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## After the Crisis: Towards a Smaller and More Efficient Government

**PODGORICA, November 1, 2011** – The major points of the report “After the Crisis: Towards a Smaller and More Efficient Government:”

### General

Montenegro as a society as well as its government faces twin challenges in improving the efficiency of the public sector: to improve the efficiency and quality of public services and keep public expenditures at a sustainable level.

Montenegro’s economy has an enormous growth potential. By reforming key sectors of the economy (such as pensions, wage bill, education, health, and social protection) and attracting large, productivity-enhancing foreign-direct investment, Montenegro should be able to put its economy on a dynamic, sustained growth path.

However, there are external risks and internal institutional and capacity constraints that could tip the favorable outlook and set off a prolonged period of socio-economic stagnation. Therefore, the role of prudent economic, especially fiscal policy cannot be overemphasized in ensuring macroeconomic stability and creating a hospitable environment for domestic and foreign investments.

### Fiscal and Debt management

During 2009-2011, the government managed the socio-economic effects of the global financial well albeit at the cost of the rapid build up of Montenegro’s public **debt**. At 44% of GDP, the public debt remains manageable and moderate fiscal deficits are being reduced as part of the government’s medium term fiscal consolidation after the crisis. To anchor these efforts in the medium- to long-term, the authorities would benefit from a benchmark on public debt. To allow for a comparable response to any future crisis, economic policymakers should outline a **longer-term fiscal-adjustment program anchored on a public debt-to-GDP ceiling of 35±5 percent**, with a limited response window that would allow Government increase debt during extraordinary periods but commit it to a post-crisis adjustment to pre-crisis levels within a pre-specified period of time.

## **Reforming pensions and public administration**

Long-term fiscal consolidation can only succeed if the overall **pension system** expenditures are brought under control while providing adequate benefits to Montenegro's pensioners. About a quarter of the budget is spent on pensions. Important reforms, including the gradual increase in the pension age to 67 are already being implemented. Nevertheless, as in many other countries with aging population, the pension system's current financial position is unsustainable, with contribution revenues falling systematically below benefit expenditures. The budget cannot afford to subsidize the current pension system on the order of about 4 percent of GDP on a long-term basis. **Problems of the pension system can be addressed, however, by constraining entry benefit levels, benefit indexation, and—to some extent—the inflow of new beneficiaries.**

About one-quarter of general Government expenditures is reserved for **salaries**. The wage bill represents the principal risk to the overall fiscal sustainability, not only because it is **equivalent to 12 % of GDP** (about 3 percentage points more than the average of neighboring countries in the Western Balkans) but also because of **political and social pressures to further increase staff levels in the public sector**. It is critical to undertake public administration **reforms** which would **retain and promote qualified and high-performance staff**. The report recommends setting up a working group which would design a system to (i) ensure that the salary system is fiscally affordable and, at the same time, competitive in the labor market for well-qualified candidates; (ii) design measures to improve the transparency of the remuneration system through streamlining legislation, developing a concept of the base pay that consolidates current variable and supplemental pay elements; (iii) implement the principle of "equal pay for equal work"; (iv) recognize performance through the pay system in a transparent manner, based on, and subject to, regular performance appraisals; (v) improve staff retention through attractive career-development prospects by introducing an adequately decompressed salary structure, objective criteria for pay progression, and support to skill development; (vi) facilitate decision-making capabilities in Government by ensuring the availability of accurate pay information; and (vii) develop and implement a time-bound program of measures (and responsible officials) to introduce a new remuneration system for the public sector that is based on the core principles of the pay system and assign resources to implement this program.

## **Reforming education, health and social assistance**

Montenegro spends as much as other countries in the region on **education** but doesn't achieve comparable outcomes. As a result, there is huge scope for enhancing efficiency i.e., reducing costs while improving outcome. Moreover, the mismatch between the skills demanded by the private sector and those supplied by the system contributes to high unemployment. Reforms should address issues such as: (i) the lack of easily accessible information on spending, staffing, graduation rates, graduate employment, and research output in the (higher) education sector (making very difficult an effective steering of reforms in this sector); (ii) the financing of public higher education (with no performance-related component); and (iii) the fragmentation and internal organization of the public university.

In the **health sector**, Montenegro, relative to its per-capita income, spends an above-average amount but also generates above-average outcomes. Reforms are work in progress, with **core challenges** remaining in the areas of **fiscal sustainability and the efficiency of service**

**delivery.** The cost and affordability of medicine for poorer segments of the population is also an issue. Principal **recommendations** to achieve the policy objectives include the following:

- (i) Providing greater (budgetary) **autonomy** to—and requiring increased fiscal accountability of—the Health Insurance Fund (HIF), hospitals, and health-service providers while building local health institutions’ capacity for effective management;
- (ii) Permitting the Health Insurance Fund to **retain savings** to allow for the equalization of expenditures over longer periods of time;
- (iii) Supporting health awareness by **introducing or increasing “sin taxes”** on the consumption of alcohol, tobacco, and pre-packed food with high sugar, high salt, and/or fat content;
- (v) **Aligning health insurance benefits and health care policies with** new medical technologies akin to the already **established “positive list” of drugs**; and
- (vi) **Outsourcing** specialized health-care services **to the private sector.**

Montenegro has one of the best targeted, means-tested **social assistance** programs in the Europe and Central Asia region, also providing generous benefit level relative to consumption of beneficiaries. The principal challenge, however, is low coverage. The Government can increase the socio-economic impact of **social assistance** by linking it to the provision of social care and employment/activation services. At present, spending on social assistance does not pose a fiscal risk, partly because cash transfers are means tested. It is important to adequately finance the existing programs and to allow them to expand if demand goes up. Whereas keeping the spending on family material support at around 0.5 percent of GDP is desirable, increases in the coverage and spending on child protection (especially on the monthly child allowance) would strengthen social policy and have very positive welfare benefits. It would be reasonable to waive the limit of three children in one recipient family and extend the child allowance to all children in poor families, especially if they attend school. Some potential for savings and opportunities for cost containment could be found within the category of disability benefits. The family material support could be scaled up to capture a larger share of poor that are not covered by this program. For example, the limitation of having up to five beneficiaries in one family could be waived.

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