civilian control over military spending, following the end-August transfer of responsibility for defense spending from the General Staff to the Defense Ministry, has significantly improved fiscal transparency and expenditure management. An internal audit of the defense budget will be initiated soon with a view to generating savings and averting further accumulation of expenditure arrears.

11. **The federal budget for 2002 will continue to operate with a cash balance and avoid any new accumulation of arrears.** In light of the 15 percent wage increase in the last quarter in 2001, further wage increases during 2002 will be strictly limited to keep the real wage bill constant on a year-on-year basis. Defense spending is expected to be contained to 3.8 percent of GDP through measures to restructure the military, including a shortening of the compulsory military service, offset by increased spending in southern Serbia to address security needs in accordance with international treaties.

Serbia

12. **The Serbian government continues to execute the budget cautiously.** Strong revenue performance and containment of spending have compensated for delays in foreign budgetary assistance and privatization receipts that were programmed for late 2001. Revenue is expected to exceed the program target by the equivalent of 1½ percent of FRY's GDP due to strong performance by the sales tax, excises, and the personal income tax. Spending is expected to be lower than originally programmed by the equivalent of 2.3 percent of GDP owing mainly to a shortfall in foreign-financed projects and lower interest payments on

foreign debt. Larger transfers to the social security funds would be offset by savings in material spending and subsidies.

13. **The social security funds have been affected more adversely by the mid-year tax reform than initially envisaged.** High growth in recorded wages in July–August—which seems to have moderated thereafter—in conjunction with delays in amending the pension indexation scheme, have worsened the financial position of the pension fund. As a result, budget transfers to the pension fund will need to increase by the equivalent of 1.1 percent of GDP. Pension arrears incurred in February 2001 are expected to be eliminated by end-March 2002. The health care fund and the labor market fund, on the other hand, will be able to clear some of their arrears to beneficiaries and maintain the current level of services, with transfers to them from the budget contained below programmed levels.

14. **The 2002 Serbian budget will face serious challenges as bank and enterprise restructuring will drain substantial resources and debt servicing will rise sharply following normalization of relations with foreign creditors.** Based on preliminary estimates, revenue will improve relative to GDP owing to the full-year impact of the tax reform that started mid-year in 2001 and increases in excises, partly offset by a lowering of the financial transactions tax and sales tax exemptions for selected basic food items and medicines. On the expenditure side, the Serbian budget will bear most of the external debt servicing obligations of the FRY. The budget will also need to provide for spending on bank and enterprise restructuring of about 1.5 percent of GDP, in the form of severance payments to redundant bank and enterprise workers and limited payments to depositors of banks undergoing liquidation. Wage policy will be guided by the principle of maintaining a constant wage bill in relation to GDP. Other spending will also be kept constant in relation to GDP. Most importantly, the pension system was reformed through the adoption of legislation in December 2001 that raised immediately the retirement age by 3 years and changed the indexation scheme for pensions along the lines of the Swiss model, with a view to keeping pensions in line with available resources. The Serbian budget is expected to run a cash deficit of about 5.6 percent of GDP in 2002, to be financed by 1.0 percent of GDP of grants, 2.7 percent of GDP of foreign borrowing on concessional terms, 1.3 percent of privatization receipts, and 0.6 percent of GDP of domestic bank borrowing. The privatization proceeds anticipated in the budget (equivalent to about US$150 million) compare with a Privatization Ministry estimate of US$200–400 million for 2002 (¶28 below). Privatization receipts in excess of the amount that is anticipated in the budget would be used, in the first instance, to reduce the government's net indebtedness and, in consultation with the Fund and the World Bank, for the restructuring of enterprises with a view to facilitating their privatization.

15. **Fiscal reform continues.** Following the wide-ranging tax and budgetary reforms in the first half of 2001, further progress has been made in improving expenditure management. The health fund adopted a revised drug list consistent with WHO guidelines and the line ministries' sub-spending accounts were eliminated, in line with structural benchmarks for end-September. Moreover, a set of draft laws, including the Organic Budget Law and the Public Procurement Law, were adopted by the government recently and are to be submitted to parliament by end-December 2001, while draft Tobacco and Lottery laws are to be submitted to parliament by end-January 2002. A new law on tax assessment and collection is

being prepared; after revisions to take into account the anticipated reform to the payment system it will be submitted to parliament by mid-February 2002. Preparations for the establishment of Large Taxpayer Offices are running behind schedule owing to staffing constraints, but these are being addressed with the assignment of additional staff and the assistance of a resident tax administration advisor. In addition, progress is envisaged toward the establishment of a Treasury in the Ministry of Finance by mid-2002.

Montenegro

16. **Fiscal pressures eased somewhat in Montenegro after mid-year, on the basis of stronger revenue performance.** Tax revenue is projected to be higher than budgeted by about 4 percent of Montenegro's GDP, mainly on account of sales tax and custom duties, reflecting a robust tourist season and measures to fight smuggling and tax evasion. In the context of higher than programmed inflation, the budget experienced expenditure overruns in almost all spending categories—with the exception of wages and salaries due to a nominal wage freeze. The consolidated general government of Montenegro is estimated to register a deficit (after grants) of about DM 28 million for the full year, down from DM 50 million at mid-year, while the central government is expected to effect previously delayed transfers to the social funds, thus permitting the clearance of arrears of about DM 22 million which had been accumulated by these funds earlier in the year.

17. **For 2002, the Government of Montenegro is committed to improve expenditure efficiency and reduce non-interest current expenditure in relation to GDP to restore fiscal balance and bring the budget on a path of sustainability.** The government will delink the minimum wage from public sector pay scale so that the announced 12.5 percent increase in minimum wage will not lead to automatic increases in the public sector wages and benefits. Wage policy in 2002 will maintain the wage bill broadly constant in relation to GDP, reflecting a 5.4 percent rise in the base salary, increased employment mainly to fight the gray economy, and a corrective increase in teachers' salaries. Capital expenditure will also remain constant in relation to GDP, while subsidies to enterprises will increase in relation to GDP owing to the counterpart of foreign-financed electricity imports. As a result, the share in GDP of other non-interest current expenditure will decline, so as to accommodate the sharply higher external debt servicing cost. This would result in a deficit of 6.5 percent of GDP, financed entirely by foreign grants and loans (5.5 percent) and privatization revenue (2.6 percent), after taking into account a repayment of 1.6 percent of GDP to the central bank.

18. **The government has achieved substantial progress in fiscal reform.** Specifically, the new Organic Budget Law and Public Procurement Law were adopted by the parliament in August 2001. An interim Treasury was set up in October, and is expected to operate fully from the beginning of 2002. Furthermore, six new drafts of tax codes covering personal income tax, corporate income tax, excises, property tax, the VAT and tax administration are being discussed in the government and parliamentary approval is expected by end-2001. With a view to enhancing fiscal transparency and efficiency, the Ministry of Finance requested a reputable foreign accounting firm to undertake an audit of the financing of the budget. The report, which was completed on November 15, 2001, revealed inter alia

weaknesses in internal controls over budget borrowing and issuance of guarantees. This helps explains the issuance of government guarantees for two loans (totaling DM 200,000) from a commercial bank to an enterprise with mixed state/social ownership, in violation of a performance criterion. These problems are being addressed, in part by the newly established (with assistance from the USAID) Treasury in the Ministry of Finance.

C. Wage and Pricing Policies

19. **Wage policy is geared to protecting competitiveness and lowering inflation.** Wage policy in *Serbia* has generally aimed at maintaining the real wage bill of the state sector in 2001 unchanged from 2000 on the basis of the targeted rate of inflation. Consistent with this policy, wages in the federal government were raised in the last quarter of this year by 15 percent, unwinding the freeze that had been in place from November 2000; and wages in state enterprises, which had been frozen at their January level, were allowed to rise by about 10 percent in September in the context of cost-cutting restructuring measures. Wages in the Serbian government, which, unlike wages in the federal government and state enterprises, did not benefit from a large increase in late 2000 or early 2001, were instead allowed to rise in the course of 2001, with the annual wage bill kept unchanged in real terms from last year. Looking ahead, the federal and Serbian authorities will continue to contain wage growth to prevent an increase in the state sector wage bill in relation to GDP in 2002. In *Montenegro*, where public sector wages and the minimum wage have been kept constant since late 2000 in the context of an annual rate of inflation of over 20 percent, a tight wage policy will remain in effect so as to contain inflation and protect external competitiveness. In light of a 12.5 percent increase in the minimum wage as of January 1, 2002, to compensate partially for inflation over the past year, public sector wages and social benefits will be delinked from the minimum wage by end-2001, in line with an undertaking under the program (monitored through a structural benchmark). So as to manage the public spending on wages and social benefits in a fiscally sustainable manner, public sector wages and social benefits will no longer be based on the minimum wage but on a new "base wage," which for 2002 will rise by 5.4 percent. In both republics, the demonstration effect of wage restraint in the state sector should help contain wage growth in the rest of the economy. In addition, recent changes in labor legislation in Serbia have enhanced the flexibility of the wage determination process, while privatization should help improve corporate governance and financial discipline at the enterprise level.

20. **Pricing policy aims to reduce distortions and quasi-fiscal deficits.** Electricity prices in Serbia were increased by 15 percent on October 1, 2001, bringing the cumulative increase since the beginning of this year to almost 120 percent. With the last increase, revenues would cover operating costs, after taking account of some DM 170 million in grants and DM 50 million in soft loans that are expected to fund reconstruction of assets destroyed or neglected during the 1990s and electricity imports during the winter season. The electricity price in Serbia is expected to be further increased from US¢ 2.03 to US¢ 3.0 per kWh by end-2002. This strategy will necessitate YUD 5 billion in budgetary support, in addition to envisaged donor support for maintenance and reconstruction. The prices of other utilities as well as the administered price of bread have also been adjusted by large amounts. In Montenegro, most administrative price controls have been removed with the exception of

electricity and other utility prices. Electricity prices were effectively increased by 50 percent in November 2001 to the equivalent of US¢ 2.7 per kWh and will be further increased in during 2002.

D. Monetary and Exchange Rate Policy

21. **The financial program targets for 2001 have been further revised to take account of the remonetization of the economy.** The much higher-than-programmed growth in reserve money is explained entirely by net NBY purchases of foreign exchange from the public, an indication of growing confidence in the dinar. In light of these developments, reserve money is now targeted to grow by about 76 percent during 2001 (compared with 46 percent under the revised program), with the NDA and the NFA of the NBY contributing 10 and 66 percentage points to this growth, respectively, as compared with contributions of 25 and 21 percentage points, respectively, under the revised program. Within reserve money, currency in circulation is expected to rise by 90 percent in line with recent trends, while the other components of reserve money are expected to decline sharply in real terms mostly on account of the banks' excess reserves (these were relatively high at end-2000 and have since been absorbed through money market operations). In the event of higher-than-projected NFA, the NBY will consult with the Fund staff on the implications for credit policy and—if the NFA overperformance does not appear to reflect increased money demand—will maintain the NDA below the program ceiling.

22. **Exchange rate policy will seek to strike a balance between safeguarding external competitiveness and stabilizing inflation expectations.** The broad stability of the exchange rate of the dinar against the DM (euro), in conjunction with the strengthening of foreign reserves, has contributed to the restoration of market confidence. Furthermore, the current level of the exchange rate appears to be broadly adequate, considering that the NBY continues to be a net purchaser from the foreign exchange market and that the real exchange rate of the dinar is still below its level in 1998, when international sanctions were still in effect. However, in light of the sizable real appreciation of the dinar since the beginning of the year, the NBY will continue to monitor closely developments in the foreign exchange market with a view to adjusting exchange rate policy as needed to safeguard the external position. Owing to uncertainty about the external outlook and underlying position, exchange rate policy will be reviewed quarterly under the program.

23. **The NBY is liberalizing further the foreign exchange market and reforming monetary policy instruments.** In the first quarter of 2002, a new foreign exchange law will be adopted, along with changed regulations on open positions, which will allow banks to participate actively in the foreign exchange market. Pending the adoption of this law, the exchange rate band within which commercial banks may transact outside the interbank market will be widened to +/-2½ percent, and the NBY will repeal the surrender requirement for foreign currency banknotes. In addition, the reserve requirement system is being reformed through (a) the abolition of the supplemental reserve requirements as of September 2001 and (b) the adoption, in January 2002, of a unified system of monthly averaging for reserve requirements (in both domestic and foreign currencies) at a rate that leaves the effective reserve requirement unchanged (around 15 percent), compared to the current rate of

24.5 percent). To complement the change in required reserves, the NBY will simultaneously lower liquidity requirements on foreign exchange deposits in a compensating fashion (by about 15 percentage points) and abolish liquidity requirements on dinar deposits. To facilitate banks' short-term liquidity management needs, a marginal lending facility and a permanent deposit window will be developed by end-March 2002.

24. **Further measures to accelerate financial market development will facilitate monetary operations and privatization.** A new Law on Securities will be submitted to Parliament by March 2002 and a Law on Investment Companies will be submitted to Parliament by June 2002 to facilitate the operation of primary and secondary securities markets. By December 2001, a working group will be established to promote financial market development through the issuance of market-friendly instruments that are issued to repay frozen foreign currency deposits. Another working group, including representatives of the Belgrade Stock Exchange, will be established to develop money market infrastructure.

25. **The NBY is committed to improve its accounting, audit, and control systems.** Accordingly, by end-December 2001, the NBY will take a decision to (i) address the accounting treatment of unresolved succession issues and (ii) prepare financial statements for financial year 2001 on the basis of International Accounting Standards (IAS). By mid-February 2002, the Internal Audit Department of the NBY, as part of its regular audit cycle, will review the reconciliation of the accounting records and the NFA data submitted to the Fund for program purposes on a monthly basis, effective with the end-December 2001 data. In addition, by mid-February 2002, the NBY will strengthen the functioning of the Internal Audit Department by: (i) defining its role with the development of a charter and ensuring an appropriate degree of independence and objectivity; (ii) continuing to recruit additional staff with skill levels necessary to successfully conduct financial and information systems risk-based audits; and (iii) commissioning an independent assessment of the Internal Audit Department. Furthermore, it is envisaged that: by mid-2002, the Law on the NBY will be amended to (i) adopt IAS as the permanent accounting framework, and (ii) provide for a Supervisory Board (the By-laws of the NBY will also define the establishment of an Audit Committee). Finally, by end-June 2002, the IAS-based financial statements of the NBY will be published.

E. Bank Restructuring

26. **Substantial progress in bank restructuring has been made in line with the Bank Restructuring Strategy prepared by the NBY last May.** Of about 85 banks, 19 banks have been closed as insolvent and nonviable, another 17 banks have been merged (or are in the process of being merged) with other banks to meet capital requirements, and one small bank has been placed under NBY administration owing to irregularities. In addition, five solvent but undercapitalized banks have been placed in the problem bank unit of the NBY and 8 insolvent banks (including five large ones) have been brought under the control of the Bank Rehabilitation Agency (BRA) for possible rehabilitation. The BRA Board, based on the recommendations of the NBY, has appointed new managers, recognized the losses on bad loans, written off the equity capital, and established the BRA as the exclusive owner of the five largest banks. In late September, the federal Parliament approved amendments to the

Law on the Financial Rehabilitation, Bankruptcy, and Liquidation of Banks, as well as to the Law on the Agency for Deposit Insurance and Bank Rehabilitation, Bankruptcy and Liquidation or the BRA law, which will allow for speedier resolution through the authorization of the BRA to become designated as the receiver and liquidator of banks while curtailing the powers of the bankruptcy judge as regards banks. As a step toward deciding on the future of the large banks that are under BRA administration, detailed information has been compiled on the income, expenses, and cash flow of these banks and their liquidity positions are closely monitored. Problems related to these banks will be resolved in an expeditious and fiscally prudent manner.

27. **Banking supervision at the NBY will be strengthened through new legislation and improvements in technical capacity.** In particular, by end-2001, an amendment to the Law on the National Bank setting out its supervision functions will come into effect, and revisions to the Law on Banks would empower the NBY to issue regulations on bank supervision in line with international practice. Implementing regulations will take effect at the beginning of 2002, covering, *inter alia*, capital adequacy, exposures, liquidity, lending to connected parties and shareholders, loan classification and provisioning, internal control and risk management, credit activities, and investment in fixed assets as well as other bank and enterprise capital. The NBY has increased the number of staff trained to carry out on-site supervision and a computerization project is underway to automate off-site supervision. From the beginning of 2002, the frequency of bank reporting will increase from quarterly to monthly. Lastly, to facilitate NBY's efforts to curtail opportunities for money laundering from the outset of EURO conversion process, the Bankers' Association has agreed upon regulations requiring banks to report transactions in excess of DM 20,000.

28. **The Central Bank of Montenegro (CBM) has taken steps to restructure the banking system.** The largest bank, Montenegro Banka (MB), is under Central Bank control and the authorities have eschewed the possibility of a capital injection. A decision regarding privatization or liquidation of the bank will be made by end-December 2001. Documents inviting investors to acquire MB, in part or in full, have been made available to potential investors and posted on the website of the CBM. If liquidation is adopted, a program will be designed to mitigate the social impact of bank closure, costing about DM 1.8 million for an expected 440 layoffs. Diagnostic reports for the remaining 10 commercial banks in Montenegro have been completed with assistance from bilateral donors. Four of these banks have been re-licensed based on new regulation. A decision regarding the re-licensing of the remaining six banks will be made by mid-January 2002, following the expected adoption of the proposed amendments to the Law on the Banks.

29. **Further progress has also been made in strengthening the CBM's bank supervision capacity.** The Law on Bankruptcy and Liquidation of Banks and amendments to the Law on the Central Bank, which regulates banks' lending as well as purchases and sales of government securities, have been passed. Decisions on liquidity risk, internal control, internal and external audit, and implementation of the CAMEL system have been issued. A law on the International Accounting Standards (IAS) is expected to be adopted by end-November 2001 and a decision implementing a new chart of accounts for banks—in line with IAS—is expected to become effective in January 2002. This would allow for, inter alia,

better monitoring of credits to government. To enable CBM to supervise the existing offshore banks, in line with the rules and regulations applicable to onshore banks, an amendment to the Law on Banks is being drafted and is expected to be submitted to parliament by year-end. Meanwhile, the Ministry of Finance has ceased issuing licenses to new off-shore banks since late 2000. The CBM is well advanced in its plans to introduce the euro on January 1, 2002, in line with the Law on the Central Bank.

F. Enterprise Restructuring and Privatization

30. **Privatization is moving forward in Serbia despite some delays in obtaining privatization receipts.** Tenders for the three cement companies were published in late October and, in light of strong interest among investors, the transactions are expected to be completed in January 2002, slightly later than envisaged under the program, and to generate substantial fiscal revenues. Moreover, 27 companies are to be privatized under the World Bank-supported program: 15 companies in 4 pools, to be followed by 12 companies in 2 pools. A structural benchmark for the conclusion of at least four contracts for the privatization of pools of companies by end-October, 2001 was missed due to a slowdown in consultations with the World Bank, in the wake of the September 11 events. Under the revised schedule, for the first 4 pools, advisors are to be appointed in January 2002, tenders are to be launched in February/March 2002 and privatization is expected to take place in 2002 Q2. For the remaining 2 pools, advisors will be appointed in March 2002 and privatization is expected to be completed in 2002 Q3. In addition to these 27 companies, two other large enterprises (Beopetrol and Frikom) will be offered for sale through international tender during 2002. Auctions and sales of minority interests in selected companies will also start in 2002. Auctions can be initiated by the Ministry, the workers or potential investors. The authorities intend to initiate the auction process of some 30 companies during 2002 and to encourage further interest in this process by publishing basic information on some 500 socially-owned small and medium-sized companies. Total privatization revenue could reach the equivalent of US$200–400 million during 2002. Some 28–35 large diversified and insolvent companies will be restructured over the next two years prior to their privatization, starting with the automobile company Zastava. Restructuring of up to 10 other companies will be undertaken with assistance from the European Agency for Reconstruction.

31. **The processes of bank and enterprise restructuring will be coordinated.** A memorandum of understanding between the Privatization Agency (PA) and the BRA will guide the restructuring of debts to banks under BRA administration. A write-off of tax arrears and a haircut of BRA claims either directly or through a debt/equity swap would facilitate the privatization process significantly. If legally feasible, a memorandum of understanding will give BRA creditors equal treatment to at least the recovery percentage that all creditors could realize under current bankruptcy procedures. The Supreme Court will be invited to give its opinion on this approach by end 2001. Moreover, the state will not remove or "clean" bank assets (related to frozen foreign currency deposits, World Bank, Paris Club, and London Club debts) prior to or during liquidation of banks; these will remain as assets of the banks and as liabilities to government.

32. **Progress in privatization is also being made in Montenegro.** The mass privatization plan is proceeding as envisaged and 51 percent in Montenegro's telecom company is being offered for sale through a tender. Six privatization investment funds, representing Montenegrin and foreign investors from 15 foreign entities, have been licensed to manage privatization vouchers. These companies control over 60 percent of all vouchers. During December, these companies and the citizens of Montenegro will receive shares in 227 companies. Following registration of the shares with the Central Depository Agency in January 2002, shareholder meetings will be called to appoint new directors to all privatized companies. Tenders for a majority share will be offered in selected companies including the Montenegrin telecommunications and Yugopetrol (Montenegro) that are expected to be completed during 2002.

Federal Republic of Yugoslavia: Quantitative Performance Criteria and Indicative Limits Under the 2001-2002 Stand-By Arrangement 1/

(In millions of dinars, unless otherwise noted)

	2000	2001								
	End-Dec.	End-Mar.	End-June		End-Sep. Target			End-Dec. Target		
	Actual		Target	Actual	Original	First Review.	Actual	Original	First Review.	Revised
A. Quantitative performance criteria										
Floor on the net foreign assets of the NBY 2/	-308	-231	-283	-170	-303	-255	-98	-283	-244	-103
Ceiling on net domestic assets of the NBY 3/	39,315	34,526	39,064	35,770	41,766	43,185	35,508	42,909	44,328	41,351
Ceiling on net credit of the banking system to the consolidated general government 4/ 5/	3,373	89	5,373	-22	7,373	8,792	1,898	7,373	8,792	8,792
Ceiling on contracting or guaranteeing of new nonconcessional external debt with original maturity of more than one year by the public sector 2/ 6/	...	0.0	0.0	7.3	0.0	57.3	7.3	0.0	57.3	57.3
Ceiling on new external debt owed by the consolidated general government or guaranteed by the public sector with an original maturity of up to and including one year 2/ 7/	...	0	0	0	0	0	0	0	0	0
Ceiling on new guarantees and the assumption of enterprise debt to banks by the public sector 8/	...	0	0	0	0	0	6	0	0	6
Ceiling on outstanding external debt service arrears 2/ 9/	...	0	0	0	0	0	0	0	0	0
B. Indicative targets										
Ceiling on net domestic assets of the banking system 10/	19,433	15,720	24,604	18,513	28,226	29,198	22,969	31,226	32,831	33,602
Ceiling on change in the arrears of										
the federal government	...	0	0	1,200	0	0	-3,469	0	0	-3,469
the consolidated general government in Serbia	...	4,691	0	5,391	0	0	4,691	0	0	4,691
the consolidated general government in Montenegro	...	0	0	382	0	0	700	0	0	0
Ceiling on the wage bill of the 8 largest public enterprises, cumulative from beginning of year 11/	9,992	4,318	8,756	8,609 2/	13,207	13,355	12,952	17,658	18,251	18,251

1/ Quantitative performance criteria and indicative targets are defined in Annex C of the Revised Memorandum of Economic and Financial Policies of September 4, 2001 (Appendix IV of EBS/01/154, 9/5/01). Contrary to the definition of debt contained on page 61 of that document, the term debt for the purposes of the end-December 2001 performance criterion on external debt will exclude debt contracted in the context of rescheduling agreements.

2/ In millions of U.S. dollars.

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

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

5/ The consolidated general government comprises the federal, the Serbian republican and local governments, the Montenegrin republican government, the Serbian and Montenegrin social security funds, and the Serbian special extrabudgetary programs.

6/ Excluding loans from the IMF, EBRD, EIB, IBRD, or IFC, as well as debt contracted in the context of rescheduling agreements. The public sector comprises the consolidated general government and the National Bank of Yugoslavia. The increase of $50 million for end-Sept. and end Dec. ceilings represents anticipated borrowing by the Serbian governments under relatively favorable terms to rehabilitate the ailing energy sector.

7/ Excluding normal import-related credits.

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

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

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

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

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

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

	Implementation Date Reported in EBS/01/154	Status/revised implementation date
I. Prior Action for Board Consideration		
1. Submission to Federal, Serbian and Montenegrin parliaments of proposed budgets for 2002, consistent with key policy parameters described in MEFP of December 26, 2001.	...	Implemented
II. Structural Performance Criteria		
1. (Serbia) Increase in average electricity tariff (weighted by consumption) by 15 percent.	October 1, 2001	Implemented
III. Structural Benchmarks		
A. Fiscal Sector		
1. (Serbia) Issuance of decree revising the list of drugs offered to the general public population in state pharmacies, to bring expenditure on drugs in line with financial resources available to the health care system.	end-September 2001	Implemented in mid-October 2001
2. (Serbia) Improvement of cash management and fiscal reporting by eliminating primary budget managers' expenditure accounts and own accounts of direct spending units (637 accounts and their 850 subaccounts) and by creating ledger accounts within account 630.	end-September 2001	Implemented.
3. (Montenegro) Completion of a report on the external audit of the budget financing by a reputable international accounting firm.	November 15, 2001	Implemented
4. (Serbia) Submission of the Organic Budget Law and the Public Procurement Law to parliament.	...	end-December 2001
5. (Montenegro) De-linking of the statutory minimum wage from public sector pay and social benefits levels through legislation.	end-December 2001	...
6. (Serbia) Establishment of a Central Accounting Division in the Ministry of Finance and Economy.	end-December 2001	...
7. (Serbia) Establishment of a new system of commitment control based in the Treasury's Central Accounting Division.	end-December 2001	...
8. (Serbia) Set-up of a Large Taxpayer Office in Belgrade.	end-December 2001	...
9. (Serbia) Submission of a new law on tax assessment and collection to parliament.	...	mid-February 2002
10. (Federation and Serbia) Adoption of pension reform legislation, providing for an immediate increase in retirement age by 3 years and indexation of pension to the arithmetic average of price and wage increases.	end-December 2001	...
11. (Serbia) Submission of the Tobacco Law, and the Lottery Law to parliament.	...	end-January 2002
B. Financial Sector		
1. (Federation and NBY) The NBY will (a) refine, in close coordination with the BRA and in consultation with Fund and World Bank staff, its pricing matrix to be used to estimate the total costs and fiscal needs for bank restructuring, and (b) recommend either liquidation or possible rehabilitation (through the BRA) of the remaining 7 (of the 11) banks that were found to be category C banks.	September 15, 2001	Implemented

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

	Implementation Date Reported in EBS/01/154	Status/revised implementation date
2. (Federation) Approval by Parliament of the amendments to Law on the Financial Rehabilitation, Bankruptcy and Liquidation of Banks, allowing BRA to act as a bankruptcy liquidator.	end-September, 2001	Implemented
3. (Montenegro) The CBM will decide on the resolution (liquidation, rehabilitation, mergers, no action) of all banks.	end-September, 2001	end-December 2001
4. (Federation) The BRA will develop rehabilitation/resolution plans for the 4 large banks under its control. The plans will include (a) monthly cash flows and operational losses during the rehabilitation period with a view to assessing progress toward achieving core profitability; (b) future business strategies; (c) the fiscal costs of restructuring, which will critically depend on progress in securing creditor haircuts, and (d) a recommendation on whether the bank should be rehabilitated or closed.	October 15, 2001	Implemented.
5. (Federation) The Board of Directors of the BRA, will decide, under Articles 7 and 22(a) of the Act governing its operations, whether the banks should be subjected to a rehabilitation plan or liquidated. Bank rehabilitation will be undertaken only if it is expected to produce a viable bank with good prospects for privatization; and can be implemented with identifiable fiscal resources. If this does not appear to be achievable based on performance during the first six months of a rehabilitation program, the banks will be closed and liquidated.	end-October, 2001	Implemented
6 (Federation) The NBY will take a decision: (i) to address the accounting treatment of unresolved succession issues, (ii) for financial year 2001, to prepare financial statements on the basis of International Accounting Standards (IAS), and (iii) to adopt IAS as its permanent accounting framework, effective with the 2003 financial year.	...	end-December 2001
7 (Federation) The Internal Audit Department of the NBY, as part of its regular audit cycle, will review the reconciliation of the accounting records and the NFA data submitted to the Fund for program purposes on a monthly basis, effective with the end-December 2001 data. In addition, the NBY will strengthen the functioning of the Internal Audit Department by: (i) defining its role with the development of a charter and ensuring an appropriate degree of independence and objectivity; (ii) continuing to recruit additional staff with skill levels necessary to successfully conduct financial and information systems risk-based audits; and (iii) commissioning an independent assessment of the Internal Audit Department.	...	mid-February 2002
C. Private Sector Development		
1. (Serbia) Conclusion of at least four contracts for the privatization of pools of companies (of 3-5 enterprises each) with investment banks hired through competitive international tenders (out of a total of seven pools for which international advisors will be solicited this year).	end-October 2001	end-December 2001
2. (Serbia) Offer of at least one pool of companies consisting of 3-5 enterprises for sale observing well defined, internationally accepted tender rules.	end-December 2001	end-February 2002
3. Appoint advisors for the privatization of 2 pools comprising a total of 12 companies.	...	January 15, 2002

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

	Implementation Date Reported in EBS/01/154	Status/revised implementation date
4. (Serbia) Offer of at least one pool of companies consisting of 3-5 enterprises for sale observing well defined, internationally accepted tender rules.	...	end-February 2002
5. (Serbia) Offer of at least two pools of companies consisting of 3-5 enterprises for sale observing well defined, internationally accepted tender rules.	...	end-March 2002
6. (Federation and Serbia) Request for the opinion of the Supreme Court on a draft memorandum of understanding between the Privatization Agency and the Bank Restructuring Agency.	...	end-December 2001
7. (Serbia) Adoption of a new labor law to liberalize the labor market.	...	end-February 2002

INTERNATIONAL MONETARY FUND

FEDERAL REPUBLIC OF YUGOSLAVIA

Second Review Under the Stand-By Arrangement and Modification of Performance Criteria

Supplementary Information

Prepared by the European I and Policy Development and Review Departments

(In consultation with other Departments)

Approved by Carlo Cottarelli and Shigeo Kashiwagi

January 10, 2002

1. This paper supplements EBS/01/216 (12/28/01) with an update on budgetary developments and progress in bank reform and enterprise privatization. As reported in EBS/01/216 (page 63) and further explained below, all prior actions for the Board consideration of the second review have been implemented. Attached to this paper is a letter from the authorities dated January 4, 2002 (see ¶3 below).

2. The federal, Serbian, and Montenegrin parliaments have approved budgets which, according to information available to the staff, are consistent with the key policy parameters described in the MEFP of December 26, 2001 (Appendix V of EBS/01/216). Under the program, the *submissions* of such federal and republican government budgets to the respective parliaments had been designated as the only prior actions for Board consideration of the second SBA review.

3. As described in the attached supplementary Letter of Intent of January 4, 2002 and accompanying memorandum of the federal and Serbian authorities, four large insolvent banks were put into bankruptcy on January 3, 2002, pending their liquidation. These banks account for about 55 percent of the book value of banking system assets but have been insolvent for years, and their share in domestic payments operations is well below 20 percent. In line with the authorities' undertakings under the program (¶26 of the MEFP of December 26, 2001), the bankruptcy procedures—agreed with Fund and World Bank staff—seek to ensure that the bankruptcies are carried out in an expeditious and fiscally prudent manner, consistent with the recently approved 2002 budget. The "incremental" bank liquidation costs—mainly in the form of payouts to depositors and severance payments to about 9,000 workers at banks being liquidated—are estimated at about 1.2 percent of annual GDP, of which about 0.6 percent of GDP will be incurred in the 2002 budget. (These are additional to the "fixed" costs of bank restructuring, which relate to government-guaranteed

additional to the "fixed" costs of bank restructuring, which relate to government-guaranteed liabilities of banks, mainly to Paris and London Club creditors, totaling about 60 percent of annual GDP; non-guaranteed debt liabilities will not be honored.)

4. On December 28, the Serbian government approved the sale of 70 percent of the equity in each of the three cement companies to foreign investors, on the basis of international tenders, for the total amount of US$140 million. This amount is expected to become available to the Serbian budget in March 2002 and compares with planned privatization proceeds in the Serbian budget of US$150 million for the whole year. In addition, the foreign buyers reportedly agreed to invest about US$150 million in these companies and to service their foreign liabilities of about US$60 million.

5. The staff welcomes these developments, which confirm the Yugoslav authorities' commitment to the Fund-supported program. The federal and republican government budgets for 2002, as approved by the respective parliaments, are consistent with the agreed fiscal framework for this year. The closure of the four large insolvent banks underscores the authorities' willingness to undertake the politically and socially difficult measures needed to reform the economy. Finally, the privatization of the three cement companies augurs well for the success of the privatization program, in addition to providing critical support to the budget.

January 4, 2002

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

Dear Mr. Köhler:

Further to our letter of December 26, 2001, and the accompanying Revised Memorandum of Economic and Financial Policies, attached please find a memorandum describing recently adopted measures with regard to the resolution of four large insolvent banks and the associated fiscal costs. As noted in the attachment, these banks were put into bankruptcy on January 3, 2002, as an important step toward building a sound financial system in Yugoslavia. The related costs—mainly in the form of deposit payouts and severance payments to redundant workers—are estimated to be about 1.2 percent of annual GDP. Of this amount, about one half will be incurred in the 2002 budget, consistent with the fiscal framework for this year under the Fund-supported program.

Yours sincerely,

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

Mladjan Dinkic /s/
Governor
National Bank of Yugoslavia

Bozidar Djelic /s/
Minister of Finance
Republic of Serbia

FEDERAL REPUBLIC OF YUGOSLAVIA: RESOLUTION OF THE FOUR LARGE INSOLVENT BANKS AND EXPENDITURES ON FINANCIAL SECTOR RESTRUCTURING

1. **The federal and Serbian authorities are convinced that closure of the four large insolvent banks (Beobanka, Beogradska banka, Investbanka, and Jugobanka Belgrade) is an important step toward rebuilding the financial system in Yugoslavia. Orders to initiate bankruptcy proceedings against these four banks were issued on January 3, 2002,** while resolution of Jugobanka Bor has been deferred, pending the formulation of a comprehensive plan to address the economic and social problems of the Bor region.

2. **The budgetary expenditures associated with bank restructuring in Serbia will be limited to about DM 324 million (equivalent to 1.2 percent of GDP in 2002) in net present value (NPV) terms,** including (a) liquidation costs of about DM 271 million in the form of redundancy payments to workers and payments to depositors and (b) rehabilitation costs of about DM 53 million. The flow (or recorded budgetary) cost of bank restructuring in 2002 will be lower than the stock (NPV) cost, as some of the costs will be covered through the issuance of bonds rather than cash payments. Specifically, the flow cost—in the form of cash payments of redundancy payments to workers, cash payouts of deposits to depositors or banks receiving these deposits, and interest on bonds issued to recipient banks—will be limited to DM 168 million (equivalent to 0.6 percent of GDP) in 2002, compared with less than 0.1 percent of GDP in 2001.

3. Redundancy payments to the workers of the four large banks are expected to amount to about DM 40 million in 2002. Redundancy payments of about DM 10 million have been made for other banks already in liquidation.

4. **The total NPV payout of deposits for the four large banks is expected to amount to about DM 191 million.** In light of the limit on recorded budgetary costs in 2002 (DM 168 million or 0.6 percent of GDP in 2002) and the likely cash cost of the redundancy payments (DM 40 million), the cash cost of payouts in 2002 will be limited to about DM 128 million, through reliance in part on bonds issued to the banks receiving the deposits. In general, the payout of the deposits will vary by category of depositor as follows:

- **Individual depositors, public sector entities (federal and Serbian governments, NBY, and municipalities), budget-supported institutions (schools, hospitals, etc.)** will be paid upon bank closure.

- **Public and non-public enterprises** will generally be paid only a fraction of their deposits, and the Ministry of Finance will have the discretion to exclude enterprises from this payout on a case-by-case basis. In the event that a company can certify that it is a net creditor vis-à-vis the four banks and the government (particularly as regards outstanding taxes, social contributions, etc.), the payout could be raised to the amount of the net credit position.

- **Banks, bank-owned financial institutions, and nonresidents** will receive no compensation, with the exception of the deposit insurance limit of YUD 5,000 (equivalent to DM 165) for individual depositors.

5. The Bank Restructuring Agency (BRA), as liquidator of the banks and with the support of the World Bank and donors (notably the U.S. Treasury and DFID), will sell the assets of the 4 banks, including real estate, and use the proceeds of these sales to repay creditors. With a view to facilitating enterprise privatization, a Memorandum of Understanding has been signed by the BRA and the Privatization Agency regulating their financial relationship in the processes of bank liquidation and enterprise privatization.

Liquidation Costs for Other, Smaller Banks

6. The liquidation costs for banks already in liquidation are estimated at DM 10 million in 2002 in the form of redundancy payments. The liquidation costs for other small banks not yet in liquidation are preliminarily estimated at about DM 20 million.

Rehabilitation Costs

The stock (NPV) cost of rehabilitating Niska, Prokupacka, and Valjevska banks is estimated at DM 53 million, while the flow (recorded budgetary cost) in 2002 is estimated at DM 13 million.

INTERNATIONAL MONETARY FUND

NEWS BRIEF

FOR IMMEDIATE RELEASE

News Brief No. 02/2
FOR IMMEDIATE RELEASE
January 11, 2002

International Monetary Fund
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Washington, D. C. 20431 USA

IMF Approves US$63 Million Tranche Under Stand-by Credit to Federal Republic of Yugoslavia

The Executive Board of the International Monetary Fund (IMF) today completed the second review of the Federal Republic of Yugoslavia's (FRY) economic program supported by a stand-by credit. The completion of the review will enable the FRY to draw another SDR 50 million (about US$63 million) from the IMF immediately.

The stand-by credit of a total of SDR 200 million (about US$252 million) was approved on June 11, 2001, and will expire March 31, 2002 (see Press Release No. 01/31). So far, the FRY has drawn SDR 100 million (about US$126 million) from the IMF.

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

"The Fund commends the Federal Republic of Yugoslavia's impressive progress in stabilization and reform over the past year, as evidenced by a sharp decline in inflation, a strengthening of the external position, a recovery in output, and important steps in bank restructuring and enterprise privatization.

"Macroeconomic policy implementation has been excellent for Yugoslavia as a whole, with the latest information indicating that fiscal, credit, and wage policies remain firmly on track. The authorities' fiscal policy framework for 2002 is consistent with further progress in stabilization and reform, providing for critical restructuring and investment needs of the economy, while containing inflationary pressures by strictly limiting domestic borrowing. Important measures to reform the pension system—including a significant and immediate increase in the retirement age and a change in the indexation method—will help put the financing of the pensions on a more sustainable basis.

"While the current level of the exchange rate remains broadly appropriate, the Fund welcomes the National Bank of Yugoslavia's commitment to continue to monitor closely developments in the foreign exchange market and to adjust the exchange rate policy as needed to protect the external position.

"The authorities' courageous decision to close four large insolvent banks was a key element of the strategy designed to create a healthy banking system. It needs to be followed up by a strengthening of bank supervision to avoid the recurrence of problems in the banking sector. The successful sale of three large companies late last year augurs well for the success of the privatization program, and has generated significant revenue for the budget. The ultimate success of the reform effort requires that the authorities persevere with difficult decisions on bank and enterprise restructuring, underpinned by adequate measures to mitigate the social impact of restructuring.

"Continued donor and creditor support will be essential to mitigate the burden of transition and permit the authorities to maintain broad support for their reform policies. In this regard, a recent decision of the Paris Club creditors to write off a substantial portion of their claims on Yugoslavia has greatly enhanced the country's prospects for external sustainability. It will be important that Yugoslavia obtain similar terms from commercial creditors," Ms. Krueger said.

Statement by Roberto F. Cippà, Executive Director and Srboljub Antic, Advisor to the Executive Director for the Federal Republic of Yugoslavia
January 11, 2002

At the outset, we would like to thank the staff for the concise and candid report. It goes without saying that our authorities very much welcome the staff's positive assessment of the economic and policy performance under the current stand-by arrangement. The commitment of the authorities to take the necessary measures to rapidly stabilize the macroeconomic situation and implement an ambitious reform program has remained firm. This is underscored by the fact that the main program targets in the macroeconomic and structural areas were reached or exceeded with a substantial margin. With one exception, all end-September 2001 quantitative performance criteria and 10 out of 11 structural benchmarks were observed. The authorities have informed us that not all the information needed to assess compliance with the end-December 2001 performance criteria is available yet and, therefore, they request a waiver of applicability of these performance criteria. However, based on the latest data and trends, the authorities believe that all end-December 2001 performance criteria will be observed.

Since the publication of the staff report, the authorities have introduced some additional key measures: (i) four insolvent public sector banks have been put in bankruptcy; (ii) the privatization of three cement plants has been completed; and (iii) the Federal and Serbian parliaments have approved budgets consistent with the continuation of macroeconomic stabilization and structural reform. These measures underscore the excellent record of the FRY authorities in implementing the program and bode well for the future.

The strict implementation of the program has begun to yield results. Real GDP for 2001 is forecast to increase by 5.5 percent, albeit from a very depressed level. While the agriculture sector has rebounded strongly and the service and tourism sectors have performed well, industrial output stagnated. However, with the impact of the accelerating bank and enterprise restructuring, unemployment and social tension are rising. Unless carefully managed, these tensions could bring the entire reform program into jeopardy.

The restrictive monetary policy stance has reduced end-of-period headline inflation to 42 percent, which represents a decline of about two-thirds from the end-2000 level. Core inflation rate is estimated at 15 percent and the difference stems from increases of administered utility prices and higher indirect taxes. The foreign exchange reserves almost doubled and are close to the value of three-month imports.

An important step was also taken to improve the sustainability of the FRY's external debt burden. A breakthrough was achieved with Paris Club creditors, with whom the authorities reached an agreement on a phased 66 percent reduction of the net present value of the debt. Negotiations with London Club creditors have started, with the authorities aiming at achieving terms similar to those of the Paris Club agreement. Moreover, negotiations will take place with the remaining bilateral creditors with government guaranteed claims. At the end of the debt reduction and rescheduling process, FRY's external debt should decrease from the current level of $12 billion to about $7 billion. The reduction of the heavy debt burden will remove important hurdles in achieving stable, long-term economic growth.

Fiscal Policy

Fiscal policy has remained on track in the FRY as a whole and has supported economic stabilization and recovery. Important fiscal reforms have enhanced the efficiency of the tax and expenditure system and helped to lower the consolidated general government budget deficit in 2001 to only 2.4 percent, well below the original program target of 6.1 percent. The lower deficit is a result of better-than-envisaged performance on the revenue side and a cautious expenditure policy to compensate large shortfalls in privatization proceeds and foreign financing. Revenue performance increased mainly because of the comprehensive tax reform in Serbia and the improvement in tax administration in Montenegro.

The budget deficit is projected to reach 6.2 percent of GDP in 2002. While this deficit is significantly higher than last year, only a small part of it will be financed through borrowing from the banking system (0.6 percent of GDP). The remaining deficit will be covered by grants and concessional aid, resources from international financial institutions, and privatization revenues. Privatization revenues in excess of the volume anticipated will be used to reduce the government's net indebtedness and, in consultations with Fund and World Bank, for the financing of enterprise restructuring. In the authorities' view, targeting a lower fiscal deficit would not be feasible given the numerous additional expenditure demands, as described in the staff report, and their assessment that the economy could not sustain higher taxes.

At the federal level, the stronger than predicted revenues coupled with a restrictive wage policy enabled a reduction in the stock of expenditure arrears. The main objectives for 2002 are to prevent an increase in the level of arrears, to continue with the restrictive wage policy and to constrain military spending. The containment of military spending will now be easier, because the responsibility for defense spending is under civilian control. This has improved expenditure management and transparency.

As regards the Serbian government level, the outcome for 2001 is also expected to be significantly better than programmed. The budget was executed very cautiously, mainly to compensate for shortfalls in privatization revenues and in foreign aid flows. However, in 2002 the Serbian budget will face a number of challenges that stem from expenditures related to bank and enterprise restructuring and the resumption of external debt service. The authorities are engaged in wide-ranging tax and budgetary reforms. In this connection, a new set of laws was submitted to the parliament. Furthermore, laws regarding the lottery and tobacco are under preparation. These should help to reduce the scope of the gray economy.

At the level of the Montenegrin government, the difficulties have started to ease following strong revenue performance in the second half of 2001. For 2002 the main objectives are an improvement of expenditure efficiency and a reduction of non-interest current expenditure. Montenegro has started to enhance fiscal transparency and efficiency through a set of new laws and by addressing weaknesses in internal budget control over budget borrowings and issuance of guarantees.

Monetary Policy

The National Bank of Yugoslavia (NBY) has successfully continued to pursue its goals of reducing inflation and maintaining the stability of the national currency. This is underscored by lower inflation rates and by higher-than-programmed growth of reserve money. The rise in real money balances reflects growing confidence in the domestic currency and the shift out of DM into dinars ahead of conversion into the euro. The strong trend of remonetization of the economy is encouraging and reflects the population's positive approach towards monetary reform.

Exchange rate policy played an important role in stabilizing inflation expectations in 2001. The higher supply of foreign exchange in relation to demand has been present throughout the whole reform period and resulted in a steady growth of foreign reserves. Notwithstanding the real appreciation of the dinar, the authorities consider the current exchange rate to be broadly adequate. In their view, the issue of external competitiveness should be resolved mainly through other instruments, such as the restructuring of the export sector and improvements in productivity. Nevertheless, the NBY will closely monitor developments in the foreign exchange market, with a view to adjusting exchange rate policy as needed to safeguard the external position.

Bank Restructuring

One of the main prerequisites for effectively conducting monetary policy is a sound banking sector. The authorities have made significant progress in implementing their Bank Restructuring Strategy. Following the implementation of the first phase, which focused on bank categorization and liquidation of smaller insolvent banks, an important step was recently taken in the second phase of the strategy. On January 3, 2002, the Bank Restructuring Agency (BRA) decided to liquidate four large banks under its control. These banks, which account for about 50 percent of total assets and about 30 percent of total deposits, had been put under BRA surveillance in June 2001. The BRA came to the conclusion that even after the measures taken last year, the four banks remain unviable. The impact of the liquidation on depositors and employees will be mitigated by partial compensation and severance payments.

Privatization

The privatization process in Serbia under the new Privatization Law has picked up speed. After the launch of tenders for three cement plants in October 2001, they were sold to foreign investors in late December 2001. While the price of $139 million was slightly below the authorities' expectations, the investors are assuming important obligations regarding future investments and social programs for workers. The bidding process was carried out in a smooth and transparent manner. The privatization process will continue in the context of a

World Bank-supported program, with 27 companies scheduled for privatization in the second and third quarter of 2002.

Conclusion

Our authorities would like to thank staff and management for the assistance provided in designing the comprehensive macroeconomic reform strategy. This gave the authorities additional confidence in implementing the necessary reforms and in taking tough and unpopular decisions to address the major economic challenges. The authorities are also grateful for the wide range of technical assistance they received from the Fund and World Bank.

The challenges regarding the completion of the stabilization agenda and the implementation of comprehensive structural reforms remain daunting. It will be crucial to keep up the reform momentum and to appropriately sequence the wide range of measures. A multi-year Fund program would provide an essential framework for these endeavors. The recent disturbances in Belgrade following the closure of the four major public banks indicate that social pressures are mounting and that the position of the reformers could be at risk. Therefore, when designing the program, particular care should be given to ensure that the implementation of difficult fiscal and enterprise restructuring measures go hand-in-hand with the establishment of adequate social safety nets.

Our authorities look forward to the upcoming EFF negotiations. They hope that a successful conclusion of the negotiations will allow the approval of a new medium-term program soon after the expiration of the current arrangement.