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Republic of Serbia: Program Statement, Technical Memorandum of Understanding

June 29, 2018

Republic of Serbia: Program Statement

Ms. Christine Lagarde
Managing Director
International Monetary Fund
Washington, D.C., 20431
U.S.A.

Belgrade, June 29, 2018

Dear Ms. Lagarde:

Our 2015-18 economic program, supported by a precautionary Stand-By Arrangement (SBA), was instrumental in reducing Serbia's long-standing economic imbalances, restoring growth, and starting to address key structural weaknesses of the Serbian economy. The Government of the Republic of Serbia requests approval of a new macroeconomic and structural reform program supported by the Policy Coordination Instrument (PCI) for the period August 2018–January 2021. To support this request, this Program Statement (PS) outlines the government's objectives and sets out the economic policies that the Government and the National Bank of Serbia (NBS) intend to implement under this new program.

The new program is intended to maintain macroeconomic and financial stability and support the implementation of a comprehensive structural and institutional reform agenda, necessary to put Serbia on a faster, sustainable and inclusive income convergence path. With this aim, the program will seek to increase investment levels, and advance reforms to boost productivity, increase private sector employment, and reduce the informal economy. These goals are compatible with our aspirations to become an EU member, having started the accession process in January 2014.

The implementation of our program will be monitored through quantitative targets, indicative targets, reform targets, and an inflation consultation clause, as described in the PS and the attached Technical Memorandum of Understanding (TMU). There will be five reviews of the arrangement by the Fund, scheduled to be completed on a semi-annual basis to assess progress in implementing the program and reach understandings on any additional measures that may be needed to achieve its objectives.

We believe that the policies set forth in this PS are adequate to achieve the objectives of the PCI-supported program, and we will promptly take any additional measures that may become appropriate for this purpose. We will consult with the Fund on the adoption of these measures and in advance of revisions to the policies contained in this PS. Moreover, we will provide all information requested by the Fund to assess implementation of the program.

In line with our commitment to transparency, we wish to make this letter available to the public, along with the PS and TMU, as well as the IMF staff report on the request for a PCI. We therefore authorize their publication and posting on the IMF website, subject to Executive Board approval. These documents will also be posted on the official website of the Serbian government.

Sincerely,

/s/
Ana Brnabić
Prime Minister

/s/	/s/
Jorgovanka Tabaković	Siniša Mali
Governor of the National Bank of Serbia	Minister of Finance

Attachment: Technical Memorandum of Understanding

Program Statement

1. This program statement sets out our economic program for the next 30 months. The program aims to strengthen the foundation for healthy economic growth by addressing Serbia's short-term and medium-term economic challenges. To this end, the program focuses on policies to ensure macroeconomic stability, most notably by maintaining fiscal sustainability, bolster resilience of the financial sector, and improve competitiveness of the economy.

2. Serbia has succeeded in addressing macroeconomic imbalances and restoring growth. Supported by a three-year precautionary SBA successfully completed in February 2018, we have restored fiscal sustainability, put public debt on a firm downward path, and realigned the external position with fundamentals. Monetary policy has kept inflation under firm control, while supporting the economic recovery and maintaining broad exchange rate stability. The stronger confidence associated with the improved macroeconomic situation has been reflected in higher private investment and supported employment and growth.

3. Financial sector resilience has been strengthened. Financial sector reforms have resulted in improved financial soundness indicators and sharply reduced non-performing loans. The banking system is now on a stronger footing to support economic growth. Prudential and regulatory standards are becoming aligned with EU standards.

4. We have started to address key structural weaknesses of the Serbian economy. Employment in general government and local public utilities has been reduced. Steps have been taken to reduce losses and lower fiscal risks from some systemic SOEs. The business climate has strengthened with macroeconomic stability and an improved regulatory environment, and efforts to remove obstacles to private sector development and attracting new investments have started to pay off.

5. However, further efforts in implementing the structural and institutional reform agenda are needed to ensure Serbia is put on a faster convergence path. Our plans envisage measures to foster private sector-led growth, reduce the size of the shadow economy, and complete reforms in public administration and restructuring of state-owned utilities, enterprises, and financial institutions. We will continue to advance reforms in public finance, tax administration, judicial, and education reform, while public infrastructure needs remain large. Growth also needs to be made more inclusive through higher labor market participation, especially among women.

Recent Economic Developments and Outlook

6. Strong economic performance continues. After slowing down to 1.9 percent in 2017 mostly due to temporary supply shocks, growth has accelerated in 2018 (4.6 percent year-on-year in Q1) supported by continued recovery of private consumption and strong FDI. Labor market indicators continue to improve, with robust employment growth in the formal sector, and a declining unemployment. Private sector wages have picked up, the minimum wage was increased by 10 percent, and public wages increased by 7 percent on average in January, on the back of improved economic and labor market conditions.

7. Inflation remains low and relatively stable. Headline inflation temporarilly fell below the target band in March and April, but has since recovered. The decline is mainly due to low food prices and base effects from 2017. Core inflation remains low. Led by accomodative monetary policy, financial conditions became more favorable.

8. We expect the consistent implementation of the policy actions and reforms envisaged under our economic program to maintain the virtuous cycle of boosting confidence, improving private sector dynamism, and fostering economic growth.

- **Real GDP growth** is projected at 3½ percent in 2018-19 and to rise to 4 percent over the medium term. Full implementation of our structural reform agenda will further boost growth potential.
- **Headline CPI inflation** is projected to gradually increase but remain in the lower half of the inflation target band over 2018 and 2019, remaining at around 3 percent over the medium term.
- **The current account deficit** is projected to remain at about 5¾ percent of GDP in 2018, driven by investment-related imports and energy prices, and to decline to around 4 percent of GDP over the medium term. The current account deficit will continue to be fully financed by net FDI. External financing will continue to rely mostly on FDI, and bilateral and infrastructure project loans.

Economic Policies

A. Fiscal Policies

9. We are committed to preserve the hard-won fiscal gains to keep public debt-to-GDP ratio firmly on a downward path, while supporting economic growth. The estimated structural fiscal adjustment in 2015–2017 amounted to over 6½ percent of GDP. This sizeable adjustment was driven by stronger revenues and tight control of current spending. For 2018, we project a general government fiscal surplus of 0.6 percent of GDP, compared to a budgeted deficit of 0.7 percent of GDP. Public debt is projected to decline further in 2018, while the debt profile will continue to improve, with increased maturity and higher share of dinar-denominated debt.

10. For 2019 onwards, we will aim at an overall deficit of about ½ percent of GDP. This stance will imply a reduction of public debt to about 50 percent of GDP over the medium term. It will also allow an increase in capital spending to address Serbia's sizeable infrastructure needs and reduce the tax burden on businesses and labor. Moreover, this fiscal stance will accommodate the unwinding of the crisis-era temporary pension cuts and the transition to the new public wage system, while ensuring that the pension and wage bills do not increase in percent of GDP.

11. We will aim to further reduce fiscal risks and will prepare contingency measures as needed. We will maintain an adequate level of fiscal buffers and will not accumulate public sector external debt payment arrears (continuous target). We will also refrain from accumulating domestic payment arrears. Our efforts to contain public spending will be monitored through a ceiling on current primary expenditure of the Serbian Republican budget, excluding capital spending and interest payments (quantitative target).

B. Structural Fiscal Policies

12. We are committed to complete the general government employment and wage system reforms, which are critical for improving the efficiency of public services and containing current expenditure. The public wage bill has recently been reduced via administrative wage and employment restraints, which are not optimal over the medium-term.

- **General government employment framework.** The current framework is governed by (i) the annual Law on the Maximum Number of Employees, which sets the employment ceiling on permanent staff at the institution level; and (ii) an employment freeze, with exceptions managed through the government Employment Commission, considering individual institutions' employment ceilings, budgetary envelopes, and specialist staffing needs. This system, which includes public enterprises, has helped to reduce public employment, but also resulted in reliance on fixed-term and contractual positions and staffing shortages in some units. We will examine options to replace the existing framework with a more flexible system that will contain fiscal pressures from public sector wages, ensure adequate allocation of staffing across the public administration, and restrain hiring by public enterprises.

- **Public wage system reform.** The Law on Public Sector Employees Wage System approved in 2016 sets the stage for a new system where employees are granted equal pay for equal work across the government, in a more transparent and systematic manner. Secondary legislation for local governments and public services (health, education, culture, and social protection) was approved in December 2017. The decree specifying the coefficients under the new wage system will be adopted (**end-September reform target**). We are mapping employees to the new wage matrix and will adopt secondary legislation for all other sectors (including police and armed forces) by end-2018. We will set the base under the new wage system to contain the general government wage bill below 10 percent of GDP.

13. To improve execution and reduce gaps in quantity and quality of public infrastructure, we will strengthen public investment management frameworks. All project loans were included in the 2017–18 budgets and we adopted a government decree enhancing the project appraisal process in mid-2017. In April, we adopted the Planning System Law, which established a national planning framework and will lead to preparation of a national Development Plan and a corresponding Investment Plan. However, structural weaknesses in implementing public investment remain significant. We are committed to improve the public investment management framework in line with recommendations of recent IMF technical assistance. Specifically, we will:

- Issue a detailed guideline as a Rule Book to the 2017 decree on capital expenditure projects covering project appraisal and selection (**end-January 2019 reform target**), and publish summaries of feasibility studies of large and mega projects, as defined in the guideline.
- Establish the Capital Investment Commission (CIC) and update the 2017 decree on public investment project appraisal to (i) clarify the roles of the MOF, CIC, and Expert Commission; and (ii) remove the exclusion of IPA-funded projects as well as those financed through government-to-government agreements (**end-April 2019 reform target**).

14. To raise the efficiency of revenue collection and improve the business environment, we are committed to improve tax administration. This work is based on recommendations of IMF technical assistance and the Tax Administration Diagnostic Assessment Tool review.

- The new **Transformation Action Plan (TAP, 2018-23)** developed with IMF experts and approved by the government in December 2017 provides strategic guidance and timelines on actions needed to create a modern tax administration utilizing electronic business processes, improved taxpayer services, and a risk-based approach to compliance. We will implement a list of measures covering: (i) separation of core and non-core activities administered by the STA to be supported by separate organizational structures with their own program budget allocation, headquarters design, business plans, management structures, and reporting lines; (ii) consolidation of core tax administration functions into fewer sites (**end-June 2019 reform target**); and (iii) modernization of IT and records management systems and business process re-engineering. As a **prior action**, we launched a public tender for external consultants to assist with the implementation of the TAP.
- We will also introduce **measures to reduce the average processing-time for VAT refunds**. Refunds are processed according to the legally prescribed timelines and the STA takes a cautious approach to minimize fraud. We will monitor the stock of pending refunds with an aim to substantially reduce the processing time, with a specific target to be determined following the modification of the VAT-management software in July.

15. We will use existing fiscal space on measures to support growth and improve the business climate.

- **Tax policy** to support investment and employment. Guided by IMF technical assistance, we will examine the scope to: (i) review the *corporate income tax* legislation to incentivize investment; (ii) review the *personal income tax* legislation to simplify it and improve progressivity; (iii) reduce the labor tax wedge and regressivity by lowering *social insurance contributions*; and (iv) review *presumptive taxation* for self-employed to improve transparency and eliminate abuses.

- **Rationalizing parafiscal charges.** In March, we completed the public consultation on the draft Law on Charges, which aims to consolidate all charges and corresponding rates faced by businesses in one law to reduce uncertainty and increase transparency. We will also eliminate or merge some charges and support the reduction of non-core activities of the STA. We will submit the draft law to parliament **end-October reform target** with a view to be adopted by parliament by end-December.

16. We will strengthen the fiscal framework, anchored by a robust fiscal rule. We will revise the framework over the program period to achieve the following principles: (i) stronger institutional significance of the debt limit as the primary medium-term anchor for fiscal policy; (ii) a more transparent and credible operational rule to help achieve the objective, while also helping to improve accountability and facilitate transition towards the EU fiscal framework; and (iii) a retain a strong role of the Fiscal Council. We also intend to review, with a view to rationalizing, the systems of revenue sharing and transfers to local government.

17. We will continue implementing public financial management measures.

- To stop accumulation of arrears, we will continue the publication of monthly reporting of overdue receivables to Srbijagas and EPS of their top 20 debtors on the companies' websites.

- We have been strictly limiting issuance of state guarantees since 2015. We will not issue any new state guarantees for liquidity support, or state guarantees for any company in the portfolio of the former Privatization Agency. The Government will continue to refrain from issuing any implicit state guarantees.

18. To safeguard fiscal consolidation, limit risks, and strengthen institutions:

- We will continue to submit financial plans of social security funds with estimates for their indirect beneficiaries to the National Assembly, in parallel with Republican budget. We will include all indirect budget beneficiaries of the central government (except for indirect budget beneficiaries of the Ministry of Education, Science and Technological Development) in the Information System for Budget Execution (ISIB) gradually by end-2019. We have upgraded the budget execution system to be able to support the integration of new users. We have included institutions for the enforcement of penal sanctions and cultural institutions in ISIB since January 1, 2018. In 2019, social protection institutions will be integrated, having in mind that they are the most numerous and diverse and will continue to upgrade their capacities over 2018–2019.

- We are committed to ensure that a full assessment of all proposed Public-Private Partnerships (PPPs) is reviewed by the Ministry of Finance (MOF), including PPPs' key financing features, cost-benefit analysis, and risk sharing arrangements with the government. To improve control of fiscal implications and risks, we amended the existing Law on Public-Private Partnership and Concessions mandating that PPPs larger than EUR 50 million are submitted to the government for consideration only after receiving the MOF's consent. By end-2018, we will adopt additional amendments to the Law aimed at limiting overall fiscal exposure, ensuring a competitive tender process.

- We will ensure that the fiscal risks management unit at the MOF is fully staffed by September.

C. Monetary and Exchange Rate Policies

19. The current inflation targeting framework remains appropriate for maintaining stable inflation and protecting the economy against external shocks. We remain committed to the objective of keeping inflation within the inflation tolerance band (3±1½ percent). Inflation developments will continue to be monitored via a consultation clause with consultation bands set around the central projection (Table 1). In this context, we implemented two consecutive 25 basis points key policy rate cuts in March and April, on the back of subdued core inflation, reduction in the medium-term inflation outlook, and continued exchange rate appreciation pressures. We also narrowed the interest rate corridor to +/-1.25 percentage points (from +/-1.50) in April.

20. We will maintain the current managed float exchange rate regime in line with the inflation targeting framework. We believe that well-managed exchange rate flexibility provides a needed buffer against external shocks. Therefore, foreign exchange interventions will continue to be used to smooth excessive short-term exchange rate volatility without targeting a specific level or path for the exchange rate, while considering the implications for financial sector and price stability. The current level of gross international reserves is comfortable for precautionary purposes.

21. We have made significant progress in advancing our dinarization objective. The dinarization strategy adopted in 2012 is based on three pillars: (i) maintaining overall macroeconomic stability; (ii) creating favorable conditions for developing the dinar bond market; and (iii) promoting hedging instruments. Macroeconomic imbalances have been reduced significantly and inflation has remained low and stable, which should all support dinarization. We have introduced several measures to increase dinarization, such as higher reserve requirements on FX deposits and mandatory down-payment ratios for FX loans. We have also enhanced our communication to the public on the risks of unhedged FX borrowing, need of prudent management of FX risks, and availability of hedging instruments. Meanwhile, we have increased the share of public debt in local currency, issuing dinar securities at longer maturities. The recently adopted Law on Financial Collateral will remove legal impediments to the development of the repo and FX derivatives markets. By March 2018, deposit dinarization has increased to 30 percent, while household lending dinarization has also increased, reaching 50 percent.

22. We will update our dinarization strategy (**end-December reform target**) to facilitate dinarization, further strengthen liquidity management, and develop local currency debt and hedging markets. Specifically, we plan to:

- Continue efforts to (i) further instill awareness of two-way exchange rate movements (ii) further develop local and foreign currency markets, and (iii) encourage prudent pricing of credit risks of unhedged foreign currency borrowing.
- Strengthen public debt management by (i) updating by the Ministry of Finance the legal foundation of debt management (**end-December reform target**), (ii) establishing the primary dealer system and developing adequate supervisory framework, and (iii) improving the PDA's operational framework and setting up a Debt Market Committee comprising of representatives of the PDA, MOF, NBS, and primary dealers.
- Further strengthen the liquidity management framework by (i) formalizing the communication between the NBS and the Ministry of Finance through a Service Level Agreement concerning TSA management andinformation provision; and (ii) establishing a joint Consultative Committee on Liquidity Management aimed at strengthening the management and oversight of the Consolidated Treasury Account balance and improving the quality of liquidity forecasting by end-December.

23. During the period of the PCI we will not, without IMF approval, impose or intensify restrictions on the making of payments and transfers for current international transactions, nor introduce or modify any multiple currency practices or conclude any bilateral payment agreements that are inconsistent with Article VIII of the IMF's Articles of Agreement. Moreover, we will not impose or intensify import restrictions for balance of payments reasons.

D. Financial Sector Policies

24. We will continue to strengthen financial sector regulatory and supervisory frameworks, to fully align them with international standards. Basel III-compliant regulatory standards on capital, liquidity, and risk management, as well as updated standards on disclosure and regulatory reporting have been implemented. Minimum capital requirements have been reduced from 12 percent to 8 percent, while additional capital buffers have been introduced—in line with the EU's Capital Requirement Directive. Further enhancements of the prudential framework for banks and insurance companies are being enacted to ensure full compliance with international standards and EU requirements.

25. We will further enhance financial safety nets. Significant progress has been achieved in strengthening the bank resolution, deposit insurance, and crisis management frameworks, and additional efforts will be made to further enhance them. We will complete the ongoing work on resolution procedures and further align the deposit insurance scheme with international standards. Specifically, we will (i) review the appropriate parameters of the deposit insurance fund, including the target level, premium, deposit base for calculation, and investment policy, and conduct an IADI core principles assessment by December, and (ii) submit to parliament amendments to the Law on Deposit Insurance Agency and the Law on Deposit Insurance to reflect the findings of the review and assessment and introduce risk-based premia (**end-June 2019 reform target**).

26. Results of the implementation of the NPL resolution strategy have been impressive, but SOBs still lag. As of March, the NPL ratio reached 9.2 percent, a decline of around 14 percentage points since the 2015 peak, but progress has been uneven. In private banks, sizeable NPL sales helped lower NPLs to below pre-crisis levels (8.7 percent in March). Although NPLs remain relatively high for some SOBs (13.9 percent in March, on average), they are fully covered by regulatory reserves for estimated losses and significant improvements have been made driven primarily by write-offs. We will update, with support of IFIs, our NPL resolution strategy by end-September, focusing on measures to accelerate NPL resolution in SOBs, while also broadening the scope to include the export promotion agency (AOFI), the Development Fund (DF), and the bad assets managed by the Deposit Insurance Agency (DIA) on behalf of the State and the bankruptcy estates of banks in liquidation. In line with the updated strategy, the government and the DIA, as an **end-December reform target**, will: (i) approve a time-bound action plan to resolve part of the DIA portfolio of bad assets by end-2020 through a tendering process implemented in two phases (portfolios of about EUR 145 million and EUR 830 million consisting of both bad assets managed on behalf of the state and on behalf of bankrupt banks, as agreed with the World Bank); and (ii) complete the first phase of the sale by end-December. The action plan will also propose options to resolve the residual portfolio of low-value assets. As a first step, the DIA has engaged consultants to prepare the first phase of the tender process based on the portfolio of bad assets agreed with the World Bank.

27. We will continue to implement our state-owned financial institutions reform agenda. We are strengthening our oversight over financial institutions with state-ownership.

- We are committed to implement the new strategy for Banka Postanska Stedionica (BPS), with the support of the Word Bank. The focus of the strategy is on (i) the bank's commercial reorientation towards retail banking, entrepreneurs, micro-enterprises and small enterprises, (ii) improvements of the bank's internal organization, corporate governance and risk management, (iii) enhancement of its IT infrastructure, and (iv) a business plan for the period 2018-20. BPS will sign contracts with external consultants for the implementation of the business plan and for the procurement and implementation support of a new core banking system by end-2018.

- We will adopt a decision to initiate privatization of Komercijalna Bank by end-February 2019, with a view to launch a privatization tender (**end-June 2019 reform target**) and complete the sale by end-December 2019. Meanwhile, the bank is implementing necessary measures to address corporate governance weaknesses.

- We are working on the implementation of strategic options for the smaller banks, based on the updated government strategy for state-owned banks. In April, we (i) withdrew the banking license of Jugobanka Jugbanka and approved a takeover of part of the bank's assets and liabilities to BPS, after protracted efforts to find a strategic investor to recapitalize the bank failed; and (ii) initiated procedures concerning the sale of the State's shares in Jubmes Bank.

- The DF and AOFI have continued to implement (i) the supervisory boards' decisions recognizing losses on their credit portfolios and (ii) the government conclusion to restrict the institutions' exposures to SOEs, enhance risk management frameworks and prevent further deterioration in asset quality, and establish a timeline to resolve impaired assets.

28. We are strengthening the AML/CFT framework in line with the FATF action plan. We are addressing shortcomings identified in the 2016 MONEYVAL AML/CFT mutual evaluation report through an inter-agency working group, with the aim to complete the work ahead of the January 2019 deadlines agreed with the FATF. The Law on Anti-Money Laundering came into effect on April 1 defining notaries as a new obliged entity and providing clear legal base for the STA to start inspection in two casinos. Targeted National Risk Assessment (NRA) was completed in June, with support from the World Bank. We are committed to implement all measures listed in the action plan to address the AML/CFT weaknesses identified by the FATF (**end-February 2019 reform target**). In this regard, competent institutions adopted relevant by-laws introducing significant improvements in accordance to FATF recommendations.

29. We will work on strategies for capital market deepening and development finance. Serbia's capital markets remain underdeveloped with limited stock-market activity, nascent domestic bond market volumes, and a virtually nonexistent corporate bond market. Alternative sources of financing such as private equity or venture capital, are negligible. With World Bank support, we will (i) develop an effective model for development finance; and (ii) undertake a diagnostic assessment focused on developing capital markets and diversifying sources of long-term financing. A working group will be created and a diagnostic report will be prepared with the support of the World Bank, with a view to inform the government's strategy to enhance capital markets.

E. Structural Policies

30. We will implement a comprehensive set of structural reforms to improve the business environment to support higher private sector-led growth. We focus on policies that improve the business environment and private investment climate, promote job creation, and complete the resolution of public and state-owned enterprises.

31. We are implementing measures to fight the grey economy. In December 2015, we adopted a National Program for Countering the Grey Economy and an Action Plan for the Implementation of the National Program for 2016-2017, which was updated in 2017 to cover 2018-19. Our priorities include improvements in the inspection system (better coordination and increased usage of IT systems), modernization of Tax Administration (risk based audits, trainings, reorganization, and better control of trading in excise goods), and strengthening of incentives for voluntary compliance. In this regard, we will amend the Law on Inspection Supervision (**end-September reform target**) and align all sectoral laws to permit supervision of unregistered activities. We will also improve coordination across inspections.

32. We will implement measures to further increase labor force participation:

- In June, we adopted the Law on Simplified Seasonal Employment in Specific Industries defining rights and obligations in the context of seasonal work and allowing simplified registration of seasonal workers.

- By end-2018, we will adopt the Law on Work Through Temporary Employment Agencies, which will contribute to improving labor conditions for agency employees working in beneficiary companies, eliminate unfair competition in this area, and increase employment.

- We have amended the Law on Financial Support for Families with Children to increase the bonuses for child birth aimed at raising fertility rates, completing the replacement of the previous entitlement to VAT reimbursement for baby food and equipment.

33. We are committed to continue restructuring large public utilities companies to enhance efficiency and contain fiscal costs. We are planning to fully implement the required corporate and financial restructuring in these companies over the medium term.

- **Elektroprivreda Srbije (EPS).** We have continued implementing the 2016–19 labor optimization plan. We have engaged the World Bank and the EBRD to support our plan to enhance corporate governance, management, and procurement and planning frameworks. We will complete a tariff review for 2018 by end-August with the assistance of the World Bank. In 2020, we will change the legal status of EPS to a joint stock company, in line with the ongoing corporate restructuring process and financial consolidation, aiming to improve the viability of the company and ensure its professional management.

- **Srbijagas.** Payment discipline has improved and an investment appraisal methodology proposed by the World Bank based on an economic and financial cost-benefit framework and including other relevant appraisal criteria, has been adopted in November 2017. We will adopt a capital expenditure plan in line with the new methodology by end-2018. These measures will help improve Srbijagas' financial position and put the company on a sustainable path. We will ensure phasing out Srbijagas' reliance on government support for servicing debt by the end of the program period.

34. We will make progress on the few strategic companies in the portfolio of the former Privatization Agency for which resolution is still pending:

- After the unsuccessful first tender to privatize MSK, we launched a second one in May and a third one, if necessary, will be launched by end-September.

- After failed attempts to find a strategic investor for Azotara by the end-March deadline stipulated in the government conclusion, the Ministry of Economy requested the State Attorney Office to initiate bankruptcy procedures (**prior action**).

- In July, we will launch the tender for a strategic partner for RTB Bor. Meanwhile, the company has been meeting all liabilities, including on taxes, wages, and electricity, as per the pre-pack agreement.

- Will launch the privatization tender for Petrohemija (**end-September reform target**).

- We will launch the privatization tender for PKB in July, with a view to finalize the process by end-2018.

- We are developing, with the assistance of the World Bank, an action plan for Resavica mines. By end-2018, we will (i) begin the closure procedures of two unviable mines; and (ii) update the closure timetables for at least two additional unviable mines, and (iii) develop a voluntary social program and labor optimization plans and ensure that sufficient resources are allocated in the 2019 budget.

35. We continue to resolve enterprises in the portfolio of the former Privatization Agency through either privatization or bankruptcy, in accordance with the revised Privatization Law. By April 2018, more than 300 companies entered bankruptcy, and more than 50 were privatized since end-2014. About 33,500 employees from around 320 companies have received severance payments. 114 companies with nearly 45,000 employees remain to be resolved.

36. We are working to improve the quality and transparency of our national statistics:

- We commit to comprehensive, timely, and automatic data sharing across relevant compiling agencies (including SORS and NBS) for statistical purposes (updating existing or signing new memorandum of understandings where necessary).

- In April 2018, we published the list of institutional units that are defined as part of the general government as well as other main sectors of the economy, in line with European System of Accounts (ESA) 2010 and GFSM 2014. By the end of the program, the Serbian Statistical Agency (SORS) will submit monthly GFSM 2014 fiscal accounts to the Enhanced General Data Dissemination System (eGDDS), covering the budgetary government and road funds.

- In June 2018, we subscribed to the IMF's eGDDS. We will continue to improve our data standards by publishing a 12-month ahead data release calendar for the Ministry of Finance by end-December 2018, to support our goal of achieving the top threshold of eGDDS by the end of the program period. In December 2018, we will also subscribe to the World Bank/IMF Public Sector Debt Statistics Database covering core debt of the budgetary central government. Public sector debt data will be transmitted quarterly for loans and debt securities covering budgetary central government units valued at face value.

- In conjunction with Eurostat and the IMF, we are working to upgrade our national accounts. In September 2018, we will release revised annual and quarterly GDP time series for the period 2015–17, with final revisions due in September 2019. We continue to develop and improve metadata to support compilation processes, in particular the informal economy, and will make new metadata available on the SORS website by December 2018. We are also developing supply and use tables (SUT) for 2015-17, to be disseminated by September 2019.

Program Monitoring

37. Progress in the implementation of the policies under this program will be monitored through quantitative targets (QTs) and indicative targets (ITs)—including an inflation consultation clause, continuous targets (CTs) and reform targets (RTs). These are detailed in Tables 1 and 2, with definitions provided in the attached Technical Memorandum of Understanding.

Table 1. Serbia: Quantitative Targets 1/

	2018				2019			
	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.
	Act.	Proj.	Prog. QT	IT 6/	Prog. QT	IT 6/	Proj.	Proj.
I. Quarterly Quantitative Targets (QT)/Indicative Targets (IT)								
1 Ceiling on the general government fiscal deficit 2/ 3/ (in billions of dinars)	-3.7	-22.8	-31.3	-27.3	11.8	2.5	7.5	24.1
2 Ceiling on current primary expenditure of the Serbian Republican Budget excluding capital expenditure and interest payments (in billions of dinars) 2/	198.8	428.1	648.7	921.3	234.1	484.8	726.4	1003.7
3 Ceiling on accumulation of domestic payment arrears by the consolidated general government except local governments, the Development Fund, and AOFI (in billions of dinars)	-0.2	...	0.0	0.0	0.0	0.0	0.0	0.0
II. Continuous Targets								
4 Ceiling on accumulation of external debt payment arrears by General Government, Development Fund, and AOFI (in billions of euros)	0.0	...	0.0	0.0	0.0	0.0	0.0	0.0
III. Inflation consultation band (quarterly) 4/								
Upper band limit (1.5 percent above center point)			3.0	3.4	4.1	3.9	4.4	4.2
End of period inflation, center point 5/	*1.4*	*1.6*	*1.5*	*1.9*	*2.6*	*2.4*	*2.9*	*2.7*
Lower band limit (1.5 percent below center point)			0.0	0.4	1.1	0.9	1.4	1.2

1/ As defined in the Program Statement and the Technical Memorandum of Understanding.
2/ Cumulative since the beginning of a calendar year.
3/ Refers to the fiscal balance on a cash basis, including the amortization of called guarantees.
4/ Staff level consultation is required upon breach of the band limits.
5/ Defined as the change over 12 months of the end-of-period consumer price index, as measured and published by the Serbian Statistics Office.
6/ Indicative targets are not monitored as part of the program conditionality.

Table 2. Serbia: Prior Actions and Reform Targets

Actions	Target Date	Status	Objective
Prior Actions			
Publish a public tender for external consultant to assist the implementation of the Tax Administration		Met	Advance reforms of the State Tax Administration.
Initiate bankruptcy procedures for Azotara.		Met	Reduce fiscal risks.
Reform Targets			
Fiscal			
Approve a government decree defining wage coefficients under the new Public Sector Employee Wage System for local governments, public services, public administration, and police.	End-September, 2018		Rationalize pay and improve incentives across public sector.
Submit to the National Assembly a draft Law on Charges.	End-October, 2018		Improve transparency and predictability, reduce parafiscal tax burden on businesses.
Issue a detailed rule book to the 2017 Capital Project Regulation, covering methodology for project appraisal and selection.	End-January, 2019		Unifies methodology for the project and cost-benefit analysis and raise transparency.
Establish Capital Investment Commission (CIC) and update Capital Project Regulation to (i) clarify roles of MoF, CIC, and Expert Commission, (ii) remove the exclusion of IPA-funded projects, and (iii) expand the coverage to government-to-government agreements.	End-April, 2019		Improve selection, appraisal, and implementation of public infrastructure projects.
Complete consolidation of core activities into fewer sites.	End-June, 2019		Advance reforms of the State Tax Administration.
Financial			
Approve a time-bound action plan to resolve part of the DIA portfolio of bad assets by end-2020 through a tendering process implemented in two phases (agreed with the World Bank); and complete	End-December, 2018		Resolve bad assets.
Approve an updated Dinarization Strategy in line with the IMF recommendations.	End-December, 2018		Strengthen financial stability and increase dinarization.
Submit to the National Assembly amendments to the Law on Public Debt with a view to update legal foundation of debt management.	End-December, 2018		Strengthen public debt management.
Implement items listed in Serbia's action plan to address the significant AML/CFT weaknesses identified by the FATF.	End-February, 2019		Remove Serbia from FATF listing and prevent pressures on capital inflows and correspondent banking relationships.
(i) Submit to the National Assembly amendments to the Law on Deposit Insurance Agency and the Law on Deposit Insurance to incorporate the findings of IADI assessment and update parametrization; and	End-June, 2019		Align deposit insurance scheme with international standards.
Launch a privatization tender for Komercijalna Banka.	End-June, 2019		Reduce state involvement in the financial sector and reduce fiscal risks.
Structural			
Adopt a government decision to launch a privatization tender for Petrohemija.	End-September, 2018		Reduce fiscal risks.
Approve amendments to the Law on Inspection Supervision.	End-September, 2018		Reduce gray economy.

Attachment I. Technical Memorandum of Understanding

1. This Technical Memorandum of Understanding (TMU) sets out the understandings regarding the definition of indicators used to monitor developments under the program. To that effect, the authorities will provide the necessary data to the European Department of the IMF as soon as they are available. As a general principle, all indicators will be monitored on the basis of the methodologies and classifications of monetary, financial, and fiscal data in place on May 18, 2018, except as noted below.

A. Fiscal Conditionality

2. The general government fiscal deficit is defined as the difference between total general government expenditure (irrespective of the source of financing) including expenditure financed from foreign project loans, payments of called guarantees, cost of bank resolution and recapitalization, cost of debt takeover if debt was not previously guaranteed, repayments of debt takeover if debt was previously guaranteed, and payment of arrears (irrespective of the way they are recorded in the budget law) and total general government revenue (including grants). For program purposes, the consolidated general government comprises the Serbian Republican government (without indirect budget beneficiaries), local governments, the Pension Fund, the Health Fund, the Military Health Fund, the National Agency for Employment, the Roads of Serbia Company (JP Putevi Srbije) and any of its subsidiaries, and the company Corridors of Serbia. Any new extra budgetary fund or subsidiary established over the duration of the program would be consolidated into the general government. Privatization receipts are classified as a financial transaction and are recorded "below the line" in the General Government fiscal accounts. Privatization receipts are defined in this context as financial transactions.

3. Current primary expenditure of the Republican budget (without indirect budget beneficiaries) includes wages, subsidies, goods and services, transfers to local governments and social security funds, social benefits from the budget, other current expenditure, net lending, payments of called guarantees, cost of bank resolution and recapitalization, cost of debt takeover if debt was not previously guaranteed, repayments of debt takeovers if debt was previously guaranteed, and payment of arrears (irrespective of the way they are recorded in the budget law). It does not include capital spending and interest payments.

Adjustors

- The quarterly ceilings on **the general government fiscal deficit** will be adjusted downward (upward) to the extent that cumulative non-tax revenues of the General Government from dividends exceed (fall short of) programmed levels.
- The quarterly ceilings on **the general government fiscal deficit** will be adjusted downward to the extent that cumulative non-tax revenues of the General Government from debt recovery receipts, debt issuance premiums, and concession and Public Private Partnership (PPP) receipts

recorded above-the-line exceed programmed levels. The IMF Statistics Department will determine the proper statistical treatment of any concession or PPP transaction signed during the IMF program.

Cumulative Programmed Revenues of the General Government from Dividends, Debt Recovery Receipts, and Debt Issuance at a Premium

(In billions of dinars)

	End-Sep. 2018	End-Dec. 2018	End-Mar. 2019	End-Jun. 2019	End-Sep. 2019	End-Dec. 2019
Programmed cumulative dividends	17.1	17.1	17.1	17.1	17.1	17.1
Programmed cumulative debt recovery receipts	0	0	0	0	0	0
Programmed cumulative debt issuance at a premium	0	0	0	0	0	0
Programmed concession and PPP receipts recorded above the line	0	0	0	0	0	0

- The quarterly ceilings on the **primary current expenditure of the Republican budget** will be adjusted upward (downward) to the extent that (i) cumulative earmarked grant receipts exceed (fall short of) the programmed levels and (ii) cumulative proceeds from small-scale disposal of assets (the sale of buildings, land, and equipment) recorded as non-tax revenues exceed the programmed levels up to a cumulative annual amount of 2 billion dinars in each year. For the purposes of the adjustor, grants are defined as noncompulsory current or capital transfers received by the Government of Serbia, without any expectation of repayment, from either another government or an international organization, including the EU.

Cumulative Receipts from Earmarked Grants and Small-scale Asset Disposal
(In billions of dinars)

	End-Sep. 2018	End-Dec. 2018	End-Mar. 2019	End-Jun. 2019	End-Sep. 2019	End-Dec. 2019
Programmed cumulative ear-marked grants receipts	7.6	14.2	2.5	5.5	9.3	15.1
Programmed cumulative receipts from small-scale disposal of assets	0	0	0	0	0	0

4. Domestic arrears. For program purposes, domestic arrears are defined as the belated settlement of a debtor's liability which is due under the obligation (contract) for more than 60 days, or the creditor's refusal to receive a settlement duly offered by the debtor. The program will include an indicative target on the change in total domestic arrears of (i) all consolidated general government entities as defined in ¶4 above, except local governments; (ii) the Development Fund, and (iii) AOFI. Arrears to be covered include outstanding payments on wages and pensions; social security contributions; obligations to banks and other private companies and suppliers; as well as arrears to other government bodies.

5. Debt issued at a premium. For program purposes, debt issued at a premium refers to proceeds accruing to the government that are recorded as revenue when the government issues debt at a premium. It most commonly occurs when a bond with an above-market coupon is reopened ahead of a coupon payment.

B. Ceiling on External Debt Service Arrears

6. Definition. External debt-service arrears are defined as overdue debt service arising in respect of obligations incurred directly or guaranteed by the consolidated general government, the Export Credit and Insurance Agency (AOFI), and the Development Fund, except on debt subject to rescheduling or restructuring.[1] The program requires that no new external arrears be accumulated at any time under the arrangement on public sector or public sector guaranteed debts. The authorities are committed to continuing negotiations with creditors to settle all remaining official external debt-service arrears.

[1] Debt subject to rescheduling or restructuring includes the US$44.7 million in arrears to Libya.

7. Reporting. The accounting of external arrears by creditor (if any), with detailed explanations, will be transmitted on a monthly basis, within four weeks after the end of each month.

C. Inflation Consultation Mechanism

8. Inflation is defined as the change over 12 months of the end-of-period consumer price index (CPI), base index (2006=100), as measured and published by the Serbian Statistics Office (SORS). Where the official press release differs from the index calculation, the index calculation will be used.

9. Breaching the inflation consultation band limits (specified in Program Statement, Table 1) at the end of a quarter would trigger discussions with IMF staff on the reasons for the deviation and the proposed policy response.

D. Reporting

10. Net international reserves of the NBS will be submitted within one week of the end of the month.

11. General government revenue data and the Treasury cash position table will be submitted weekly; and the stock of spending arrears as defined in ¶6 45 days after the end of each quarter. General government comprehensive fiscal data (including social security funds) will be submitted by the 25th of each month.

12. The stock of spending arrears (> 60 days past due) as reported in the MOF e-invoice system will be submitted within 14 calendar days after the end of each month.

13. Gross issuance of new guarantees by the Republican budget for project and corporate restructuring loans will be submitted by the 25th of each month.

14. Cumulative below-the-line lending by the Republican budget will be submitted by the 25th of each month.

15. Borrowing by the Development Fund and AOFI will be submitted within four weeks of the end of each month.

16. New short-term external debt (maturities less than one year) contracted or guaranteed by the general government, the Development Fund, and AOFI will be submitted within four weeks of the end of each month.

17. Monthly average VAT refund time, stock of pending VAT refunds, and the value of the VAT refunds provided each month will be submitted by the Serbian Tax Administration within 14 calendar days after the end of each month.

18. Receivables of the top 20 debtors to Srbijagas and EPS will be submitted in the agreed-upon templates within 14 calendar days after the end of each month as well as published on the company websites.

Data Reporting for Quantitative Targets		
Reporting Agency	Type of Data	Timing
Statistical Office and NBS	CPI inflation	Within four weeks of the end of the month
Ministry of Finance	Fiscal deficit of the consolidated general government	Within 25 days of the end of the month
Ministry of Finance	Current primary expenditure of the Republican budget excluding capital expenditure and interest payments	Within 25 days of the end of the month
Ministry of Finance	External debt payment arrears by general government, Development Fund and AOFI	Within four weeks of the end of the month
Ministry of Finance	Gross accumulation of domestic payment arrears by the general government (without local government, the Development Fund, and AOFI)	Within 45 days of the end of the quarter
Ministry of Finance	Earmarked grants and receipts from small-scale disposal of assets	Within four weeks of the end of the quarter