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Focus Notes: Serbia

Serbia: No unfreezing of wages and pensions

The negotiations between the IMF staff mission and the government were completed successfully. The approval of the agreement by the IMF board will allow the government to tap into another €380 million. The government has already made use of €1.3 bn that have already been disbursed out of the €2.9bn total amount of the regular stand by agreement. The IMF mission assessed that the program is performing satisfactorily on all target, except that of the budget deficit which was exceeded by a small margin owing to shortfalls in revenue. The IMF revised its growth forecast for 2010 downward to 1.5% (in line with EFG forecast since the beginning of 2010) against 2% previously, citing the weak domestic demand dynamics. Accordingly, the IMF agreed to relax the budget deficit target in 2010 from 4.0% to 4.8% of GDP.

There are two important developments coming from the review of the program. Firstly, the government conceded to IMF requests not to unfreeze public wages and pensions, confirming our expectations. The issue was hotly debated. The coalition government has sought to freeze public wages and pensions for a second year in a row in 2010, as part of the IMF program's commitments. Yet, public discontent and the prospect of a growth rebound in 2010 had led to growing voices both within the government and the opposition for an unfreezing of wages and pensions.

In our March issue of New Europe Economics & Strategy, we argued that unfreezing would not be possible under the current economic circumstances. The relative intention tested the government's working relationship with the IMF, which strongly opposes such policy deviations. However, the government secured the consent of the IMF to increase spending on low income social groups. As a result,

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the government could utilize RSD 6.5 billion to provide one-off payments to public sector employees, pensioners, poor municipalities, as well as to increase targeted social assistance.

In our view, the IMF had the least lenient stance on the review of the program since its beginning. Although it provided some flexibility with respect to the quantitative fiscal target, it tied access to further funding upon pushing the pension and public sector reforms. The government has pledged many times unsuccessfully to slash public sector employment, particularly at the central government level. In addition, the pension reform law has been submitted to the parliament and awaits approval. The adoption of the fiscal responsibility law is postponed to next September. In a nutshell, the scope of further delay in government action on structural reforms is limited. The government needs to push urgently for public sector lay offs in order to tap IMF funding on time.

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