

Chapter 17: Economic and monetary policy

The *acquis* in the area of economic and monetary policy contains specific rules requiring the independence of central banks in Member States, prohibiting direct financing of the public sector by the central banks and prohibiting privileged access of the public sector to financial institutions. Member States are expected to co-ordinate their economic policies and are subject to the Stability and Growth Pact on fiscal surveillance. New Member States are also committed to complying with the criteria laid down in the Treaty on the Functioning of the European Union (the Treaty) in order to be able to adopt the Euro in due course after accession. Until then, they will participate in the Economic and Monetary Union as a Member State with a derogation from the use of the Euro and shall treat their exchange rates as a matter of common concern.

The *acquis* in the area of economic and monetary policy is mainly governed by Title VIII (Articles 119 to 144) of the TFEU, and by relevant implementing legislation. Treaty provisions of Chapter 4 (specific to Member States whose currency is the euro) and those defined in Article 139 of the Treaty do not apply to Member States with a derogation.

The *acquis* consists mainly of Treaty provisions and protocols (primary legislation) and the provisions of instruments enacted by the EU institutions by virtue of them (secondary legislation e.g. regulations, decisions). Nonetheless, as indicated in Article 131 of the Treaty, each Member State shall ensure that its national legislation including the statutes of its central bank is compatible with the Treaties and the Statute of the European System of Central Banks (ESCB) and of the European Central Bank (ECB).

I. MONETARY POLICY

A. Country alignment

1. Please provide a copy of the constitution and central bank law (including the central bank's statute) and other important monetary and financial laws (in one of the official EU languages).

The Law on the National Bank of Serbia (“RS Official Gazette”, Nos 72/2003, 55/2004, 85/2005 – other Law and 44/2010) is provided as a part of submitted legislation.

2. What are in your view the necessary reforms in national legislation (central bank law, laws on banking sector, insurance companies, pension funds, social security funds, compensation funds, interest rates, exchange rate law etc) with a view to EU membership requirements? Which reforms are already underway?

In view of the amendments to the Law on the National Bank of Serbia, yet to be implemented as to meet the requirements set for the European Union membership, the National Bank of Serbia (NBS) prepared and submitted Draft for a new Law on the National Bank of Serbia to the ECB. Having received the expert opinion from the ECB, and at the Proposal of 28th March 2008, we took into account all comments and recommendations under that opinion and prepared the final version of the Proposal for a Law on Amendments and Supplements to the Law on the National Bank of Serbia. The Law on Amendments and Supplements to the Law on the National Bank of Serbia (“Official Gazette of the RS”, no. 44/2010) entered into force on 1st July 2010.

In regard to the requests set for European Union membership, and particularly in view of the provisions under the EU Treaty, the Statute of the ESCB and the ECB, the most important changes covered by this law are as follows:

- The strengthening of institutional, personal, operational and financial independence of the NBS (objectives are specified and clearly classified by priority; tenure of the Governor and of the Vice Governor and Members of the Council of the Governor of the National Bank of Serbia (hereinafter as: the Council) are extended ; procedure for election of the Governor is changed; the right to judicial review of the decisions on removal from office is prescribed, prohibition is introduced on third persons to jeopardise the NBS independence, or autonomy, as well as to influence the NBS, its bodies, or members of the bodies while performing their tasks; it is explicitly prescribed that administrative proceeding may be initiated against NBS administrative act adopted while performing its functions, while the court may not decide on the administrative matter where the Law on the National Bank of Serbia prescribes the NBS jurisdiction thereof, etc.);
- How the NBS is managed (the three bodies – the Governor, the Executive Board and the Council; the Executive Board partially took over responsibilities from the Monetary Board, as well as portion of Governor's responsibilities in the field of supervision of banks, insurance companies, voluntary pension funds and financial leasing, as well as portion of responsibilities from the existing Council (it takes decisions on the uniform tariff for the NBS services); role of the Council, being the supervisory body, has been strengthened (it supervises the system of financial reporting, risk management and internal control in the NBS, evaluates the appropriateness of adopted accounting policies and procedures, adopts the annual plan on the performance of the internal audit, periodically reviewing the reports on the performed internal audit, supervises the performed internal audit and the compliance of the activities carried out by the NBS), whereas it has also been conferred the competencies as regards the By-Law adoption, as well as the NBS developmental strategies; provisions have been specified relating to the election, conflict of interest and the removal of the Governor, Vice Governor, and Members of the Council);
- Determining the exchange rate regime for the dinar (the Council determines the exchange rate regime for the dinar, at the proposal by the Executive Board, and with Government's consent);
- Key policy instead of discount rate;
- Prohibition to finance public sector (the prohibition relates to credits, loans, overdraft, or other models of credit facilities in the Republic of Serbia, autonomous province, or local self-government units, public undertakings and other legal persons founded by the Republic of Serbia, the autonomous province, or the local self-government units, i.e. those where the Republic of Serbia, autonomous province, or local self-government units have a controlling participation; likewise, the NBS may not directly purchase securities issued by the above entities; the prohibition shall not relate to daily credits whose maturity may not be extended, and to credits intended for the settlement of the obligations of the Republic of Serbia arising from its membership in the IMF; besides this, the NBS may approve credits and credit facilities to banks where the Republic of Serbia, autonomous province, or local self-government unit, have controlling participation, under conditions and in the manner valid for banks where these entities have no controlling participation);
- The right of the NBS to propose laws, in accordance with the Constitution of the Republic of Serbia;

- The NBS capital (Special reserves in the amount of 20.000.000.000,00 dinars; new rules relating to profit distribution and loss coverage);

Besides the above changes, the provision relating to the status of the NBS employees has also been changed (general law governing labour relations applies to the rights, obligations and responsibilities of the employees under employment contract, instead of the law governing civil servants), adding the explicit provision whereby the NBS, the Governor, the Vice Governor, and other employees shall not be liable (even after termination of the employment contract with the NBS, i.e. termination of the job position) for any damages ensuing the performance of the NBS activities, save if the damage was caused intentionally, or due to gross negligence. Validity of certain provisions relating to the conflict of interest of the Governor, the Vice Governor and the Council members has been extended to cover all employees.

It should be noted that in the field of the monetary policy, as of 1st January 2009, the NBS has been implementing the targeted inflation regime as its monetary strategy and key instrument of monetary policy, in compliance with the widely accepted central bank practice, using the key policy rate in monetary policy core operations. The key policy rate, being the monetary policy key instrument is implemented by symmetric corridor of interest rates – from interest rates to deposited facilities, as the lowest, to interest rates to credit facilities, as the highest interest rates applied by the NBS on the money market. Exchange rate, formed through implementation of the managed floating exchange rate regime, is an indicator of monetary policy transmission.

The NBS shall continually develop the normative and operational framework for the implementation of the monetary policy instruments and measures, with maximum possible framework alignment with the EU and ECB regulations. Further alignment of domestic regulations in the field of monetary policy with the EU regulations, including regulations on the exchange rate, shall depend on the accomplished level of economic and financial stability, financial markets development, banking system solvency position as well as other conditions for implementation and planning of the monetary policy. The proposal for a new Law on the NBS includes solutions improving the normative framework for the monetary policy instruments and monetary operations implemented by the NBS.

Moreover, one of the conditions to be fulfilled by Serbia for full EU membership is the complete liberalization of capital movements. In Serbian legislative capital movements is regulated by the Law on Foreign Exchange Operations. This law fully liberalizes current payments, complying with Article VIII of the IMF Statute. As regards capital operations, Serbia has opted gradual, time-phased liberalisation of the free movement of capital. To that effect, the Law on Foreign Exchange Operations has liberalized the long-term capital operations as follows: resident and non-resident direct investments, resident investments in equity securities abroad not being direct investments, as well as long-term debt securities if their issuers are the OECD member states and international financial institutions, operations with financial derivatives as well as foreign long-term credit operations, while deposit operations of residents have been partially liberalized, given that certain categories of physical persons may freely keep foreign exchange abroad, whereas legal persons need approval by the NBS for foreign operations.

The Law on Foreign Exchange Operations includes restrictions relating to the short-term movement of capital: residents are not allowed to invest in short-term securities abroad. This restriction shall not cover the National Bank of Serbia and banks carrying out their operations under conditions prescribed by the NBS, as well as domestic investment and voluntary pension funds and insurance companies, investing in compliance with the laws governing their operations. Also, non-residents are not allowed

to invest in domestic short-term securities. Residents (banks, legal persons and entrepreneurs) are not allowed to use foreign short-term financial credits for the settlement of the liabilities in the Republic (conversion into national currency), banks solvency and other purposes as determined by the National Bank of Serbia.

Necessary reforms relating to the accession of Serbia to the EU are defined under Article 63. paragraph 3, of the Stabilization and Association Agreement. This Article of the SAA shall be binding for Serbia to, four years after the Agreement became effective, secure free movement of capital relating to the portfolio investments and financial loans and credits with maturity period shorter than one year. It was assessed that four years period was needed for the establishment of a sustainable macroeconomic stability and for the fulfilment of the preconditions for neutralization of the potential negative effects of the short-term capital flow liberalization.

For continued liberalization of the movement of capital, reforms are underway as to prepare the amendments and supplements to the Law on Foreign Exchange Operations, of which we emphasize the following:

- 180 days time limit is repealed for foreign exchange entry after export and for the import paid in advance, whereas these operations shall be deemed as foreign credit operations and registered with the National Bank of Serbia, after expiration of one-year time period.
- obligation to enter profit realized from foreign investment operations is repealed ,
- all guarantee operations have been regulated, rather than only guarantees and suretyships considered as foreign credit operations, so that domestic legal persons, other than a banks, shall be able to issue suretyships to non-residents against foreign operations and to acquire guarantees and suretyships from non-residents against foreign operations and operations with other legal persons in the Republic,
- banks, residents and non-residents shall be able to buy and sell foreign exchange on the foreign exchange market, not laying down the reason for the buying and the selling of foreign exchange,
- possible foreign exchange crediting in the country is being extended, save to citizens, banks shall be able to approve foreign exchange credit also to legal persons and entrepreneurs for the purchase of real estate,
- grounds for payment in foreign exchange in the country are increased: donations for humanitarian, scientific and cultural purposes, programs and projects financed from the development aid of the EU, and similar,
- international financial organizations and development banks, or financial institutions whose founders are foreign states, shall be allowed to approve credits to residents in the dinar, under the conditions and in the manner prescribed by the NBS, and such operations shall be deemed as foreign credit operations,
- banks shall be enabled to participate in syndicated financial credit approved by a group of foreign creditors to resident, irrespective of the purpose, provided bank's downpayment is not less than 10% of the amount of the credit. In addition, banks shall be enabled to buy from the non-residents and sell to non-residents outstanding claims against downpayments in the syndicated financial, or commodity credit or loan,
- resident legal person founded by the Republic of Serbia through a special law for the financing of export, shall be enabled to carry out foreign credit operations in compliance with the special

law, for smooth performance of operations for which it was founded.

In the field of banking sector, from the standpoint of the Bank Supervision Department, and considering the requests for the alignment of the domestic legislative with the EU acquis, reforms are necessary in the area of banking regulations, both laws and by-law acts. To that effect, draft of the new Law on Banks is underway, largely to be aligned with the latest amendments to relevant European Directives, and to appropriately regulate the establishment (of credit institutions), operations and supervision of operations. In addition, preparation of by-law legislation has largely been finalized, thus introducing the Basel II standards to bank operations and supervision with particular regard to the emerging Basel III standards. The above acts are foreseen to take effect by the beginning of 2011.

National Program for Integration with the EU (NPI), as of 2008 and 2009, defined the issues where alignment between national regulations and EU legislative was needed in the area of insurance services. Likewise, NPI short-term priorities in the field of insurance services were defined as follows: adoption of the Law on Compulsory Traffic Insurance and preparation of the Proposal for a Law on Amendments and Supplements to the Insurance Law and supporting by-law acts.

The National Assembly of the Republic of Serbia adopted the Law on Compulsory Traffic Insurance, ("RS Official Gazette", 51/2009), at its session held on 8th July 2009. Core decisions under this law are for the most part aligned with the EU legislative, whereas the implementation of certain decisions was postponed until the accession of the Republic of Serbia to the European Union, both because these decisions are preconditioned by the EU membership, and because of the economic capacities of the citizens and insurance companies.

As regards the Insurance Law ("RS Official Gazette" Nos. 55/2004, 70/2004, 61/2005, 61/2005—other Law, 85/2005—other Law and 101/2007 and 107/2009), decisions foreseen by this law are partially aligned with the European Union legislative. However, there remain issues where alignment is needed. Primarily, these issues relate to the current level of insurance development and economic abilities of insurance companies.

To that effect, the proposal for Amendments and Supplements to the Insurance Law (whose preparation is underway) shall lead to the harmonization with EU Directives on the direct insurance (life and non-life insurance) and the supervision of insurance company group, as regards the following issues: supervision of the insurance company group, obligation to inform the beneficiary and obligation to professional secret. This proposal shall also lead to additional alignment as regards the coverage and placement of technical reserves, qualified participation and affiliated persons, contract of cooperation and information exchange, auditor information disclosure, regular reporting – business plan monitoring, operating licence termination and fit & proper criteria.

NPI midterm priority in the field of insurance services, includes finalized harmonization process and regulations in the field of insurance with the EU acquis, in particular in the following areas: direct insurance (life and non-life), reinsurance and supervision of insurance company groups, annual accounts and consolidated statements of insurance companies, intermediation in insurance, reorganization and liquidation of insurance companies, financial conglomerates in EU and insurance from auto responsibility.

As regards the alignment with the Directive EU SOLVENCY II, and considering that it is a new Directive whose application by EU member states shall begin on 01/11/2012, preparation for the alignment with this Directive shall take place in this period.

Lastly, the pension system reform started in 2005, by adoption of the Law on Voluntary Pension Funds and Pension Schemes (“Official Gazette of the RS: no. 85/2005), introducing a system of voluntary pension funds, so that pension system of the Republic of Serbia now includes the First and the Third pension insurance pillar. The First Pillar is the state Pension and Disability Fund, obligatory for all employees and functioning according to the system pay-as-you-go. The Third Pillar includes voluntary private pension funds functioning according to the system of accumulation and capitalization of assets and defined contributions, where the amount of the pension is not guaranteed, but depends on the amount of the realised contributions.

The Law on Voluntary Pension Funds and Pension Schemes regulates the issue of the establishment and operations of companies for voluntary pension funds management, organization and fund management, membership in pension funds, remunerations, reporting, assessment of the fund assets value, the manner of supervision of companies for voluntary pension funds management, as well as other issues related to the system of voluntary pension funds. The Law has been implemented as of 1st April 2006.

From the standpoint of aligning domestic regulations with EU acquis in the field of voluntary pension funds, of relevance is the Directive 2003/41/EC of the European Parliament and Council, on operations (activities) and supervision of institutions for professional pension insurance, of 3rd June 2003. The Law on Voluntary Pension Funds and Pension Schemes is partially aligned with the Directive 2003/41/EC.

The Draft Law on Amendments and Supplements to the Law on Voluntary Pension Funds and Pension Schemes has been prepared (hereinafter as: the Draft Law) whose adoption is expected in 2010. Proposer of the Draft Law is the Ministry of Finance. The Draft Law, adhering to the Directive, prescribes that the management company shall be prohibited to put its, or interests of its founders, i.e. of affiliated persons, before the interest of the fund members. Additionally, supervisory body shall be authorised to request from the management company also other reports, information and data of relevance for the supervision, as well as to, in the course of supervision, view the business books and other documents and request information from legal persons affiliated with the management company through property, management or business relations.

The coming period shall allow further amendments to the Law on Voluntary Pension Funds and Pension Schemes. The law needs to be aligned with the provisions of the Directive prescribing investment limitations, and fund property investments need to be enabled complying with the provisions of the Directive. Besides, it is necessary to allow the voluntary pension fund management companies to provide services and to have their services consumed, as well as the services of custody banks with registered office in other member states of the European Union (cross-border activities).

B. Implementation Capacity

Central bank institutional, personal and financial independence:

- 3. What is the degree of functional independence of the central bank from public authorities (President, Government, especially Ministry of Finance, Parliament etc)? What is the specific role of those actors in the functioning of the central bank? Describe the present situation both in legal terms (information based on the central bank law) and in practice.**

Given that functional independency requires the primary objective of every national central bank to be clearly and precisely defined, as well as fully in compliance with the main objective determined by Treaty – that is price stability maintenance; and the requests included in the Treaty of the EU, relating to the independence of the central bank, to reflect the widely accepted opinion that the main objective (price stability maintenance) can be best accomplished through completely independent institution with precisely defined competencies; and the independence of the national central bank to be completely compatible with its accountability for the decisions adopted – we point to the following provisions of the Law on the National Bank of Serbia (hereinafter as: the Law on the NBS):

Article 2, of the Law on the NBS, prescribes that the NBS is independent and autonomous in performing its tasks defined by this and other law, that it is subject to the supervision by the National Assembly of the Republic of Serbia, to which it reports on the performance. Paragraph 3, of the same Article establishes prohibition for the NBS, its bodies and members of the bodies to, while performing their tasks, receive or request instructions from the government bodies and organizations, as well as other persons. It is also strictly prohibited on these persons (government bodies, organizations and other persons) to jeopardise the independence and autonomy of the NBS, as well as to influence the NBS, its bodies and members of the bodies while performing their duties (Article 2, paragraph 4).

Article 3, of the Law on the NBS defines the objectives of the NBS. According to this Article, the main objectives of the NBS is to accomplish and maintain price stability. Without prejudice to the accomplishment of this main goal, the NBS shall contribute to the maintenance and strengthening of the financial system stability. Besides, and without prejudice to the accomplishment of these objectives, the NBS shall support implementation of the economy policy of the Government of the Republic of Serbia, operating in compliance with the principles of the market economy.

The Law on the NBS also includes numerous provisions governing the relation between the NBS and the National Assembly, the Government of the Republic of Serbia, and particularly the Ministry of Finance. As regards the relation between the NBS and the National Assembly, we indicate the following provisions:

Primarily, as mentioned before, the NBS is subject to the supervision by the National Assembly, to which it reports on the performance (Article 2, paragraph 2). Hence, the Law on the NBS lays down the following reporting obligations:

- monetary policy program for next year shall be submitted to the National Assembly for information, not later than 15th December of the current year (Article 71, paragraph 1);
- annual report on monetary policy, elaborating the factors which influenced implementation of the policy, as well as annual report on stability of the financial system, shall be submitted to the National Assembly, not later than 30th June next year (Article 71, paragraph 2);
- half-year report on monetary policy, elaborating the factors which influenced implementation of the policy, shall be submitted to the National Assembly, not later than 30th September of the current year (Article 71, paragraph 3);
- annual report on the NBS performance and results, shall be submitted to the National Assembly, not later than 30th June next year (Article 71, paragraph 4).

The Governor shall explain the monetary policy program to the National Assembly as well as

the above reports, whereby it shall be explicitly defined that the National Assembly may not give any instructions to the NBS based on the enclosed program or submitted reports.

In addition, the Council shall submit to the National Assembly annual financial statements, with the report from the authorized auditor, for information, before 30th June next year (Article 79, paragraph 2), whereas financial plan for next year shall be submitted to the National Assembly not later than 30th December of the current year.

The National Assembly shall elect the Governor, at the proposal of the President of the Republic of Serbia (Article paragraph 1) and decide on the dismissal of the Governor (Article 28, paragraph 6).

The National Assembly shall also elect the president and members of the Council (NBS supervisory body), upon the proposal of the committee of the National Assembly in charge of finance (Article 22, paragraph 1) and decide on the removal from office of the members (Article 28, paragraph 6). In addition, the Council shall be obliged to report on its performance to the National Assembly at least once a year (Article 23, paragraph 2).

Relations between the NBS and the Government of the Republic of Serbia, and particularly the Ministry of Finance, shall be governed by the following provisions:

The Minister of Finance shall be summoned to Executive Board meetings (body determining the monetary and the foreign exchange policy, as well as activities for the financial system stability maintenance and strengthening), participating thereof with no voting rights (Article 16, paragraph 6). In turn, the Governor may be summoned to the sessions of the Government (Article 72, paragraph 1).

Complying with Article 72, paragraph 2 and 3, of the Law on the NBS, the Government, or competent ministries shall submit to the NBS, for an opinion, draft laws and other regulations relating to the objectives, functions, rights and the NBS responsibilities, as well as the draft memorandum on the budget, economic and fiscal policies and draft law governing the budget.

The Ministry of Finance shall also, at least once a year, submit to the NBS a written notification on planned new commitments of the Republic of Serbia undertaken abroad, and on the expected deployments of foreign credits and repayments thereof, as to overview the influence these commitments have on the laying down and implementation of the monetary policy. This Ministry shall in addition duly inform the NBS on all transactions of the Republic of Serbia, relating to its external debts (Article 72, paragraph 4. and 5).

As regards the situation in practice, we inform you that provisions of the Law on the NBS relating to the NBS functional independence are respected.

4. Does the central bank act provide for the following prohibitions for third parties?
– to give instructions;

Article 2, paragraph 3, of the Law on the NBS, prescribes that NBS and its bodies and members of the bodies, while performing their duties, shall not receive or request instructions from the government bodies and organizations, as well as from other persons. In turn, explicit prohibition is prescribed on third persons to give instructions to NBS, its bodies and members of the bodies. Paragraph 4, of the same Article, determines that public authorities and organizations, as well as other persons, may not

jeopardize the NBS independence and autonomy, and influence NBS, its bodies and members of the bodies while performing their duties. As regards the monetary policy program and NBS reporting to the National Assembly, Article 71, paragraph 8 determines explicit prohibition for the National Assembly to give any instructions to the NBS on the basis of the delivered monetary policy program or submitted reports.

– **to approve, suspend, annul or defer decisions;**

The Law on the NBS does not include explicit prohibition for third persons to approve, suspend, annul, or defer the implementation of the decision of the National Bank of Serbia, whereas, save for the court, no other body may annul decision taken by the NBS. Article 86c, of the Law on the NBS prescribes that an administrative dispute may be initiated against an administrative act of the National Bank of Serbia passed in the performance of its tasks, but an action against such act may neither prevent not postpone its implementation. In addition, it is explicitly specified that in the administrative dispute the court may not resolve an administrative matter whose resolving is under the competence of the NBS, by the Law on the NBS.

– **to censor decisions on legal grounds;**

The Law on the NBS does not include explicit prohibition for third persons to assess the legality of the NBS decisions, whereas, save for the court, no other body is entitled to assess the legality of such decisions. In addition, as specified, it is explicitly foreseen that the court may not resolve the matters whose resolution is under the competence of NBS, by the Law on the NBS (the court may only annul the decision of the NBS).

– **to participate in decision-making bodies of the central bank with a voting right;**

Members of the Executive Board (the body determining the monetary and foreign exchange policy, and activities for the maintenance and strengthening of the financial system stability, adopts regulations in the field of supervising functions, and certain administrative acts thereof) are the Governor and the Vice Governors (employed in the NBS). Article 16, paragraph 6, of the Law on the NBS, prescribes that the Minister of Finance shall be summoned to Executive Board sessions and participate thereof without voting rights.

In turn, members of the Council are not NBS employees. Although the Council determines the exchange rate regime for the dinar at the proposal of the Executive Board and with the Government' consent, it shall not be authorised to adopt decisions relating to the performance and accomplishment of the NBS objectives.

– **require *ex ante* consultation on the central bank's decisions?**

The Law on the NBS does not include explicit prohibition for third persons to request from NBS, before adoption of the decision, to consult them, or obtain their opinion, whereas there is no legal obligation for NBS to consult anyone, or obtain opinion from any third persons before adoption of its decisions.

5. Does the central bank have any *ex ante* reporting obligations towards other authorities regarding its monetary policies?

According to Article 71, of the Law on the NBS, the National Bank of Serbia shall submit, for information, to the National Assembly the monetary policy program for next year, no later than 15th December of the current year. The National Bank of Serbia shall be obliged to publish the monetary policy program without delay in the “Official Gazette of the Republic of Serbia”. The Governor shall, in addition, explain the monetary policy program in the National Assembly, whereas the National Assembly may not give any instructions to the NBS based on the submitted policy program (Article 71, paragraph 8).

According to the Agreement on Inflation Targeting, the National Bank of Serbia and the Government agree that inflation targets shall be set by the National Bank of Serbia, in cooperation with the Government, and publicly announced by the National Bank of Serbia.

6. How is the management of the central bank organised (composition and responsibilities of the governing bodies, in particular the managing board)?

According to Article 12, of the Law on the NBS, bodies of the NBS are as follows:

- Executive Board of the National Bank of Serbia
- Governor of the National Bank of Serbia
- Council of the Governor of the National Bank of Serbia.

Executive Board and the Governor are NBS management bodies, whereas the Council shall primarily have supervising role and functions.

Members of the Executive Board are the Governor and Vice Governors (Article 13). Executive Board sessions shall be chaired by the Governor, in the event of a tie, he has the casting vote).

Executive Board defines the monetary and the foreign exchange policy, and the activities for the maintenance and strengthening of the financial system, and determines in particular (Article 14)

- 1) the monetary policy program of the NBS;
- 2) the manner of setting the interest rates of the NBS and the manner of calculation, collection and payment of interest on placements and other receivables of the NBS, as well as on the funds the NBS pays interests on;
- 3) terms and conditions of issuing securities of the NBS;
- 4) terms and conditions under which the NBS performs open market operations discount activities.
- 5) short-term credit policy;
- 6) dinar exchange rate policy;
- 7) the required reserve base and ratio, as well as the terms, conditions and time limits for the allocation and use of bank's required reserves;
- 8) the strategy and policy of foreign exchange reserves management, and guidelines for foreign exchange reserves management;

- 9) other instruments and measures of monetary and foreign exchange policies;
- 10) measures for maintaining the liquidity of banks;
- 11) measures and activities within scope of authority of the NBS for the maintenance and strengthening of the financial system.

Executive Board shall determine the key policy rate and other interest rates applied by the NBS while implementing the monetary policy.

The Executive Board has certain competencies in the field of supervisory functions (Article 15). Namely, the Executive Board adopts the NBS regulations in this field, and decides on the following: a) granting preliminary approvals, as well as granting and withdrawal of banks' operating licences; b) granting and revoking insurance companies licences for carrying out insurance operations; c) granting and withdrawal of permits for financial leasing activities; d) granting to and revoking from companies managing voluntary pension funds the licences for managing such funds.

Lastly, the Executive Board has certain competencies relating to the proposals of acts for adoption by the Council. The Executive Board shall propose the By-Law of the NBS and its development strategy (for adoption by the Council), whereas the dinar exchange rate regime shall be determined by the Council at the Proposal of the Executive Board, with Government's consent.

The Governor shall manage, stand for and represent the NBS (Article 9). Competencies of the Governor determined under Article 18, of the Law on the NBS are as follows:

- 1) management of the operations of the National Bank of Serbia and organization of its work;
- 2) implementation of the decisions of the Executive Board and the Council;
- 3) adoption of regulations, general and individual acts within the NBS competencies, not assigned by law under the competences of the Executive Board and the Council;
- 4) proposing regulations, general and individual acts relating to the Executive Board and the Council, unless otherwise prescribed by the Law on the NBS;
- 5) regulating the NBS internal organization and job classification in NBS, as well as labour relations of the NBS employees;
- 6) appointments and dismissals of managing staff;
- 7) other tasks laid down by the law in the manner not contrary to the objectives of the NBS.

The Governor shall also adopt acts on obtaining, managing, using and disposing of the property of the Republic of Serbia, to be used by the NBS, with the exception being alienation of immovable property (Article 73, paragraph 3).

Eventually, the Governor shall propose to the Council the appointment of the Vice Governor (Article 21, paragraph 1), select and hire employees with special authority (Article 84, paragraph 1) and give consent to employees for the performance of additional, paid operations and activities (Article 85, paragraph 3).

Executive Board and the Governor shall be accountable for the accomplishment of the NBS objectives within their competencies, as specified by the Law on the NBS (Article 12, paragraph 2).

Key functions of the Council are specified under Article 23, of the law. The Council:

- 1) adopts the By-Law, at the proposal by the Executive Board;
- 2) establishes the dinar exchange rate regime, at the proposal by the Executive Board, and approval by the Government);
- 3) adopts the NBS financial plan;
- 4) adopts the NBS annual financial statements;
- 5) appoints external auditor, reviews external auditor's report and monitors application of auditor's recommendations to the NBS;
- 6) supervises the system of financial reporting, risk management and internal controls in the NBS;
- 7) evaluates the appropriateness of the accounting policies and procedures adopted by the NBS;
- 8) adopts annual plan on the internal audit in the NBS, periodically reviewing reports on the internal audit;
- 9) supervises the internal audit implementation and the compliance of the activities in the NBS;
- 10) adopts NBS development strategy, proposed by the Executive Board, and monitors its implementation.

The Council elects the Vice Governors of the NBS, complying with Article 21, paragraph 1, of the Law on the NBS.

7. Which provisions from the law ensure democratic accountability and transparency of the central bank?

Democratic accountability of the NBS, is reflected in the exercising of the Council's competencies, being the supervisory body, i.e. in other bodies' obligation to report to the Council. Likewise, Article 24, of the Law on the NBS, lays down the Governor's duties to, at least quarterly, submit to the Council the report on the monetary policy implementation, granting and revoking of the operating licences and on the exercising of its controlling or supervising function as regards the NBS, as well as on the adoption of regulations within the NBS competency. The Council may also, for implementation of the tasks conferred under its competency, request the Governor to submit appropriate documents and data ensuing the activities of the NBS.

In turn, relating to the principles of democratic accountability and NBS transparency, as regards the National Assembly, certain procedures have been established ensuring accomplishment of these principles (submission of annual reports, general debate on the monetary policy, presentation of plans and programs before the competent Assembly boards, justification of the reports, etc.). As described, the law prescribes for NBS obligation to report on the following:

- monetary policy program for next year to be submitted to the National Assembly for information, not later than 15th December of the current year (Article 71, paragraph 1);

- annual report on monetary policy, elaborating the factors which influenced the implementation of the policy, as well as annual report on the financial system stability to be submitted to the National Assembly, not later than 30th June next year (Article 71, paragraph 2);

- half-year report on monetary policy, elaborating the factors which influenced implementation of the policy to be submitted to the National Assembly, not later than 30th September of the current year (Article 71, paragraph 3);

- annual report on the NBS performance and results, shall be submitted to the National Assembly, not later than 30th June next year (Article 71, paragraph 4).

Democratic accountability and NBS performance transparency is reinforced through the provision of the Law on the NBS prescribing obligation on NBS to announce, without delay, the monetary policy program, which it submitted to the National Assembly, in the “Official Gazette of the RS” (Article 71, paragraph 6), as well as through the provision specifying the Governor’s duty to elaborate the monetary policy program as well as the here above mentioned reports to the National Assembly (Article 71, paragraph 7).

In addition, the Council shall submit to the National Assembly annual financial statements of the NBS, with authorized auditor report, by 30th June next year, and NBS shall be obliged to announce these reports in the “Official Gazette of the RS”, within one month as of the date of the submission to the National Assembly (Article 79, paragraph 2 and 3). Financial plan for next year shall be submitted to the National Assembly for information, not later than 31st December of the current year (Article 74, paragraph 2);

As regards NBS transparency, we would also like to emphasize that the By-Law (Article 6) and the Decision on the Dinar Exchange Rate Regime (Article 43, paragraph 3), are announced in the “Official Gazette of the Republic of Serbia”, and that the key policy rate is announced on the NBS webpage (Article 41, paragraph 1).

Besides, complying with the Law on Free Access to Information of Public Interest (“Official Gazette of the RS”, no. 120/2004, 54/2007, 104/2009 and 36/2010), the NBS publishes its Information Paper on operations of the NBS (publication containing relevant data on the mandate, organizational structure and operations of the NBS, as well as the manner in which interested persons may exercise their right to information as regards the activities of the NBS).

8. What are the appointment and removal conditions and procedures for the central bank governor and the other members of the decision-making bodies of the central bank?

According to Article 19, of the Law on the NBS, National Assembly appoints the Governor, on the basis of the proposal by the President of the Republic of Serbia, for the period of six years, and the right to be reelected. Requirements to be elected the Governor are as follows:

1. citizenship of the Republic of Serbia,
2. fulfilled general employment requirements,
3. university diploma acquired from the second degree studies,

4. at least ten years work experience in the fields of economy, finance and banking.

Conditions for the selection of the Vice Governor (Article 21, paragraph 3), and members of the Council (Article 22, paragraph 4) are identical to those for the selection of the Governor. Besides these conditions, at least one member of the Council must have at least ten years of experience in accounting or auditing.

The Council appoints the Vice Governors at the proposal of the Governor, with the right to be reelected (Article 21, paragraph 2 and 3).

The National Assembly appoints the President and the Council members at the proposal by the committee of the National Assembly in charge of finance, for the period of six years, with the right to be reelected (Article 22, paragraph 1 and 2).

Termination of office of the Governor, Vice Governors, and Council Members is stipulated by Articles 26 to 29, of the Law on the NBS. The Governor, the Vice Governors, and the Council Members appointments shall cease as of the tenure expiration, and before tenure expiration if they submit a written resignation, if their employment terminates due to compulsory retirement, as well as in case of the removal from office.

Concerning the resignation, the Governor and Council Members submit resignations to the National Assembly and are obliged, without delay, to inform the Council thereof, while the Vice Governors submit resignations to the Council, informing the Governor thereof, without delay. Office of the resigning Governor and Council Member terminates once the new Governor, or Council Member, are appointed, and office of the resigning Vice Governor terminates once the new Vice Governor is appointed, i.e. six months after filing of the resignation. In view of the compulsory pension requirements, the office shall terminate as of the moment of employment termination due to fulfilled pension requirements, and the Governor and Council Members are obliged to inform the National Assembly and the Council thereof, at least six months before the fulfilment of the requirements, whereas the Vice Governors have such obligation only regarding the Council.

The Governor, the Vice Governor and the Council Member shall be removed whenever:

- 1) that person is finally convicted for business crime, labour related rights, property, public authorities, judiciary, public order and legal traffic and misconduct, or final conviction for criminal offence to unconditional imprisonment, longer than six months;
- 2) found that the unprofessional and conscienceless carrying out of the tasks and serious misconduct in decision making and in implementing and organizing the NBS operations, caused significant deviation from the accomplishing of the main objective;
- 3) based on the findings and opinion of the competent health institution, it is found that health condition permanently restricted that person's work capacity for the given position, or due to temporary incapacity for the given tasks for a period longer than six months;
- 4) if the person fails to file, or files fraudulent statement on the data under Article 20, paragraph 5, of the Law on the NBS (stating in writing that neither he/she nor his/her affiliated persons hold positions and carry out tasks mentioned under paragraph 1, item 1 and 2 of that Article, that he/she does not possess shares, stakes, or debt securities of a bank, insurance company, leasing provider, company for voluntary pension fund management, audit firm, or other legal person whose performance is supervised by, the NBS, or cooperating with while carrying out his/her duties, as well as shares, stakes or

debt securities of legal persons with share in the mentioned legal persons, i.e. that he/she, if in possession thereof, will alienate them within three months as of the appointment), i.e. in case he/she acts contrary to paragraph 1 of that Article;

5) it is found that requirements under Article 19 of the Law on the NBS were not met.

Concerning the removal of the Governor, the Vice Governor, or the Council member, the Council shall review existence of the grounds for the removal from the Governor and the Vice Governor office, and the committee of the National Assembly in charge of finance shall review existence of grounds for removal from the Council member office. If the Council, i.e. the committee of the National Assembly in charge of finance decides that there are some grounds for the removal of the Governor, i.e. Council member, it shall be obliged to inform and give respective elaboration to the President of the Republic of Serbia and the National Assembly in writing, or to the President of the National Assembly. When reviewing the existence of the grounds for the removal, the Council shall be obliged to request Governor's, i.e. Vice Governor's statement, and the committee of the National Assembly in charge of finance shall request Council Member's comment. The Governor's comment, with notification on the existence of the grounds for the removal, shall be filed to the National Assembly, and Council Member's comment to the President of the National Assembly. Based on justified notification from the Council, i.e. the committee of the National Assembly in charge of finance on the existing grounds for the removal, the National Assembly shall decide to remove the Governor, i.e. Council member. The decision on the removal of the Vice Governor shall be taken by the Council, proved such reasons for the removal exist.

Official's office shall terminate as of the adoption of the decision on the removal. Although administrative dispute may be initiated against this decision, the action against the decision shall neither prevent nor defer its execution.

9. Does the central bank's law comply with the following requirements?

- **Minimum term of office of the Governor should be at least 5 years (indicate the current term of office);**

The Law on the NBS is aligned with the requirement that minimum term of office of the Governor should be at least 5 years. Namely, Article 19, paragraphs 1 and 2, of the Law on the NBS, specify that the National Assembly shall appoint the Governor, to a six years term, with the right to be reelected.

- **grounds for dismissal of the Governor may not be different from the following: if the Governor no longer fulfils the conditions required for the performance of his/her duties or if he/she is guilty of serious misconduct;**

We believe that the Law on the NBS is aligned with this requirement, because, as already mentioned (under question 8), grounds for the removal of the Governor basically boil down to not meeting the requirements needed for the carrying out of the tasks, no longer meeting such requirements, or being responsible for serious misconduct.

- **security of tenure of other members of decision-making bodies of the central bank (how long is the term of their office?) and grounds for their dismissal should be similar to those here above mentioned;**

Length of the tenure of the Vice Governor (Article 21, paragraph 2), and the Council members is the same as the length of the tenure of the Governor – 6 years, with the right to be reelected. Also, grounds for dismissal of these persons are the same as the ones for the dismissal of the Governor.

- **membership of a decision-making body involved in the performance of the central bank's tasks is incompatible with the exercise of other functions that might create a conflict of interest (are members authorised to hold part-time jobs?);**

Article 20, of the Law on the NBS lays down the issues relating to the incompatibility of the functions and the conflict of interest of the Governor, the Vice Governor, or the Council members. These persons may not:

- 1) be deputy to the National Assembly, members of the Government or authorities or bodies established by the National Assembly or the Government, or officials of political organizations, i.e. may not exercise the function of the body, or members of the bodies of the autonomous province, or self-government unit, or union organization; and may not exercise any other public function or public job;
- 2) be members of the management, executive, or supervisory board, or other bodies of a bank, insurance company, leasing provider, of a company for voluntary pension management, audit firm, or any other person whose performance is controlled, i.e. supervised by, the NBS, or cooperating with while exercising the functions, and may not be employees in these undertakings, or their associates.
- 3) possess shares, stakes, or debt securities of a bank, insurance company, leasing provider, company for voluntary pension fund management, audit firm, or other legal persons whose performance is controlled, i.e. supervised by, the NBS, or cooperating with while exercising the function.
- 4) possess shares, stakes, or debt securities of legal persons with shares in a bank, insurance company, leasing provider, company for voluntary pension fund management, audit firm, or other legal persons whose performance is controlled, i.e. supervised by, the NBS, or cooperating with while exercising the functions (share means direct or indirect right or possibility to exercise the voting right in the legal person, i.e. direct, or indirect possession of capital of the legal person).

Besides this, the Governor, the Vice Governor, or the Council member may not be persons connected with the persons performing the here above mentioned functions, or tasks, i.e. those possessing the shares, stakes, or debt securities. If the Governor, the Vice Governor, or the Council member possesses those shares, stakes or debt securities, they will be obliged to alienate them within three months as of the date of the appointment and to make a written comment for the National Assembly, thereof.

The Governor, the Vice Governors, or the Council Members are obliged, immediately after the appointment, to make a written comment for the National Assembly, thereof, stating that neither they, nor their connected persons, have exercised the here above mentioned functions, and tasks, possessed shares, stakes, or debt securities and that they shall, in case they possess them, alienate them within three months.

Six months after termination of the function, the Governor, the Vice Governor, or the Council member may not be employed in a bank, or other legal person whose performance is controlled, i.e. supervised by, the NBS, or cooperating with while exercising the functions (Article 29, paragraph 1).

Also, the Governor, the Vice Governors and the Council members are obliged to act fully complying with the regulations governing the prevention of the conflict of interest while exercising public functions.

– **right of judicial review of any dismissal decision by independent national courts?**

Article 28, paragraph 8 of the Law on the NBS explicitly prescribes that against the dismissal decision an official administrative dispute may be initiated, whereas the claim against this decision shall not prevent or defer its execution.

10. Is the central bank in a position to avail itself of the appropriate means to ensure that its tasks can be properly fulfilled? Does a consultation on and/or right exist for a third party to amend, approve or control by any means the central bank's draft budget and annual accounts? If yes, where is it regulated? If yes, where is it regulated?

Considering the NBS position which is determined by the constitutional and lawful provisions, and primarily the financial aspect of its independence, the NBS is capable to ensure sufficient means for duly and efficient exercise of the functions defined by the law.

Article 73 of the Law on the NBS specifies that property of the Republic of Serbia, used by the NBS, consists of the dinar long-term placements, foreign exchange, securities, other assets and property rights in possession of the NBS, movable and immovable property and monies on the NBS gyro account. This property shall be used for the NBS operations, and the Governor shall adopt acts on obtaining, managing, using and disposing of the property, save on alienation of the immovable property.

Here above mentioned property is sufficient for the NBS operations, although issue may be raised due to the fact that the owner of such property is the Republic of Serbia, and not the NBS (being merely its user).

The NBS has a financial plan determining its planned income and expenditures for the next year. Financial plan for the coming year the NBS submits to the National Assembly exclusively for information, not later than 31st December, in the current year (Article 74). Financial plan is adopted by the Council (Article paragraph 23, paragraph 1, item 3), at the proposal by the Governor (Article 18, paragraph 1, item 4).

Article 75, of the Law on the NBS, stipulates that the NBS shall accomplish income as follows: 1) from interest rate and other income from assets deposited abroad, 2) from interest on credits and other placements and claims, 3) from remuneration for provided services, 4) through share purchase and sale, 5) from positive exchange rate differences, 6) other income accomplished from its operations, or operations of a specialized organization within its composition. Executive Board determines the uniform charges tariff for the services provided by the NBS.

From the NBS income, complying with provisions of Article 76, the following shall be settled: 1) interests and other expenditures against foreign credits, 2) interests on funds kept with the NBS, 3) interests and other expenditures against securities, 4) expenditures for the issuance of banknotes and coins, 5) material and non-material amortization costs, 6) negative

exchange rate differences, 7) employees salaries, 8) other expenditures NBS has from its operations and activities of a specialized organization within its composition.

Annual financial statements, with report from authorized auditor, Council submits, for information, to the National Assembly, before 30th June next year (Article 70).

Therefore, there is no possibility for a third person to supplement, approve, control, or in any other similar way influence the preparation and adoption of the financial plan (budget) and the NBS financial statements.

We emphasize that smooth activities of the NBS are secured through provisions specifying that the Republic of Serbia is obliged to cover the losses of the NBS where that is not possible from the funds of the NBS core capital and special reserves. Namely, the resulting NBS loss shall be covered from special reserves and core capital above the level of the minimum share capital, and if the here mentioned funds are not sufficient, from the budget of the Republic of Serbia, or securities issued for that purpose under market conditions by the Republic of Serbia and transferred to the NBS (Article 78, paragraph 1).

11. What are the provisions governing the distribution of the central bank's profits?

Distribution of the profit is laid down by Article 77, of the Law on the NBS. This Article prescribes that before reaching the minimum amount of NBS core capital, that is RSD 10,000,000,000, the complete NBS profit shall be distributed to the core capital. Having reached the amount of the minimum core capital, the complete NBS profit shall be distributed to special NBS reserves, until reaching the amount of these reserves, that is RSD 20,000,000,000.

Having reached the amount of the minimum core capital of RSD 10,000,000,000, and the amounts of special reserves, of RSD 20,000,000,000, the profit resulting from the exchange rates and revaluated NBS reserves shall be distributed as follows: 33, 3% to core capital and 66, 7% to special reserves.

Having reached the here above mentioned amounts of the minimum core capital, and the amounts of special reserves, the profit not resulting from the exchange rate differences and the revaluated NBS reserves shall be distributed as follows: 10% to core capital, 20% to special reserves and 70% to the budget of the Republic of Serbia. Likewise, the NBS shall transfer the required portion of the profit to the budget of the Republic of Serbia, within ten days from the submission of NBS financial statements to the National Assembly, as well as the authorized auditor report.

12. Does the *ex post* review of the central bank's accounts reflect adequate safeguards to prevent it from infringing on the bank's independence?

According to Article 81, of the Law on the NBS, annual statements are audited as stipulated by the law governing the audit of financial statements and International Auditing Standards. The Council shall appoint external auditor, review the external auditor's report and monitor the implementation of that audit in the NBS (Article 23, paragraph 1, item 5).

Besides the regular annual audit by the independent external auditor, NBS operations in the part where they refer to the use of public funds and state budget operations shall be subject to the audit by the State Audit Institution, complying with the Law on State Audit Institution ("Official Gazette of the RS" no. 101/2005, 54/2007 and 36/2010).

Given the external auditor authorities as well as of the State Audit Institution, to that end, there are no reasons for the NBS independence to be jeopardised.

Prohibition of monetary financing and privileged access:

- 13. Please provide a copy of laws and regulations (in English) governing the access of government to financial institutions (e.g. laws and other regulations governing the asset allocation of banks, savings and co-operative banks, insurance companies, social, pension and special funds, other institutional investors, investors compensation schemes, tax laws, etc).**

The legislation will be submitted.

The Law on the National Bank of Serbia

The Law on Public Debt

The Law on Insurance

The Law on the Market of Securities and other Financial Instruments

The Law on Banks

The Law on Financial Leasing

Except for tax laws.

- 14. What are the principles regulating the emergency liquidity assistance? To whom the central bank can provide the emergency liquidity assistance? Where is it regulated in the law?**

The National Bank of Serbia, according to Article 14. and 42, of the Law on the National Bank of Serbia, is authorized to specify and prescribe measures for bank liquidity maintenance.

Based on this lawful authorization, the National Bank of Serbia adopted Decision on terms and conditions of extending liquidity loans to banks ("Official Gazette of the RS", no. 96/2008), prescribing the possibility to approve credits to banks for the maintaining of the liquidity with maturity of up to twelve months.

These credits may be used by banks with temporary difficulties in the maintaining of the liquidity, provided they had previously made use of all other more favourable sources of liquidity on the market and that they adopted a program of measures to overcome the difficulties.

The National Bank of Serbia shall approve credit to the bank fulfilling the conditions on the basis of the first ranking mortgage on real estate, with no registered encumbrance for the benefit of third persons, where the bank shall be registered as owner, as well as on the basis of the pledged foreign exchange, and /or bank's allocated foreign currency required reserves, collateral of gold, collateral of bank's receivables, as well as on the basis of securities pledge. Amount of the credit may not exceed 80% of the value of mortgage and/or collateral.

The bank shall be paying interest for approved credit according to interest rate of 150% of the key policy rate of the National Bank of Serbia.

15. Can the central bank provide solvency assistance to the financial institutions?

Here above mentioned credit for the maintaining of bank liquidity, according to the Decision on terms and conditions of extending liquidity loans to banks ("Official Gazette of the RS", no. 96/2008), may also, under stipulated conditions, relate to the support to the bank solvency. Currently, besides this credit, no special measures are foreseen to provide solvency assistance to financial institutions. Complying with the here above mentioned the Decision, the National Bank of Serbia may approve credits for the maintenance of the liquidity only to banks.

16. Please indicate the respective provisions in these documents, as well as any other elements, which might constitute privileged access of the government to financial institutions.

The Law on Banks, the Law on Financial Leasing, The Law on Insurance, the Law on the Market of Securities and Other Financial Instruments, and the Law on the National Bank of Serbia **do not contain** any provisions which might constitute privileged access of the government to financial institutions.

17. In particular, the following questions have to be addressed:

- **Are there national legal provisions requiring or encouraging (through tax or other advantages) banks, insurance companies, pension funds, social security funds, investor compensation fund or other financial institutions to invest (e.g. a certain portion of their assets) in domestic government securities or other government liabilities?**

As far as voluntary pension funds are concerned, domestic legislation does not recognize any regulations which would stimulate or request to invest property (or certain portion) of the voluntary pension fund in domestic government securities, or other government debt instruments.

- **To what extent has the central bank contributed to the financing of the public sector? Describe the present situation both in legal terms and in practice. Describe the rules governing central bank credit to the government (limits, repayment, maturity, etc.), if such rules exist.**

According to Article 62, of the Law on the National Bank of Serbia, the National Bank of Serbia may not approve credits, loans, overdraft facilities or other forms of credit facilities to the Republic of Serbia, autonomous province, or local government unit, public enterprises and other legal entities the founder of which is the Republic of Serbia, autonomous province, or self-government unit, i.e. where the Republic of Serbia, autonomous province, or local government unit has controlling participation. The National Bank of Serbia may not directly purchase securities issued by the here above mentioned entities. This prohibition shall not refer to daily credits with inextensible maturity terms, as well as to credits, loans, overdraft facilities, or other types of credit facilities approved to the Republic of Serbia for the settlement of its obligations based on its membership in the International Monetary Fund. The National Bank of Serbia may, under conditions specified by the law, approve credits and credit facilities to banks in which the Republic of Serbia, autonomous province, or local government unit, has controlling participation .

Although this option existed before the Law on Amendments and Supplements to the Law on the National Bank of Serbia became valid, in practice the National Bank of Serbia has not been approving credit to the Republic of Serbia since November 2003, when the Republic of Serbia returned the last credit approved for the financing of the temporary budget illiquidity, on the basis of the law provisions valid at the time.

- **Is the central bank authorised to buy Serbian public debt instruments directly on the primary market? Can it buy public debt instruments from EU Member States?**

As here above mentioned, the National Bank of Serbia, according to Article 62, paragraph 2, of the Law on the National Bank of Serbia, may not directly buy securities issued by the Republic of Serbia, autonomous province, or local government unit, public enterprises and other legal entities the founder of which is the Republic of Serbia, autonomous province, or local government unit, i.e. where the Republic of Serbia, autonomous province, or local government unit has controlling participation. Also, according to the Regulation on general conditions of issuance and sale of short-term state securities on the primary market (“OG of the RS”, no. 6/2009 and 8/2009), the National Bank of Serbia is not a direct participant on primary market of government securities.

Complying with Article 13 and 15, of the Law on Foreign Exchange Operations, the National Bank of Serbia could make payment for the abroad purchase of long-term debt securities from the EU member states, as well as for the payment of short-term securities purchase on foreign, or domestic market.

- 18. Is there an emergency liquidity mechanism/overdraft facility or any other type of credit facility provided by the central bank to the central governments, regional, local or other public authorities, or any other public bodies governed by public law or public undertakings? If yes, on which conditions and where is it regulated? If yes, on which conditions and where is it regulated?**

According to current regulations (Article 62, of the Law on the National Bank of Serbia), as here above mentioned, there is no possibility for liquidity providing, permitted overdraft or any other type of credit facility by the National Bank of Serbia to federal, or local authorities,

or public undertakings and other legal entities the founder of which is the Republic of Serbia, autonomous province, or local government unit, i.e. where the Republic of Serbia, autonomous province, or local government unit has controlling participation, except daily credits with inextensible terms, and credits and loans, overdrafts or other types of credit facilities approved to the Republic of Serbia for the settlement of its liabilities on the basis of its membership in the International Monetary Fund.

The National Bank of Serbia may, complying with Article 62, paragraph 4, of the Law on the National Bank of Serbia, approve credits and credit facilities to banks where the Republic of Serbia, autonomous province, or local government unit, has controlling participation – under conditions and in the manner prescribed by the law, otherwise applicable to other banks.

D. Monetary and exchange rate policy

19. What are the main objectives of the central bank? Who formulates the monetary policy?

The NBS objectives are determined by Article 3, of the Law on the NBS.

This Article prescribes that the primary objective of the NBS is to achieve and maintain price stability. Without prejudice to its primary objective, the NBS shall contribute to the maintenance and strengthening of the financial system stability. Without prejudice to here above mentioned objectives, the NBS shall support the pursuance of the economic policy of the Government of the Republic of Serbia, operating in compliance with the principles of a market economy.

Since 1st January 2009, the NBS has been implementing the fully fledged inflation-targeting regime as to accomplish its primary objective – price stability.

Monetary policy is defined by the Executive Board of the NBS (Article 14, of the Law on the NBS), particularly specifying the following:

- 1) the NBS monetary policy program;
- 2) the manner of setting the NBS interest rates and the manner of calculation, collection and payment of the interest on placements and other NBS receivables, as well as funds against which the NBS pays interest;
- 3) terms and conditions of issuing of NBS securities;
- 4) terms and conditions under which the NBS performs open market operations and discount activities;
- 5) short-term loan policy ;
- 6) dinar exchange rate policy;
- 7) the required reserves base and ratio, as well as the terms, conditions, and time limits for the allocation and use of bank's required reserves;
- 8) strategy and policy of foreign exchange reserves management, and guidelines for foreign exchange reserves management;
- 9) other instruments and measures of monetary and foreign exchange policy, and
- 10) measures for bank liquidity maintenance.

**20. Is the maintenance of price stability the primary objective of the central bank?
Without prejudice to that objective, does the central bank support the general economic policy objectives of the government?**

Yes, as here above mentioned under answer to previous question, the primary objective of the NBS is to achieve and maintain price stability.

Without prejudice to that objective, does the central bank support the general economic policy objectives of the government?

The NBS supports economic policy of the Government without prejudice to the accomplishment of its primary objective relating to financial stability (Article 3, paragraph 3, of the Law on the NBS).

21. Is the central bank act in accordance with the principle of an open market economy with free competition, favouring an efficient allocation of resources, and acting in compliance with the principles set out in Article 119 of the Treaty?

Even though the NBS practically carries out major part of its functions complying with the here above mentioned principles, under the Law on the NBS there is no explicit provision including these principles. An exception is the quoted provision whereby the NBS supports economic policy of the Government operating in compliance with the principles of a market economy principles (Article 3, of the Law on the NBS).

**22. Which is the official currency unit used for conducting the monetary policy?
Where is it referred to in the law?**

Complying with Article 53 and 54, of the Law on the National Bank of Serbia, monetary unit – legal tender of the Republic of Serbia is the dinar, and all pecuniary obligations arising from transactions concluded in the Republic of Serbia between undertakings, and other domestic legal entities and citizens shall be denominated in dinars and effected by dinar-denominated means of payment, unless otherwise stipulated by the law.

Complying with the here above mentioned, the National Bank of Serbia uses the dinar as official currency for conducting the monetary policy.

23. Do the basic tasks of the central bank include the following: definition and implementation of monetary policy, conduct of foreign exchange policy, holding and management of the official foreign reserves of the country, and promotion of the smooth operation of payment systems?

Yes. The most important NBS functions specified under Article 4, of the Law on the NBS, and other relevant provisions of the law, include, among others, the definition and implementation of the monetary and foreign exchange policy, foreign exchange reserves management, and promotion of smoothly operating payment system. Besides, Article 34, paragraph 5, of the Law on the NBS, explicitly specifies that NBS shall define and implement monetary and foreign exchange policy in the Republic of Serbia through independently determining the policy of the dinar exchange rate and the defining dinar exchange rate regime, approved by the Government.

24. How is monetary policy carried out (what are the specific reserve requirements, refinancing facilities, open market operations, major central bank interest rates,

other monetary instruments)? What have been the main recent developments in the use of monetary instruments? How is monetary policy carried out (what are the specific reserve requirements, refinancing facilities, open market operations, major central bank interest rates, other monetary instruments)? Is the framework for monetary policy sufficient to allow policy makers to conduct successful stabilisation policies? Are open market and credit operations, if any, based on collateral arrangements?

Monetary policy and monetary policy instruments

The Law on the National Bank of Serbia is the core legal framework for determination and implementation of the monetary policy, as well as for the determination and implementation of the dinar exchange rate policy and regime. Executive Board lays down the monetary policy, including the instruments and measures of the monetary policy (Article 14, of the Law on the National Bank of Serbia), whereas the Council of the Governor lays down the dinar exchange rate regime, at the proposal by the Executive Board, and with the Government of the RS consent (Article 23, paragraph 1, item 2, of the Law on the National Bank of Serbia). The Law on Foreign Exchange Operations provides legal framework for the functioning of the domestic foreign exchange market and for the formation of the dinar exchange rate.

The National Bank of Serbia adopted *the Memorandum on Inflation Targeting as Monetary Strategy*, on 22nd December 2008 (hereinafter as: The Memorandum), defining the formal application of the inflation targeting regime as of 1st January 2009. The Memorandum was prepared complying with the *Agreement between the National Bank of Serbia and the Government of the Republic of Serbia on Inflation Targeting*. According to these documents, The National Bank of Serbia sets up the point headline inflation targets in cooperation with the Government of the RS, and announces them in the form of a memorandum on medium-term inflation targets. Currently effective memorandum is the *Memorandum Inflation Targeting for the Period 2010-2012*, setting up the point headline inflation targets (with tolerance band), measured as annual percentage change in the consumer price index, for the period 2010-2012. The trajectory of inflation targets until 2012 is consistent with the need to achieve medium-term price stability which, in view of the orientation of the National Bank of Serbia to converge to EU prices and income levels, is defined as annual inflation of 2-4%.

Normative and operational framework of the National Bank of Serbia is predominantly based on indirect instruments of monetary policy, allowing the central bank to successfully implement monetary policy, as to achieve its main objective – price stability. The existing instruments and monetary policy measures, such as the open market operations, and standing facilities, including the role of the key policy rate with interest rates corridor are, according to their main characteristics and functions, largely aligned with the monetary ECB instruments. As regards the required reserves, deviation from the EU regulations is greater, considering that this instrument has efficient role in the withdrawal of the structural liquidity surplus of the domestic banking sector. The Decision on the banks' required reserves with the National Bank of Serbia, adopted by the NBS Monetary Policy Committee in March 2010, has more significantly improved this monetary policy instrument (decreasing the required reserve ratios, unifying the rules, etc.).

Main interest rates of the National Bank of Serbia

Key policy rate of the National Bank of Serbia is the key instrument of monetary policy, whereas other monetary policy instruments have accessory role – contributing to smooth transmission of the key policy rate influences onto the market, as well as to financial markets development. Key policy rate is interest rate applied in conducting of the main monetary policy operations (currently the interest rate on two-week repo rate operations) whereas that rate influences the short-term interest rates on the money market. Role of the key policy rate, being the monetary policy key instrument, is supported by the symmetric corridor of interest rates – from interest rates to deposit facilities, as the lowest, to interest rates to credit facilities, as the highest interest rates applied by the National Bank of Serbia on the money market. The key policy rate plays the role of a signalling interest rate while implementing monetary policy whereby the National Bank of Serbia is guided by the level of the key policy rate when defining other interest rates in monetary policy implementation. The key policy rate is defined in the sessions held by the Executive Board, according to the predefined and announced calendar. The Executive Board decides on the changes to the key interest rate, including changes of other interest rates in the corridor, on the basis of the analysis and forecasts for macroeconomic and inflation movements, presenting immediately reasons for the changes to the public.

Operations on open market

The Law on the National Bank of Serbia prescribes that the National Bank of Serbia may issue short-term securities denominated in local, or foreign exchange (Article 35, paragraph 1, of the Law on the National Bank of Serbia). Complying with this law, and on the basis of the Executive Board and the Governor special decisions, the National Bank of Serbia issues short-term bills, denominated in the dinar, for the withdrawal of liquidity surplus from the banking sector by means of repo sale of the bills to banks.

Article 36, of the Law on the National Bank of Serbia defines that the National Bank of Serbia conducts open market operations through purchase and sale of securities, as well as through performing other operations with such securities and other financial instruments. Open market operations are more specifically regulated by the Executive Board special decision on the manner the National Bank of Serbia conducts its open market operations, and by the operational rules adopted for the implementation of this decision, as well as by the frame agreement on the conduct of repo and/or permanent purchase and sale of securities concluded with banks (master agreement). This normative frame allows different types of operations and manners of their implementation: repo and permanent purchase and sale of securities; organizing of auctions with fixed and variable interest rates; possible bilateral purchase and sale of securities etc. Subject matter of the operations are securities whose issuers are the National Bank of Serbia and the Republic of Serbia. Currently, the National Bank of Serbia is conducting a two-week repo sale of its own bills (transaction for the withdrawal of liquidity) at regular auctions and with fixed interest rate, according to predefined and announced auction timetable. Securities transactions are conducted electronically, through auction platform of the National Bank of Serbia, using *Real Time Gross Settlement* System (RTGS). Transition to web platform of the NBS and performance of these transaction through special web application is planned for 2011. Clearing and settlement of securities is conducted through Central Securities Depository and Clearing House, on the day of the conclusion of transaction (T+0), the DVP (*Delivery versus payment*) model. Only banks fulfilling the prescribed conditions may be participants in securities purchase and sale transactions with the NBS.

In 2010, cooperation and coordination improved between the National Bank of Serbia and the Ministry of Finance of the RS in the field of securities market, that is in the aligning of the securities issued by these issuers (maturity, terms set up for auctions, etc.).

Required reserve base

According to the Executive Board Decision on the banks' required reserves with the National Bank of Serbia (OG of the RS", no. 12/2010 and 78/2010), the National Bank of Serbia uses the required reserves as supporting instrument for monetary regulation, in implementing the monetary policy. The main characteristics of this instrument are that required reserves are calculated in the dinar and foreign exchange obligations against deposits, credits, securities and other liabilities, at differential rates, and that the dinar required reserves are calculated and allocated in the dinar, and foreign exchange reserves in the EURO (only exceptionally in USA dollars). During one month long accounting period, banks are obliged to maintain average daily position of allocated required reserves equal to calculated reserves. The National Bank of Serbia pays interest to banks in the dinar on the amount of actual average daily balance of allocated dinar required reserves in the accounting period, not exceeding the amount of calculated required reserves.

Standing facilities

Executive Board special Decision on the conditions and manner of extending daily liquidity credits to banks against a collateral of securities (Official Gazette of the RS", no. 52/2008 and 40/2010), regulates credit facilities – credits for regulation of daily liquidity of banks against a collateral of securities : intraday and overnight credits. Collateral for intraday and overnight credits are securities whose issuers are the National Bank of Serbia and the Republic of Serbia. The bank shall pay no interest to the National Bank of Serbia on the intraday credit.

Special Executive Board Decision on Terms and Conditions of Depositing Banks' Excess Liquidity with the NBS ("OG of the RS", no. 48/2008, 60/2007, 35/2008 and 73/2008), regulates deposit facilities, the depositing of banks' excess liquidity with the National Bank of Serbia. The National Bank of Serbia shall pay interest on the assets deposited by the bank.

Utilization of credit and deposited facilities is automated.

25. Which factors hinder the conduct of monetary policy (e.g. elasticity of loans and domestic expenditure to interest rates, competition in the banking sector, changes in the structure of financial markets)?

High participation of credits indexed in foreign exchange restrains efficiency of the transmission mechanism through interest rate channel . Given the circumstances, interest rates on credits depend more on foreign interest rates, foreign exchange rate movements, as well as on banks competitiveness, and less on the key policy rate of the National Bank of Serbia.

Undeveloped domestic financial market also diminishes monetary policy efficiency, primarily because of undeveloped secondary money market and lack of interest rate that would be the reference rate for the establishment of the yield curve on the money market.

Besides that, the banking sector in Serbia disposes of dinar excess liquidity dominantly placed in short-term securities of the National Bank of Serbia, as well as in government (treasury) bills, considering that currently there are no other high-quality products on the market. Domestic foreign exchange market in turn, is shallow and there is a need for the National Bank of Serbia to occasionally intervene on that market as to encourage the turnover and secure its smooth functioning.

26. Describe the major characteristics and objectives of your exchange rate regime and policy: anchor, choice of the central rates, width of the fluctuation bands, etc:

The National Bank of Serbia conducts the managed floating exchange rate regime for the dinar, which includes the NBS interventions only in cases of excessive daily oscillations in the foreign exchange market, jeopardised financial and price stability and for protection of appropriate level of foreign exchange reserves. Given that the National Bank of Serbia is in the inflation targeting regime, it has no numeric targets for the exchange rate.

27. How is the exchange rate policy implemented? What are its instruments (interventions, monetary policy, fiscal policy, capital control)? What is the intervention policy – if any – (currencies used, financing, and sterilisation)?

In the inflation targeting regime, foreign exchange interventions of the the National Bank of Serbia are a secondary instrument restricted to cases of excessive daily oscillations in the foreign exchange market, jeopardised financial and price stability and protection of appropriate level of foreign exchange reserves.

Foreign exchange interventions are used to contribute to the accomplishment of the inflation targeted rate where effective influence of the key policy rate as the core instrument of the monetary policy has been exhausted. (The National Bank of Serbia Memorandum on Inflation Targeting as Monetary Strategy, December 2008).

Given that EURO is the key policy foreign exchange, the National Bank of Serbia conducts interventions purchasing and selling EURO. In case of intervention through foreign exchange purchase, the ensuing excess liquidity of the banking sector in local currency may be withdrawn by repo operations of liquidity withdrawal – repo sale of securities.

The National Bank of Serbia main transactions on foreign exchange market are spot transactions, while since March 2010; swap transactions have been introduced as regular monetary policy instrument, aimed at encouraging the inter-banking activities on local foreign exchange market.

28. Are any reforms of the exchange rate policy envisaged? If yes, why? What part does the prospect of EU accession play in this respect?

Implementation of inflation targeting regime includes flexible exchange rate policy, as allowed by the current legal framework on exchange rate policy, hence until the joining the

European Union, most likely the National Bank of Serbia will not plan to change the monetary regime policy and foreign exchange policy.

29. Are there any attempts to measure equilibrium (real) exchange rates? What has been the recent evolution of the equilibrium real exchange rate?

The NBS evaluates equilibrium real exchange rates of the dinar into EURO, quarterly, and the evaluations are announced in the Inflation Report. Multi-dimensional Kalman filter, consisting of equation groups, is the main means for the evaluation of the equilibrium exchange rate, simultaneously evaluating trends and gaps of the real exchange rate, real interest rates, and economic activities. Evaluations of these values are mutually consistent as well as with the inflation movement.

In addition, the estimate of the equilibrium real exchange rate is based on the assumption that prices in Serbia, being in transition, will converge to prices in the European Union in the long run, i.e. that the dinar will strengthen against the euro in real terms in the long run. This price converging was significantly impeded by the world economic crisis, although we expect dinar's strengthening compared to EURO by the gradual fading of the crisis.

Our evaluation is that equilibrium real dinar exchange rate to EURO, in the period before the crisis was appreciated by annual rate of about 4%. We presume that with the emerging crisis there has been a crash in the real exchange rate trend to about 0,8% in the fourth quarter 2008, whereas with the crisis abating, the appreciation trend of real exchange rate slowly began to grow (about 1,4% in 2010 and 1,9% in 2011).

In view of this evaluation of equilibrium exchange rate, in the fourth quarter 2010, the dinar was underestimated to EURO for about 6%.

30. What is the link between the exchange rate policy and monetary policy?

Exchange rate policy and monetary policy are tightly linked. Exchange rate indicates monetary policy transmission. When estimating the key policy rate influence it is important to monitor movements on the foreign exchange market, given that the foreign exchange channel is still the strongest channel through which inflation is influenced. (The National Bank of Serbia Memorandum on Inflation Targeting as Monetary Strategy, December 2008). High level of participation of credits indexed in foreign exchange resulted in more significant influence of the foreign exchange on the supply and demand for credits, compared to the key policy rate.

31. How will the liberalisation of capital movements affect the monetary and exchange rate policies? How vulnerable is your economy to a significant appreciation or depreciation of the currency?

Liberalised capital flows increase the importance of external factors in conducting monetary policy. This may be reflected in higher foreign exchange influx, pressing the assets prices growth (including the dinar exchange rate). With lower foreign exchange influx, this influence shall be reflected in the pressing the asset prices decline. Serbian economy is highly sensitive to strong appreciation and depreciation pressures. While the dinar exchange rate defines net export (consequently requiring financing of the foreign trade deficit), debtor

position is defined through the balance channel. From monetary policy point of view, and in line with the inflation targeting regime, the exchange rate of the dinar shall be formed independently on the foreign exchange market, where the National Bank of Serbia shall have influence only in case of exceeding daily oscillations and low trading scope on the foreign exchange market.

32. What is the situation of foreign exchange reserves? Are there any targets for the size of these? How are the reserves managed?

By the end of October 2010, foreign exchange reserves of the National Bank of Serbia (NBS) were EUR 9, 7 billion, thus securing coverage of import of goods and services for eight months. Foreign exchange reserves of the NBS secure coverage of monetary aggregates (M1) of 421%.

By the end of October 2010, foreign exchange bank reserves were EUR 1.7 billion.

Under the arrangement with IMF target NFA for 2010 was defined. By the end of October 2010, NFA of the National Bank of Serbia was EUR 4,860 billion (recalculated according to the programmed exchange rate).

The National Bank of Serbia announces data on the level of foreign exchange reserves according to the IMF Methodology, monthly in the Statistical Bulletin.

Main guiding principles for the National Bank of Serbia when managing foreign exchange reserves are safety, liquidity and profitability, respecting the inter-relationship between the risk and return acceptable for the NBS. According to the legislative, the NBS decides on the forming, managing, utilizing and disposing of foreign exchange reserves in line with monetary and foreign exchange policy for the purpose of unimpeded fulfilment of obligations according to the foreign debt of the Republic of Serbia.

Foreign exchange reserves management is based on the General and Operating Guidelines for Foreign Exchange Management adopted annually and quarterly, determining the following:

- Currency structure of foreign exchange reserves;
- Average portfolio maturity;
- Instruments which can be invested in foreign exchange reserves;
- Banks for possible foreign exchange reserves placements;

Guidelines are adopted by the Executive Board of the National Bank of Serbia, consisting of the Governor, and the Vice Governors of the NBS.

Guidelines are rooted in the following key principles:

- 1) Foreign exchange reserves are invested in financial instruments with fixed yield (short-term and long-term securities and short-term deposits) whose issuers are governments, or government agencies of top credit rating;
- 2) Exposure of foreign exchange reserves to liquidity risk is minimized, by investing in the liquid government securities with short maturity, as well as by placement in overnight deposits with central banks.

3) Foreign exchange risk is controlled using the neutral currency portfolio structure, whereby foreign exchange reserves assets are invested complying with the currency structure of the foreign debt of the Republic of Serbia;

4) The risk of changed interest rates is managed by setting the low rate targeted portfolio duration, with defined limits of deviations.

33. How has the gross external debt stock developed? Please indicate the main sources of growth and its structural elements (e.g. maturity, creditor, currency composition, etc.)? What will the past debt accumulation mean in terms of medium and long-term growth of amortisation? How has the servicing of the external debt been managed?

Excel table - Annex

As of end September 2010, total external debt of the Republic of Serbia amounted to EUR 23,115 million, out of which 38.4% pertains to external debt of the public sector.

Significant part of the external debt of the public sector of the Republic of Serbia, in the amount of EUR 4,171.6 million (47%), resulted from loan agreements concluded prior to December 2000, and it has been fully reprogrammed. The remaining part of the external debt of the public sector arose after December 2000, through cross-border borrowing by the government, and as of end September 2010 amounted to EUR 4,702.5 million, out of which EUR 4,070.1 million pertains to debt towards international financial institutions, EUR 333.7 million to , debt towards foreign governments and development banks and EUR 298.6 million to debt towards foreign banks and financial institutions.

Increase of the total external debt was mostly influenced by the rise in external debt of the private sector, which has increased more than six-fold in the previous decade, and as of end September 2010 amounted to EUR 14,240.9 million, out of which 31.1% pertains to debt of banks and 68.9% to debt of enterprises (corporate sector). The largest part of external debt of the private sector, i.e EUR 10,127.4 million (71.1%), pertains to debt towards foreign commercial banks and financial institutions. External debt of the private sector towards international financial organizations amounted to EUR 852.8 million (6%), while debt towards development banks of foreign governments and commercial debt insured by insurance agencies of foreign governments amounted to EUR 509.0 million (3.6%). The remaining debt of the private sector, in the amount of EUR 2,751.7 million (3.6%), pertains to debt towards other foreign creditors and suppliers.

Maturity structure of the total external debt is favourable, given that long-term debt comprises 94.4% of the total external debt. Share of variable interest rate in the total external debt as of end September 2010 was 47.7%, while weighted average interest rate on the total external debt was 3%.

External debt to GDP ratio, indicating external solvency, is below high indebtedness level (80%) and as of end September amounted to 77.1%, while ratio between external debt and export of goods and services and remittances, amounted to 187.3%, which is also within the sustainable limits (220%).

Indicators of Republic of Serbia' external position as of September 30, 2010

External liquidity indicators (y %)

Foreign reserves / imports	Foreign reserves / short-term debt	Foreign reserves / GDP	Debt repayment / GDP	Debt repayment / exports	Debt repayment / exports and remittances
7.6	762.3	33.0	9.5	27.5	21.3

External solvency indicators (y%)

External debt / GDP	Short-term debt / GDP	External debt / exports	External debt / exports and remittances
77.1	4.3	244.3	187.3

Euro has the largest share in the currency composition of the external debt, amounting to 76.0%. Share of dollar amounts to 10.2%, special drawing rights 8.2%, Swiss Franc 4.6%, while the remaining 1.0% of the debt pertains to other currencies.

Pursuant to the external debt repayment schedule, as of end September 2010 the largest obligations on principal and interest become due in the next six years, as follows: EUR 5,658.3 million on public sector loans, and EUR 12,993.7 million on private sector loans. The largest repayments under external public debt become due during 2013 and 2014, and amounts to EUR 1,406.3 million, and EUR 1,257.6 million, respectively. Regarding external debt of the private sector, the largest obligations become due in 2011, when payments to foreign creditors amount to EUR 3,619.1 million, out of which 15% pertains to short-term loan payments.

National Bank of Serbia, as the fiscal agent of the Republic of Serbia, is in charge of servicing the Republic's external debt, both direct (government debt) and contingent (government-guaranteed) debt. Payments on external public debt are made by the order of the Ministry of Finance, which provides funds for settling the financial obligations.

Ministry of Finance of the Republic of Serbia is in charge of the external public debt management.

A. Country alignment

34. How is the policy coordination, in particular in the fiscal and monetary policy areas, governed by your legislation and effectively implemented?

Law on the National Bank of Serbia establishes the responsibility of the NBS for implementation of monetary policy and accomplishment of primary objective of monetary policy - stability of prices. Law on the Budget System establishes the responsibility of the Government of the Republic of Serbia for implementation of fiscal policy and management of public finances.

The Government and the NBS shall be in charge of ensuring the coordination of fiscal and monetary policy, in compliance with established institutional framework, during the phases of creation and implementation of economic and monetary policy.

In compliance with the Law on Amendments and Modifications of the Law on Budget System, during the economic policy creation phase the NBS shall provide opinion to the Government on the Report on Fiscal Strategy, which contains objectives and guidelines of economic policy for the upcoming medium term, including monetary policy. In addition, in compliance with the Law on Amendments and Modifications of the Law on NBS, the NBS's Board of Governors shall determine the foreign exchange regime of the dinar, at the proposal of the Executive Board of the NBS, along with the consent of the Government. In compliance with the compatible medium term frameworks of the economic policy, the NBS shall render the Monetary Policy Program for the next year. Also, the NBS shall be included into preparation and adoption of the Budget of the Republic of Serbia for the budget year, especially from the standpoint of influence of the proposed budgetary policy on the domestic demand and consequently on the inflation.

During the implementation phase of the medium term economic policy and in compliance with the established institutional framework, the Government and the NBS shall propose and align economic and monetary policy measures, for the purposes of achievement of medium term macroeconomic objectives regarding macroeconomic stability and economic growth.

Institutional delineation between responsibility of the NBS and the Government, regarding inflation control, is of special significance. The Government shall be responsible for realization of inflation objectives through responsible fiscal policy and respecting planned growth of the regulated prices.

The NBS shall be responsible for the prices of products established freely in the market, and the Government shall be responsible for the regulated prices which are under its direct or indirect control.

The Government of the Republic of Serbia shall, in cooperation with the NBS, determine the numerical guidelines for the growth of regulated prices of products and services which are under direct or indirect influence of the Government. Pursuant to the Agreement signed between the NBS and the Serbian Government on inflation targeting, adopted on the Government session on 19th December 2008, the NBS shall set inflation targets in cooperation with the Government. By signing this Agreement, the Government obliged itself to implement a sustainable and predictable fiscal policy in compliance with the targeted inflation rates, by timely notification of the public and the NBS on changes in the economic policy that may influence realization of the targeted inflation, particularly on plans regarding market and budgetary regulation. For the purposes of effective realization of the Agreement with the Government, the NBS has initiated establishment of the working group, comprised by the representatives of the NBS and the Government, with participation of the relevant ministries and agencies working on the establishment of numerical guidelines for the growth of regulated prices and inflation targets in the medium term.

In compliance with the Law on the National Bank of Serbia (Article 61), the National Bank of Serbia may, in the name and on behalf of the Republic of Serbia, conduct fiscal agent activities with regard to debt from abroad assumed by the Republic of Serbia pursuant to the contract or law, and/or may conduct activities regarding withdrawal of funds and repayment of obligations towards foreign creditors, as well as activities regarding issuing long-term securities pertaining to membership of the Republic of Serbia in the International Monetary Fund and other activities.

Also, Article 72 of the Law on the National Bank of Serbia defines the relation between the National Bank of Serbia and the Government of the Republic of Serbia, in the following manner:

The Governor may be invited to the Government session.

The Government, and/or competent ministries shall submit to the National Bank of Serbia draft laws and other regulations regarding objectives, tasks, rights and obligations of the National Bank of Serbia, for the purposes of obtaining an opinion thereon.

Within the time limits laid down by the law regulating budget system, the Government and/or the relevant ministry shall timely submit to the National Bank of Serbia a draft of the Fiscal Strategy Report, economic and fiscal policies and a draft of the law regulating budget, for the purposes of obtaining an opinion thereon.

The ministry in charge of finance shall, at least once a year, provide the National Bank of Serbia with a written notification of planned new borrowings of the Republic of Serbia abroad, as well as of expected disbursement of foreign loans and repayment under such loans, in order for the National Bank of Serbia to analyse the impact of such borrowing on determination and implementation of monetary policy

The ministry in charge of finance shall timely notify the National Bank of Serbia of all transactions of the Republic of Serbia regarding its external debt.

The Law on Public Debt, Article 15, paragraph 3 and Article 26, paragraph 3 prescribes that the Minister of Finance may conclude a contract with the National Bank of Serbia for conduct of certain activities regarding public debt repayment, and/or regarding conduct of certain activities related to state issued securities.

Also, for the purposes of ensuring the price stability that contributes to the sustainable economic growth, the National Bank of Serbia and the Government of the Republic of Serbia have concluded the Agreement on Inflation Targeting, which determines the basic principles of cooperation and coordination of monetary and fiscal policies between the National Bank of Serbia and the Government of the Republic of Serbia regarding inflation targeting as a monetary strategy of the National Bank of Serbia. By signing this Agreement, the Government obliged itself to implement sustainable and predictable fiscal policy in compliance with inflation targeting, by timely notification of the public and the NBS on changes in the economic policy that may influence realization of the targeted inflation, particularly on plans regarding market and budget regulation. In addition, pursuant to this Agreement, the Government and the National Bank of Serbia shall agree to cooperate in the development of institutional conditions necessary for effective inflation targeting, namely by developing regulation that provides independence to the National Bank of Serbia, as well as by providing incentives for the development of financial markets and activities regarding strengthening of confidence in the national currency.

Law on the Budget System, Article 27d, paragraph 2, point 2, prescribes that the Report on Fiscal Strategy must contain, among other things, the Opinion of the National Bank of Serbia on the Draft Report.

Also, pursuant to Article 92b, paragraph 1, point 3 of the Law on the Budget System, one member of the Fiscal Council shall be proposed by the Governor of the National Bank of Serbia.

35. Please provide an overview of the current and foreseen measures/policy instruments/structures/mechanisms to ensure the coordination of the economic policies within your country as well as with other EU Member States, in line with Europe 2020 for Growth and Jobs.

On 18th December 2010, the President of the Republic of Serbia, Boris Tadic, presented the Development Concept of the Republic of Serbia until 2020. This strategic document defines main elements of community and social development of the Republic of Serbia until 2020, in compliance with objectives set in the Europe 2020 Strategy, bearing in mind the Serbian development specificities.

Development objectives of the Republic of Serbia until 2020, in compliance with Europe 2020 Strategy, are the following:

1. Increasing number of employed persons,
 - 65% of population employed, aged 20-64
2. Improved human capital
 - Less than 15% of persons that quit school prematurely and did not pass any training, including specially marginalized groups (Roma, rural population, persons with disabilities)
 - 30% of population aged 30-34 with completed tertiary education
 - Less than 25% of fifteen-year-olds with insufficient level of functional literacy in understanding the text, mathematical and scientific literacy
3. Investing into knowledge and technology
 - 2% of GDP annually invested into research and development, half of which comes from the private sector
 - 6% of GDP annually invested into education development
4. Growth based on export and rational energy consumption
 - 60% of GDP growth based on sectors producing exchangeable goods and services
 - 30% of participation of total investments in GDP
 - 40% higher energy efficiency, with 20% of total energy produced from renewable sources
5. Social inclusion and poverty reduction
 - 20% reduction in the population facing poverty risk, including reduction of number of the poor that cannot fulfil their basic needs (around 250,000 people).

In order to achieve above mentioned objectives, new export and industrial oriented policy will be created, based on production of exchangeable goods, resource and energy efficiency; legal framework for business will be adapted with the EU regulation and administrative burden on the economy will be reduced; policies for the development of innovative SMEs and clusters will be established; Scientific and Technological development Strategy of the Republic of Serbia for the period from 2010 - 2015 will be fully implemented; Education Development Strategy for period until 2020 will be adopted, with introduction of lifelong-learning system and education, based on quality and efficiency.

Development concept of the Republic of Serbia until 2020 recognizes that the main preconditions for a successful realization of objectives set in this concept, and/or steps necessary to be taken in advance, are the following:

1. Institutional reform, including, constitutional and legal reforms, judicial reform, reform of public administration and security systems, which would make Serbia a stability factor in the region
2. Development of infrastructure and defining of spatial development of Serbia, in order to create a precondition for a sustainable economic growth and development

Mentioned preconditions are specific aspects of the Serbian Development Concept in the next ten years relative to Europe 2020 Strategy. Strengthening of institutions and infrastructure development are part of Serbia 2020 because standards of the developed EU member countries have not yet been achieved in these fields; hence, they had to be integrated as a specific part of the document.

Preparation of the Development Concept of Serbia 2020 is implemented in several phases. The first phase saw the preparation of the draft Development Concept of Serbia until 2020. The first phase was completed in mid July 2010. Currently, the phase is underway in which the draft Development Concept of Serbia 2020 is being presented to all parliamentary political parties and social partners, for the purposes of achieving broad political, economic and social consensus for implementation of scheduled measures. Within this phase, the Development Concept is presented to partners in the region and to the representatives to the EU as well, in compliance with the Recommendations of the European Commission and Conclusions from the Sarajevo Summit.

Based on consultations and public debate, the Government should put in work and develop the final text of Serbia 2020, which would then be formally adopted in the first quarter of 2011. Promptly after adoption, the document shall serve as a basis for all other strategies in the Republic of Serbia (using EU as a model). After it is adopted, such Development Concept of the Republic of Serbia until 2020 shall serve as a leading global strategic document in Serbia and shall represent basis that will direct work of various councils (National Infrastructure Council, National Competitiveness Council, Social-Economic Council, Business Council, National Council for Decentralization, National Council for Regional Development, European Integration Council etc.).

It has been planned to award special competencies for monitoring implementation of the Serbia 2020 Development Concept and realization of foreseen objectives. Due to coordination needs with Europe 2020 Strategy, implementation and control may be assumed by the strengthened European Integration Council, but there is also possibility to form a new body comprised of representatives of the Government and key partners.

36. Which legal acts may contain provisions that are non-compliant with the *acquis*?

Legal acts governing the financial system are partially aligned with the *acquis*. The process of the alignment of the here above mentioned legislation is continuous, hence every modification or amendment of legal acts generates further alignment with the *acquis* (eventually to result in full compliance with the *acquis*).

37. How does your country participate in the pre-accession economic policy surveillance?

Republic of Serbia, as a country which is a potential candidate for the EU membership, starting from 2006, began submitting once a year Economic and Fiscal Program for medium term to the European Commission. European Commission's departments assesses Serbian EFP, after which a meeting is organized between representatives of the Serbian Government and representatives of the European Commission (Directorate General for Economic and Financial Affairs), where economic and fiscal policy is discussed, presented in the submitted Program. After four Serbian EFPs so far, which were positively assessed by the European Commission, in January 2011 the Serbian Government will submit fifth EFP for 2011 with projections for 2012 and 2013.

38. Which are the general objectives taken into account into the preparation of the government's medium-term fiscal framework and budget law?

When preparing medium-term fiscal framework and the Law on the Budget of the Republic, baseline assumptions are general objectives of the economic policy, such as:

- Maintaining macroeconomic and financial stability in the changed global financial and economic environment;
- Recovery of the economy and return of the sustainable real economic growth rates, with adjustments in production, demand, loans, export and external financial flows;
- Continuation of European integration processes and implementation of structural reforms, in compliance with Serbia's EU Stabilization and Association Agreement.

Medium-term fiscal framework and annual budget of the Republic shall determine primary objectives of the economic policy in the medium term:

- Macroeconomic stability;
- Sustainable economic growth and development of competitive economy;
- Increase of employment and living standard ;
- Equal regional development within the Republic.

Macroeconomic stability as a general objective includes decrease of inflation to a low and stable level, as well as decrease of fiscal deficit and current account deficit to a sustainable level. Stability is an assumption for the continuation of economic recovery trend and faster economic growth based on investment and export strengthening, which will enable gradual improvement of conditions at the labour market. Economic growth in 2011 will be moderate, at the rate of 3% as a reflection of slow recovery of trade partners, low aggregate demand, and slow adjustment of the labour market. It is expected to witness more robust economic growth in 2012 and 2013 at higher rates, based on fiscal adjustment and implementation of structural reforms ensuring increase of productivity, export and savings. Robust economic growth will enable increase of employment and living standard and more equal development across the territory of the Republic.

Achievement of macroeconomic objectives demands adjustment and strong coordination of fiscal and monetary policies.

Macroeconomic policies in the coming medium term shall contribute to changes of the economic growth model, which will be more based on strengthening of offer and export, increase of investments and improvement of the competitiveness of the economy.

Changes of the past economic growth model based on consumption include directing policies and measures to creation of conditions for investments and export as drivers of the growth.

Similarly, implementation of structural reforms will contribute to more robust economic growth, in compliance with Serbia's EU Stabilization and Association Agreement. In that respect, it is necessary to speed up implementation of measures aimed at improvement of entrepreneurial environment and continuation of reform processes in real, financial and particularly in the public sector.

Established medium term macroeconomic objectives, supported with macroeconomic policy and structural reforms, represent the basis for the medium term fiscal policies as key components of macroeconomic policy, focused at:

- Strengthening of fiscal responsibility legal framework and improvement of the budget system;
- Reduction of the fiscal deficit and its non-inflationary financing;
- Low and stable tax burden of the economy, with improvement of tax discipline;
- Firm limitation of current public spending;
- Increase of public investments;
- Strengthening of financial discipline in public enterprises in the republic and local level.

Change of economic growth model from consumption and imports to investments and exports will lead to decrease of tax base (consumption, import), which will result in reduced tax revenues relative to GDP, along with unchanged tax rates. Such a trend will make reduction of fiscal deficit harder in the coming medium and long term and will demand significant reduction of current public spending.

Medium-term and long-term fiscal policy objectives will be achieved with introduction of the fiscal responsibility principles and fiscal rules, in compliance with the adopted amendments to the Law on the Budget System.

Bearing that in mind, it is necessary to have a firm medium-term plan for reduction of fiscal deficit and control public debt in the medium-term, in order to stimulate domestic and foreign investors and ensure necessary economic and employment growth.

Necessary fiscal consolidation shall target limitation of current budgetary expenses, particularly salaries in the state sector and pensions, with creation of room for higher investments into capital projects of national importance at the same time.

Main effects of restrictive fiscal policy will be significant reduction of the share of consolidated deficit of state sector and share of public expenditures in the GDP in the medium term.

It has been planned that fiscal deficit in the next medium term be financed with loans taken from the international financial institutions and the EU, as well as by issuing the treasury notes of different maturity, in order to reduce the refinance risk.

Medium-term fiscal adjustment plan is supported by:

- The new Law on the Budget System that includes provisions on fiscal responsibility, as well as accompanying regulations that will provide for strengthening of fiscal discipline. Fiscal responsibility legal framework established the rules for improving control over medium-term fiscal framework and strengthened the fiscal procedures and mechanisms for monitoring and execution of fiscal rules;
- New Law on the Pension System which makes condition for retirement more stringent, in order to gradually reduce the share of pension expenditures in the GDP;
- Strengthening of legal framework for collection and restructuring of debt of the economy and faster resolution of blocked accounts issue and creation of mechanisms for out-of-court reprogram and restructuring of debt, in order to reduce the number of unnecessary and expensive bankruptcies and improve capacity of banks to resolve growing number of uncollectible claims.

B. Implementation Capacity

39. Does your country intend to align with the ESA 95 methodology for the purpose of statistical reporting to the EU?

The Statistical Office of the RS possesses series of macroeconomic data as of 1997, which are based on ESA 95.

In addition to GDP calculation in constant and current prices, calculated per production and expense method, the Statistical Office of the RS also possesses group of accounts for all defined institutional sectors. Also, quarterly GDP calculations in constant prices are done using production method.

All stated calculations have been adjusted fully and in detail with the ESA 95 methodology.

40. How does your country assess the conditions for long-term macroeconomic stability? How does this interact with promoting integration and convergence with the EU?

Economic policy of the Serbian Government is oriented towards creation of conditions for long-term macroeconomic stability, which is connected to the stabilization and association process of Serbia into the EU and fulfilment of conditions for full EU membership.

In that respect, primary objective of economic policy is ensuring long-term sustainable macroeconomic stability, which includes low and stable inflation rates and decrease of balance of payments' and fiscal imbalances. In that manner, credible economic policy creates an environment for faster economic growth, while key role belongs to fiscal policy.

In 2009, Serbia started a credible medium-term fiscal adjustment by reducing current public spending.

Necessary fiscal adjustment is supported by the changes of the Law on Budget System, which establishes form fiscal rules pertaining to public spending, fiscal deficit and public debt.

General and special fiscal rules will ensure long-term sustainability of the fiscal policy through planned reduction of current budgetary spending, above all salaries in the public sector and pensions, with increase of public investments at the same time and with reduction of the fiscal deficit on general government level of the state to 1% of GDP in 2015 and maximum debt-to-GDP ratio of 45% of GDP.

Such fiscal adjustment is necessary for the purposes of speeding up economic growth. Establishment of the Fiscal Council shall contribute to implementation of fiscal rules and raising credibility level of the fiscal policy.

For the purposes of establishing and maintaining macroeconomic stability, in addition to the fiscal adjustment, it is necessary to keep the existing monetary regime, where the primary objective is inflation control and consequently flexible foreign exchange rate.

Targeted inflation and floating foreign exchange rate regime enable Serbian economy to turn to investments into sectors that produce exchangeable goods and increase of exports. Low and stable inflation and the dinar stabilization at the level reflecting real value provide stimulus for investments, export and economic growth.

Coordination of fiscal and monetary policies is particularly important for macroeconomic stability. Such coordination will be increased in the post-crisis period, when the domestic and foreign demand will be increased which will affect inflation. It is desirable to have combination of relaxed monetary policy, which would stimulate private sector with low interest rates, and responsible fiscal policy that ensures reduction of the public consumption level, lower fiscal deficit and lower level of public debt.

Crucial conditions for achievement of long-term macroeconomic stability are the following:

- Implementation of market reforms and completion of transformation of the economy, with dominant private sector, market orientation, strengthening of economic freedoms and entrepreneurship, stimulating business and investment environment,
- Faster and more stable economic recovery after recession and return to higher and sustainable economic growth rates based on increase of export, investments and employment, with modernization of national economic infrastructure, above all energy, traffic and telecommunications sectors,
- Establishment of the decreasing inflation trend and its reduction to low and stable levels through monetary policy regime,
- Fiscal adjustment and decrease of fiscal deficit to sustainable level, which will depend on the economic growth and import and possibility to reduce certain public expenditures,
- Adjustment of the Serbian current account and reduction of external imbalances based on growth of export, external financing of domestic consumption, capital inflows of the private sector and financial support of international financial organizations and the EU.

41. As regards Articles 122 and 143 of the Treaty, what does your country's legislation state in the field of international treaties regulating the receipt of foreign assistance? Under which conditions is financial assistance from abroad allowed?

There are no regulations limiting and conditioning receipt of financial assistance from abroad. At the moment, the Law on Donations and Humanitarian Aid (Official Gazette of FRY, No 53/2001 and 61/2001 - Corrigendum, 36/2002 and "Official Gazette of RS" No 101/55 – other law) is in effect, which defines that donation recipients, which pursuant to this Law are state authorities, local self-governments, public undertakings, official services and other organizations and communities that do not make profit, along with domestic and foreign humanitarian organizations, may receive donations and humanitarian aid. Article 2 of the Law stipulates that donations and humanitarian aid, pursuant to the Law, may be expressed in goods, services, money, securities, property and other rights.

Financial aid from abroad may be received based on international treaties concluded between Republic of Serbia and provider of financial aid (states, European Union, multilateral organizations and financial institutions), which define terms and conditions for approving and using funds delivered through aid.

C. Compliance with Treaty provisions

42. How do you assess compliance by your country with the Treaty as it states that Member States should join with derogation for introducing the Euro?

The Republic of Serbia has accepted the Treaty of Lisbon in the field where Member States should join the Union with derogation for introducing the Euro. The currency of Serbia, the dinar (RSD), is not pegged to Euro, and the implemented exchange rate regime is the managed floating rate, with no plans to peg the local currency to Euro. The policy for entering into the European Monetary Union shall be considered only once the Republic of Serbia has gained the full status of the EU member, according to the valid European regulations governing this field.

43. Which reforms may be needed in order to comply with the relevant Treaty provisions and a possible timetable for adoption?

In compliance with the Lisbon **Treaty on the Functioning of the European Union**, *acquis* in the area of economic and monetary policy is drafted mainly in line with Title VIII (articles from 119 to 144) of the Treaty.

With regard to the **fiscal policy**, the existing *Law on the Budget System* has been expanded with provisions pertaining to the determination of fiscal accountability and the strengthening of fiscal discipline in order to ensure sustainability of public finances in the medium term. By adopting the *Law on Amendments to the Law on the Budget System* ('Official Gazette of RS' No 54/09 and 73/10) rules regarding fiscal accountability have been included and they are aimed at ensuring long-term sustainability of the system of public finances in Serbia. The Law defines general and specific fiscal rules. The objective behind implementation of fiscal rules is to reduce fiscal deficit on the general state level from 4.75% of GDP in 2010 to 1% of GDP in 2015, primarily by reducing current expenditure. *General fiscal rules* set out that the targeted annual medium-term fiscal deficit will stand at 1% of GDP, whereby it has been defined that in the year when the GDP growth rate is higher than the anticipated one, fiscal

deficit will be lower than the targeted fiscal deficit or the fiscal surplus will be generated, while in the year when the GDP growth rate is lower than the anticipated one, fiscal deficit will be higher than the targeted one. This rule has been implemented through a prescribed formula for determining the targeted fiscal deficit. Thus the obligation to pursue the anti-cyclical fiscal policy is laid down, which is assessed as appropriate and desirable. The general fiscal rules also lay down that the public debt (excluding obligations arising from restitution) must not exceed 45% of GDP. Amendments to the Law also involve introduction of fiscal rules for the local level of government and they set out that fiscal deficit of the local level of government must not exceed 10% of their revenues that year. *Specific fiscal rules* set out that the reduction of fiscal deficit in relation to GDP will be achieved primarily by reducing current public expenditure, namely by regulating the level of adjustment of salaries in the public sector as well as pensions. These rules define the manner of indexing salaries in the public sector and pensions whose aim is to reduce expenditure on pensions from approximately 13% to 10% of GDP, and expenditure on salaries in the public sector from almost 10% to 8% of GDP. In addition to the introduction of fiscal accountability rules, the amendments to the Law also envisage the setting up of a three-member Fiscal Council as an independent supervisory authority. Main competences of the Council are to evaluate Government's measures in the area of economic policy so that fiscal objectives would be realized, to assess whether the Government itself complies with the prescribed fiscal rules, to evaluate fiscal risks and the likelihood of the Government meeting the fiscal objectives, etc.

With regard to the **monetary policy**, as part of the exercise of its supervisory functions and for the purposes of achieving objectives regarding the provision of monetary and fiscal stability, the National Bank of Serbia adopted the *Memorandum on Inflation Targeting as Monetary Strategy* on December 22nd 2008 which defines formal implementation of the inflation targeting regime as of January 1st 2009. The Memorandum has been prepared in compliance with the *Agreement between the National Bank of Serbia and the Government of the Republic of Serbia on Inflation Targeting*. Pursuant to the Memorandum, the targeted inflation rate as an annual percentage change of the Consumer Price Index is the only numerical guideline for the monetary policy implemented by the National Bank of Serbia. Inflation targets are set in the form of the targeted rate of headline inflation (with deviation allowed), measured by means of an annual percentage change of the Consumer Price Index for several years in advance. Memorandum of the National Bank of Serbia on Setting Inflation Targets for the Period 2010-2012 (adopted at the session of the NBS Monetary Board on December 14th 2009) determines targeted rates of headline inflation (with deviation allowed), measured by means of the annual percentage change of the Consumer Price Index for the period 2010-2012, starting from their values at the end of the previous year.

- December 2010: 6%, with deviation of ± 2 pp allowed
- December 2011: 4.5%, with deviation of ± 1.5 pp allowed,
- December 2012: 4%, with deviation of ± 1.5 pp allowed,

The trajectory of targeted inflation rates, pursuant to the Agreement between the National Bank of Serbia and the Government, will be adjusted with the need to achieve medium-term price stability which is set at 2%-4% at the annual level taking into account Serbia's aspiration to get closer to price and income levels present in the EU. Headline inflation targets will be set by the National Bank of Serbia in cooperation with the Serbian Government, and the National Bank of Serbia will publish such targets in the form of the memorandum on determining medium-term inflation targets.