English version of the interview of Bogdan Lissovolik on *Politika Online*, November 30, 2010

Why IMF was waiting for government press release to announce that Serbian authorities and the IMF team have reached staff-level agreement?

I see no significant issue here. Any IMF program, in any country, envisions informing the public of the agreement's key elements. The standby arrangement is a joint program; and this calls for coordination. Until now in Serbia, this coordination was done through a joint, high-level press conference of the mission chief with the key Ministers at the end of missions. However, the mission was no longer in Belgrade by the time the agreement was reached. Thus, instead of having a press conference, both we and the authorities thought it appropriate to issue mutually consistent press releases at about the same time. And this is what was done.

In IMF press release you said that there was agreement on a set of expenditure and revenue measures needed to achieve target (fiscal deficit). What are the concrete measures?

The measures are mostly on the expenditure side. First, the parameters of the indexation of public wages and pensions have to be adjusted in line with the available spending envelope. Second, there would be tight limits on key categories of the so-called discretionary spending such as subsidies (a nominal freeze), transfers (although these would be increased relative to 2010), goods and services, credit support programs, and capital spending. Further, there would be active management of the budget financing flows that would help reduce the government interest bill, including through using part of the expected Telekom proceeds. And finally there would be several revenue measures. In particular, the Telekom dividend for 2010 would still be distributed to the government despite the expected sale of the company in 2011, and a few smaller tax measures would be introduced, including an additional specific excise on cigarettes.

How you decide to limit increasing of wages and salaries in January? During the last review of arrangement, indexation for January was 6 month CPI.

The key objectives are to meet the 4.1 percent deficit target while providing for more spending to the vulnerable groups, for example through the coming into effect of the social assistance law. Given these constraints, the exact parameters of the wage and pensions indexation have also depended on the extent to which savings in all other areas – whether on the revenue or spending side -- could be committed to.

How hard (in the negotiation process) for Serbian authorities was to decide that partially indexation? Especially,for minister of economy? Also, how hard for him was decision to freeze subsidies for next year?

As typical in these situations, the negotiations were not easy for anyone. What is important is that finally there was an agreed government decision in line with the key objectives of the program.

Some economy expert for "Politika" made a calculation which shows that full indexation (about 5%) increasing budget spending for more than 20 billion dinars. What shows your (IMF) calculation?

The calculation you cite seems to us approximately right -- each percentage point increase in the indexation of pensions and wages means more than RSD 7 billion in extra budgetary spending.

Do you think now, after couple of month, that IMF made a mistake when, during the last review, allowed January indexation?

It is easy to say this with the benefit of the hindsight. If you recall the August round of the negotiations, there were significant pressures to unfreeze wages and pensions even earlier, and we and the authorities were searching for solutions that were striking a proper balance as of then. And given the recent inflation surge, waiting for April 2011 indexation would now probably be even less sustainable from a social and political point of view than it looked in August. So the issue becomes what is affordable in January given the budget situation...

Inflation in the last period surprised everyone (Serbian government, National bank, IMF). Are you worried about next year?

While the rise in inflation was indeed surprisingly large and has to be taken seriously, we are confident that the NBS has the needed tools and will pursue an appropriate policy course to bring inflation within the targeted range in the second half of next year. In this context, the passage and implementation of the 2011 budget in line with the agreed framework would significantly support this objective through prudent public spending policies.

How inflation can help ministry of finance at the revenue side?

Indeed, inflation should contribute to an increase in revenues, other things equal. We have obviously made an effort to reflect this in our current projections. But high inflation, in and of itself, is clearly not good news for the economy and needs to be countered with policies.

What do you think, who is guilty for inflation? Or, what is the main reasons of increasing the food prices?

We do not think that searching for “culprits” now is a constructive way to approach the problem. In general, the NBS has the primary responsibility for inflation in the context of its inflation targeting. But the NBS’ effectiveness should not be judged based on unanticipated short-term shocks, such as those occurred this summer in relation to food prices or other short-term external shocks, from global or regional markets. Also, the typical inflation targeting horizon – not only in Serbia but elsewhere in the world – is considered to be about 12-18 months. The government should also support inflation targeting, mainly through appropriately prudent fiscal policies and a predictable strategy with respect to regulated prices.

Regarding the reasons for the high inflation in recent months, we would note three such. First, food prices in Serbia are very volatile due to several structural market rigidities. Second, there was exchange rate pass-through from the cumulative dinar depreciation. Third, import prices, even expressed in foreign currency, are recovering from the crisis lows.

From your point of view, how hard, or complicate was this 6th review? At the beginning of the negotiation, Serbian government decided to cancel Pension law. What was the IMF perception of that kind of move? Was it a "warm welcome" for mission team?

The agreement on the 6th review indeed took significant time and effort to achieve, but this is not surprising given that the key condition for the review was the 2011 budget. In any diverse multi-party coalition, including such as the one Serbia has, agreeing on the budget would require a sequence of difficult balancing acts.

As to the amendments to pension law, we understand that they were recalled from parliament under heavy pressure from trade unions. It was agreed to make only two further changes to the amendments: to protect the most vulnerable pensioners through accepting a “minimum pension floor” of 27 percent of the average wage for the period of 2011-15 and delay the tightening of eligibility requirements and benefits for women by 2 years relative to what was agreed earlier. As we reiterated before, we believe that the current round of pension reform is only a moderate step in the right direction -- an absolute minimum that gives a chance (but no guarantee) to avoid more drastic reforms in the very near future.

How Albert Jeger decide to leave Belgrade? What was the main reason? Budget for 2011 or Pension law?

The departure by the mission on November 5 was agreed in the context of the clear need for significantly more time to carefully consider, discuss, and decide on these two complex issues -- pensions and the 2011 budget -- at the technical and policy levels. As we all saw, agreement could be reached only three weeks after the mission left, despite the fact that intensive contacts and negotiations continued for all this time.

Do you believe that Serbian government will implement Budget system law, especially fiscal stability rule about public investment (4% of GDP) in the next pre-election year?

On the implementation of the Budget System law, we certainly believe so, given the major effort that has been put together in the past few weeks to achieve the key target of the budget system law of the 4.1 percent of GDP deficit.

Regarding your point about public investment, the level of 4 percent of GDP is not a truly-binding requirement of the budget system law. Rather, it is a threshold which, if exceeded, would allow additionally a higher fiscal deficit under the fiscal rule. And while we consider that increasing public investment to this level is generally desirable, the quality of implementation of investment projects would also matter in deciding which projects should proceed. If so, it may be appropriate to make room for higher spending on co-financed FDI projects, while focusing on truly high-quality and well-prioritized investment projects.