



THE SIGNIFICANCE OF INTERNATIONAL MONETARY FUND CREDIT ARRANGEMENTS IN FOSTERING THE SUSTAINABLE DEVELOPMENT OF THE REPUBLIC OF SERBIA

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Abstract:

This paper explores the relationship between the International Monetary Fund (IMF), a prominent global financial institution specializing in economic issues and aiding countries facing financial challenges, and Serbia. The primary focus of this study is to analyze the credit agreements between Serbia and the IMF and assess their influence on the country's economic circumstances. Specifically, it investigates the Stand-by Credit Arrangements utilized by the Republic of Serbia in 2011, 2015, and 2022. The research delves into various aspects, including IMF-imposed conditions, the extent of credit arrangements, policies and measures encompassed within these agreements, and their repercussions on macroeconomic stability, fiscal and monetary policies, structural reforms, and other pertinent economic indicators. This study's overarching objective is to comprehend the lasting effects of these programs on Serbia and evaluate the collaborative relationship between the country and the IMF.

Keywords:

credit arrangement, IMF, macroeconomic stability, structural reforms.

1. INTRODUCTION

The inception of the International Monetary Fund dates back to the 1944 Bretton Woods conference, in which the Socialist Federal Republic of Yugoslavia (SFRY) was a participant (Radojević, 2022). Our collaboration with this institution has its roots in that historic event. The primary objectives of the International Monetary Fund system encompass fostering international monetary cooperation, facilitating the growth of global trade and economies, and discouraging policies that may hinder overall prosperity (Hackler, Hefner and Witte, 2020).

Financing of the Fund is done through quotas. It is the amount that each member country pays, expressed in Special Drawing Rights (SDR), and on the basis of which it is determined how many financial resources the member country can use from the Fund in case of need, as well as how much SPV will be allocated to the member country. Quota determinations take into account several pivotal factors, including: gross domestic product (GDP), international trade volumes, foreign exchange reserves, and the overall financial stability of a country.

The credit arrangements offered by the IMF to member countries are diverse and depend on the needs and problems that the member country has at a given time (Kozomara, 2019). In order for the program within the credit arrangement to be adequately implemented, the IMF carries out missions to monitor the progress and development of the program and to identify potential problems in the implementation of certain policies and provide advice to member countries (Lütz and Hilgers, 2019).

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2. CREDIT AGREEMENTS OFFERED BY THE INTERNATIONAL MONETARY FUND (IMF)

The IMF approves short- and medium-term loans to member countries to overcome balance of payments difficulties. The amount of funds that a member country can withdraw depends on its participation in the Fund's credit potential - what the member country's quota is (Hadžić, 2021).

There are the following types of credit arrangements (Stakić, 2014):

- Unprivileged loans: Stand-By Arrangement, Flexible Credit Line, Extended Fund Facility;
- Preferential loans: Extended Credit Facility, Stand-By Credit Facility, Accelerated Lending Mechanism;
- Emergency Financial Assistance: Emergency Assistance, Precautionary Line of Credit, Disaster Relief;
- Exceptional Debt Assistance: Initiative to assist heavily indebted low-income nations, Multilateral Relief Initiative.

3. IMF CREDIT AGREEMENTS FOR THE SUSTAINABLE DEVELOPMENT OF THE REPUBLIC OF SERBIA

Throughout the extensive history of collaboration between the Republic of Serbia and the International Monetary Fund, which initially began within the former SFRY and continued as the independent state of the Republic of Serbia, numerous credit arrangements were sanctioned and proved effective in assisting Serbia in addressing specific challenges that emerged during different periods (Nikolić, 2022).

The most common types of credit arrangements used within this cooperation are stand-by loans and flexible credit line - FCL. The first Credit Arrangement between Serbia and the IMF was signed in 1981. During that period, Serbia was a constituent of the Socialist Federal Republic of Yugoslavia and encountered economic difficulties. A particularly significant Credit Arrangement

between Serbia and the IMF took place in 2009. During one such instance, Serbia grappled with the repercussions of the global financial crisis, necessitating essential fiscal adjustments. It is also important to mention the Flexible Credit Line (FCL) that Serbia received from the IMF in 2015. The FCL was a special instrument that gave Serbia the flexibility to use available funds as needed, without the obligation to implement certain policies in exchange for financial support. This paper analyzes the last three Stand-by Credit Arrangements from 2011, 2015 and 2022, as well as the conditions from these arrangements and their impact on the Serbian economy.

3.1. STAND-BY CREDIT ARRANGEMENT FROM 2011

On September 29th, 2011, a precautionary eighteen-month Stand-by Arrangement was granted, amounting to 935.4 million special drawing rights (approximately 1,076.75 million euros), which equaled 200% of the quota (IMF Press Release No.11/353, 2011). This program aimed to uphold balance in macroeconomics and financial resilience, safeguard against extraneous disruptions, reinforce fiscal responsibility, and address issues concerning the investment climate to stimulate job creation.

During that time, Serbia's economic condition was comparatively better than in the period following the 2008-2009 crisis. Nonetheless, there were lingering challenges, including a negative trade shock resulting in reduced demand for steel, labor market vulnerabilities with high unemployment rates in the private sector, limited foreign exchange interventions due to market volatility, and inflation peaking at nearly 15%.

The initial reconsideration of the package in February 2012 did not yield positive outcomes because it deviated from the defined fiscal program, resulting in the non-utilization of the approved funds (Relations with the International Monetary Fund, 2023). The conclusion of the initial assessment within the framework of the Stand-By Arrangement faced delays due to discrepancies in the 2012 budget, particularly related to the increased planned issuance of public debt (including government guarantees) and domestically funded projects. The mission's primary focus was on the fiscal policy for the year 2012 (IMF Press Release No.12/45, 2012).

Table 1. Serbia's Stand-by Credit Arrangements with the IMF.

Type of credit arrangement	Date of arrangement	Expiration date	Amount approved (SDR Million)	Amount Drawn (SDR Million)
Stand-By	19.12.2022	18.12.2024	1,898.92	949.46
Stand-By	23.02.2015	22.02.2018	935.40	0
Stand-By	29.09.2011	28.03.2013	935.40	0

Source: <https://www.imf.org/external/np/fin/tad/exfin2.aspx?memberKey1=1072&date1key=2099-12-31>



In September 2012, during the subsequent mission, it was observed that Serbia's economic situation had been severely affected by significant internal and external imbalances. Anticipated GDP decline, inflation acceleration due to food price shocks, substantial increases in public spending, and a double-digit deficit relative to the 2012 budget were expected to push the public debt ratio beyond 60% of GDP, leading to a country rating downgrade. Given this situation, it became imperative to curtail spending before approving the 2012 budget rebalancing and swiftly implement a clear and realistic medium-term fiscal consolidation plan aimed at reducing the public debt below 45% of the Gross Domestic Product (GDP). Although the government's deficit target for 2013 was deemed broadly appropriate, significant additional measures were necessary for its achievement. The mission also underscored the importance of corrective actions to bolster the independence of the Serbian Central bank, which had been undermined by recent amendments to the NBS law (IMF Press Release No.11/353, 2011). Furthermore, during the IMF mission in November of the same year, fiscal consolidation was highlighted as the most critical measure to safeguard Serbia's economic stability.

3.2. STAND-BY CREDIT ARRANGEMENT FROM 2015

Stand-by Arrangement was approved on February 23rd, 2015 and was granted for a 36-month period, amounting to 935.4 million special drawing rights, equivalent to approximately 1,168.5 million euros. This arrangement was established as a precautionary measure, signifying the intent to utilize the approved funds solely in case of balance of payments needs (Relations with the International Monetary Fund, 2023). The program revolved around three primary pillars: the restoration of fiscal health, the enhancement of financial zone balance and flexibility and the comprehensive implementation of systemic rehabilitation to lay a robust basis for fostering employment opportunities and maintaining long-term, sustainable growth (IMF Press Release No.15/67, 2015).

Serbia's economy at that juncture remained vulnerable, still grappling with the aftermath of the significant floods of 2014, which had led to a GDP decline, decreased domestic demand, and subdued economic activity among trading partners. The 2014 recession marked the third consecutive one in the last six years, with a public debt reaching 70% of GDP and a fiscal deficit of 6.6%. High unemployment remained as a persistent issue, as seen in the previous years.

The IMF closely monitored the Credit Arrangement through eight missions of its Executive Board, culminating in the following conclusion after the assessment of Serbia's economic achievement in its eighth revision:

- On December 20th, 2017, the Executive Board of the International Monetary Fund (IMF) ended the eighth revision of Serbia's economic achievement under the Stand-By Arrangement (SBA). With the finalization of this revision, a cumulative sum of SDR 880.835 million (approximately EUR 1.05 billion) became available. Serbia made notable strides within the economic program supported by the Fund. Economic assurance saw an uptick, with a significant reduction in public debt and a strengthened external reputation and investments and improvement exhibited resilience, accompanied by improvements in labor market conditions. Substantial progress was also observed in the implementation of the constitutional reform program. It was recommended to maintain reasonable policies and advance institutional improvements, particularly the extensive ones. The 2018 budget allowed for some tax reductions to promote employment. The demonstrated exchange rate flexibility was commended, returning Serbia's enhanced basis and market circumstances. Financial section improvement implemented as a part of the program enhanced the flexibility of banks, positioning them to better support the economy. Efforts to reduce non-performing loans yielded positive results and were encouraged to be pursued, although rehabilitations of national financial organizations needed acceleration. The improved macroeconomic stability and regulatory environment contributed to an enhanced business environment in Serbia (IMF Press Release No.17/515, 2017).

This loan arrangement was concluded successfully on February 22nd, 2018.

3.3. STAND-BY CREDIT ARRANGEMENT FROM 2022

On December 19th, 2022, the Board of Executive Directors of the International Monetary Fund authorized a 24-month Stand-by Arrangement for the Republic of Serbia, amounting to 290% of our country's quota in this international financial institution, which equals approximately 1.89 billion special drawing rights. This arrangement was put in place to support the agreed-upon economic program. It replaced the Policy Coordination Instrument and was designed with the adjustments to macroeconomic policies that consider the current global challenges, built upon previous achievements and the reform agenda. Under this Stand-by Arrangement, a portion of the total funds is scheduled for withdrawal in 2022 and 2023, while the remaining portion will be held as precautionary funds. In this regard, on February 9th, 2023, the



National Assembly passed the Law on the Regulation of the Republic of Serbia's Obligations to the International Monetary Fund based on the use of funds from the Stand-by Arrangement authorized by the Board of Executive Directors of the International Monetary Fund on December 19th, 2022. The goals of the economic program endorsed by the Stand-by Arrangement for the Republic of Serbia, supported by the Stand-by Arrangement, include maintaining macroeconomic and financial stability through adjustments in response to the current economic challenges, enhancing resilience to the energy crisis through appropriate energy integrity and improvements, addressing national energy district threats while defending sensitive groups, and fostering high, environmentally friendly, inclusive, and sustainable growth through comprehensive structural reforms (Relations with the International Monetary Fund, 2023).

According to Article 2 of the Law on the Regulation of the Republic of Serbia's Obligations to the International Monetary Fund based on the use of Stand-by Arrangement funds approved by the Board of Executive Directors of the International Monetary Fund on December 19th, 2022, the funds can be utilized in 2023 in tranches. The first tranche amounts to 785.76 million SPV (equivalent to 120% of the quota), the second tranche is 163.7 million SPV (25% of the quota), and the third tranche can go up to a maximum of 316.53 million SPV (48.34% of the quota). The remaining funds from the Stand-by Arrangement are designated for precautionary purposes. These funds can be employed for direct budget financing, refinancing the Republic of Serbia's obligations, and covering current budgetary needs.

At the time of approving this Credit Arrangement, Serbia was in the process of recovering from the global pandemic, which had a comprehensive influence on the economy. While Serbia had made strides in its recovery, it was now contending with adverse events both regionally and globally. The ongoing disagreement among Russia and Ukraine was affecting the economy due to the energy crisis and rising food prices. Inflation was anticipated to approximately 12% in 2022, primarily driven by the increased food and energy costs. GDP growth was expected to slow to approximately 2.5% in 2022 due to weakened outward interest from EU trading organizations, added to factors such as higher energy fees, supply chain disarrangement, and scarcity, with further deceleration to 2.25% in 2023. The contemporary account deficit was predicted to rise to around 9% of GDP in both 2022 and 2023, owing to higher energy import expenses, reduced domestic electricity production, and weakened external demand. Despite these challenges in the global environment, Serbia maintained financial sector stability and a stable exchange rate (Jovović, 2022).

The biennial Stand-By Arrangement (SBA) provides specific guidance to address these issues (IMF Press Release No.22/447, 2022):

- Implement adjustments to energy tariffs and systemic improvements to reinstate the financial stability of national energy companies EPS and Srbijagas within two years, while safeguarding vulnerable households and offering short-term fiscal support to energy companies.
- Maintain a resolute monetary and fiscal strategy to manage inflation and keep exchange rate stability.
- Continue enhancing fiscal clarity and implementing budget improvements to uphold fiscal development and effectively implement the new fiscal rule.
- Sustain ongoing reforms aimed at strengthening management and supervision in state-owned enterprises.

4. THE IMPACT OF CREDIT ARRANGEMENTS ON THE ECONOMY OF SERBIA

4.1. EFFECTS OF THE CREDIT ARRANGEMENT FROM 2011

The Stand-by Credit Arrangement for 2011, which was supposed to last for 18 months, was frozen after only five months of its duration, after the first revision of the program in February 2012. Exceeded debt level was the reason for its freezing. The conduct of such a policy by the Republic of Serbia sent a message that it was not able to conduct a credible economic policy, which led to many negative consequences such as an increase in interest rates, a lower inflow of foreign investments as well as an imbalance in the foreign exchange market and the public debt market.

In the realm of structural reforms, there's a pressing need to shift the focus towards bolstering exports. It's imperative to enhance and broaden Serbia's export activities to foster robust growth, ensure external sustainability, stimulate job creation, and expedite the convergence of income levels with those of the European Union. Serbia's economy is constrained by an excess of regulations, a sizable and inefficient public enterprise sector, and a labor market characterized by rigidity and protectionism. Serbia's economic growth is hindered by the abundance of regulations, a large and ineffective public company sector, and a labor market marked by inflexibility and protectionist measures.



Therefore, the key priorities for policy reform encompass the following:

- **Regulatory Reforms:** The government should streamline business laws and regulations, intensify the analysis of the regulatory influence of contemporary legislation, improve charge and customs administration, and simplify the countryside registration and relocation processes.
- **Public Company Improvement:** The mission acknowledges the government's intent to expedite the privatization and capitalization plans of public companies, working in coordination with the World Bank. Additionally, there should be a focus on enhancing transparency in their effects, implementing accurate payment and recruitment strategies entrenched on performance standard, raising public utilities tariffs to cover costs, and imposing strict limitations on subsidies and guarantees to these enterprises.
- **Labor Market Reforms:** Urgent reforms are required in the labor market to stimulate the generation of new jobs within the private sector (IMF Mission concluding statement, 2013).

The effects of this program did not fully meet the desired framework, but the Republic of Serbia showed determination and desire to implement the measure and to progress the economy. Unemployment, budget deficit, public debt, inflation, and investment climate are still key problems, as they were at the beginning of this program in 2011.

4.2. EFFECTS OF THE CREDIT ARRANGEMENT FROM 2015

On February 22nd, 2018, Serbia successfully completed a loan arrangement program worth 1.32 billion dollars with the IMF, lasting 36 months. The funds within this program were not used (they were used as a precaution). Serbia has fulfilled several goals set within the program, the effects of which we will investigate as part of the Executive Board's mission on the day the Credit Arrangement ends. *"The program recorded significantly better results than expected, exceeding many of its macroeconomic goals,"* said James Roof, head of the IMF team for Serbia. Fiscal balances, after the second largest deficit in Europe in 2014, achieved a surplus in 2017. Confidence in the economy improved thanks to increased investment from both foreign and domestic sources. The unemployment rate is near record lows and continues to fall. Banks are stable, and problem loans are currently below the pre-crisis levels (IMF News, 2018).

Nevertheless, it is necessary to maintain this kind of progress in the future. The government should focus on helping the country catch up with its Western European neighbors and prevent the outflow of skilled labor. The following measures should be observed (IMF News, 2018).

- Reform of institutions and public services,
- Reform of state-owned enterprises,
- Improving the business environment,
- Building better infrastructure.

4.3. EFFECTS OF THE CREDIT ARRANGEMENT FROM 2022

This Credit Arrangement is relatively new and within it we only have the First Review, with the following conclusions (IMF Mission concluding statement, 2023):

- Serbian economy has shown resilience despite very unfavorable circumstances. However, the fiscal results for 2022 exceeded expectations, as did the results regarding the balance of current transactions and reserves. It is expected to grow by 3% in 2024 and return to 4% in the medium term.
- Inflation has surged to 16%, primarily driven by escalating food and energy costs. Basic inflation has risen further, reaching 11%, as it reflects the widespread transmission of cost-related pressures.
- Despite experiencing a larger deficit in the current account balance, substantial foreign direct investments and other financial inflows have empowered the Central Bank of Serbia to significantly augment its reserves since mid-2022.
- The fiscal deficit for the year 2022 proved to be substantially lower than initially anticipated when the Stand-By Arrangement (SBA) was adopted, standing at 3% above GDP. This was achieved even with fiscal support extended to state enterprises in the energy sector, amounting to around 2½% of GDP. The 2023 budget, aligned with the SBA's objectives, was ratified in December 2022. As a consequence of favorable fiscal outcomes, public debt was positioned at 55% of GDP at the close of 2022.
- The reform of the energy sector remains the focal point of the SBA's attention. These endeavors should be complemented by initiatives to expand the energy protection program for vulnerable customers and increase the proportion of households benefiting from reduced energy bills. We commend the authorities for their commitment to promptly transform the state-owned entity Elektroprivreda Srbije (EPS) into a joint-stock company and develop a strategic plan for EPS restructuring by the end of 2023.



- Reforms aimed at fortifying the rule of law, enhancing the competence of the judiciary, and combating exploitation are of paramount significance in enhancing the investment climate.

The effects of this Credit Arrangement will be visible in 2 years, when this Arrangement is completed, as foreseen by the program.

5. CONCLUSION

Credit Arrangements represent an important instrument of economic cooperation between Serbia and the IMF, which aims to provide financial support and promote economic reforms in the country. Through the analysis of available data, certain effects of these arrangements on the economy of Serbia have been observed. The first effect of Credit Arrangements was to achieve macroeconomic stability. The IMF extended financial assistance through loans to address the equilibrium of the balance of payments, uphold exchange rate stability, and secure liquidity within the market. This played a role in diminishing economic volatility and fostering trust among investors. Another effect was to encourage fiscal discipline and structural reforms. Under the credit arrangements, the IMF established prerequisites linked to reducing public debt, achieving fiscal consolidation, enhancing the management of public finances, and executing structural reforms. These reforms were imperative for state-owned enterprises, education, and healthcare sectors. Furthermore, there was a need for infrastructure development to elevate the investment climate and draw in substantial investors, a goal that was successfully achieved. The third effect was visible in sectors such as banking, financial markets and economic growth. Credit Arrangements have contributed to strengthening the banking sector, improving regulation and supervision, as well as encouraging foreign investment. Additionally, IMF assistance was extended with the objective to enhance economic competitiveness, broaden export diversity, and mitigate structural imbalances. There was a stable exchange rate, record low interest rates, and favorable loans for all citizens. The most important measure within this sector was solving the problem of non-performing loans (NPL), which was achieved.

Today, Serbia is facing a successful post-Covid recovery, but it is affected by other things that have followed it, namely the energy crisis and instability at the global and regional level. For this reason, Serbia has decided on a Stand-by Credit Arrangement, from where it will withdraw certain funds within the first three tranches, and the rest will be used as a precaution. Within this program, the energy crisis should be solved by reducing energy imports and increasing production. Also, it is necessary to encourage citizens to reduce the consumption of electricity, which is foreseen by certain measures within the framework of the arrangement.

In conclusion, it can be pointed out that the Credit Arrangements between Serbia and the IMF had a significant impact on the country's economy. However, it is important to properly assess their effectiveness, as well as to implement the necessary measures to ensure a sustainable economic future for the country. Continuous cooperation between Serbia and the IMF can be the key to achieving economic goals and improving the living standard of citizens.

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