

**Federal Republic of Yugoslavia**  
**Interim Poverty Reduction Strategy Paper(I-PRSP)**

**Overview**

**I. INTRODUCTION**

1. The preparation of an interim poverty reduction strategy paper (I-PRSP) for FR Yugoslavia was initiated formally in early April, 2002 when a World Bank mission visited the country and had extensive discussions with the relevant ministries and line agencies in both republics (Serbia and Montenegro). Actual work on addressing the issues of poverty and conceptualizing a poverty reduction strategy has started much earlier and was fully reflected in government's first comprehensive statement on reform prepared for the first donor conference held in June 2001. At that time the Federal and the republican governments fully agreed that the fight against poverty together with the reform of the state and economic revival represented key medium term development priorities. The attached reports prepared by the two constituent republics reflect the developments on the poverty front since the first donor conference and, thus, truly represent an interim assessment of the poverty situation after one year of intensive economic reforms. They also set-out a detailed timeline for the preparation of a full PRSP due to be finalized by mid-2003.

2. The government recognises that poverty is multidimensional economic, social and political phenomenon which crucially depends on incomes and employment opportunities as well as social inclusion, access to education, health and other public services. Participation in social and political processes, protection of human rights, gender and ethnic equality are essential dimensions of a wider poverty definition. With such broad definition and limited resources, the choice of priorities and the design of effective and targeted public actions gain critical importance in reaching the necessary balance between shorter term and longer term needs and challenges.

**II. THE MAIN ELEMENTS OF THE INTERIM PRSP**

3. Both papers analyze the latest available data on poverty, review policies and reflect challenges facing republican governments in addressing acute poverty issues and developing a medium-term strategy to reduce poverty. Poverty in Yugoslavia has risen dramatically during the early 1990's culminating with the 1993 hyperinflation episode, and then held ground in both republics during the remainder of the decade marked with crisis and economic sanctions.

4. In **Serbia**, real GDP for 2000 fell by 55 percent from the level recorded in 1990 and p/c income dropped by almost 60 percent. More than 600.000 refugees and internally displaced persons (or 7 percent of the population) put additional pressure on the already strained fiscal situation. The latest available statistics indicate that approximately one third of the Serbian population lived in relative poverty (at less than US \$30 per month per person), and almost 1/5 lived in absolute poverty (at less than US \$20). Additionally, a considerable group lived just above the poverty line and could easily fall below it if well targeted measures are not put in place very soon.

5. In **Montenegro**, with a somewhat smaller GDP decline and an equal refugee problem (45,000 people or 7 percent of the population), poverty also affects a large segment of the population. At least 165,000 people (or 27 percent of the population) lived below the relative

poverty line (i.e. Euro 45 monthly income per person), while about 31 percent of households fell below the expenditure threshold (set at monthly expenditures of Euro 75). Moreover, about one quarter of households spent more than 60 percent of their resources on food.

6. Poverty levels in Serbia and Montenegro share some powerful correlates:

- **Unemployment:** In both republics more than half of the unemployed were likely to fall well under the poverty line. Families with unemployed head were particularly susceptible to the threat of poverty. Even though actual unemployment figures following ILO definitions<sup>1</sup> may be only half of the officially registered unemployment rates (26.8 % for Serbia and 28.6 % for Montenegro), true unemployment rates in excess of 14 % appear exceptionally high and can not be sustained.
- **Age:** With failing social safety nets and poor social services, the young unemployed (with little or no assets) and old people receiving minimum pensions are faced with the highest risk of falling below the poverty line.
- **Family size:** Large families (with 3 or more children/dependents) faced a 50% likelihood of falling below poverty line, and were much more susceptible to declining quality of education and health services.
- **Education level:** People with low education levels (especially in urban areas) were restricted to low paying industrial jobs, informal employment or inactivity. On top of being paid lower wages (half of the average wage in the informal sector and 2/3 in the formal sector), people with lower skills faced a much greater probability of losing their jobs during company restructuring and/or privatization.
- **Gender:** Gender appeared to be a relevant poverty issue. Women were more likely to be unemployed or inactive than men, and on average made less than males (in Montenegro around 20% in the formal sector or close to 50% in the informal sector).
- **Health and Disability:** Minimum disability pensions in both republics allowed people to subsist just above the respective relative poverty lines.
- **Regional Aspects:** Although existing household surveys do not provide data to evaluate regional differentials in poverty incidence, poverty is likely to go hand in hand with significant regional differences in income levels. For instance, in the less developed South and North of Montenegro where incomes fall well below the national average, it is estimated that poverty is also higher due, among other factors, to weaker informal sector employment opportunities.

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<sup>1</sup> An estimated 10 percent of the labor force works solely in the informal sector while a further 20 percent works in the informal sector in addition to having formal employment or receiving unemployment benefits. Although average wages in the informal economy are 2.5 times the poverty level, people employed only in the informal sector faced a danger of falling outside the government's social safety net in the event of illness or disability, unemployment or retirement.

7. The available data, as indicated in the attached report, obviously have serious limitations which constrain our ability to fully understand the causes and the overall incidence of poverty, as well as its distribution across regions, gender, professional, ethnic and status groups. Some of these limitations will be removed through the ongoing new household consumption surveys and the use of recent census and other data sources. Additional data collection and research will be needed, however, to highlight some of the finer points affecting particularly sensitive issues and social groups (refugees, Roma population, IDPs).

8. Even with imperfect data we know that the main reasons for the unprecedented rise in poverty to around 1/3 of the population and for clustering of additional 20 percent of the population just above the poverty line is owed to a catastrophic economic downturn marked by a huge reduction in real cash incomes for the great majority of the population. A continuous increase in open and hidden unemployment and a large influx of refugees and IDPs further exacerbated the situation.

9. A parallel increase in the informal activities partially ameliorated the problem by generating new incomes and consumer demand. The growing informal sector had a peculiar impact on the unreformed social sectors. On the one hand, it weakened the supply side through tax evasion; on the other, it distorted the demand side by openly paying cash for social services which simultaneously promoted corruption and crowded out the poorest segments of the population. This created an additional hit on the most vulnerable groups which could no longer count on free social services (health and education) or heavily subsidized urban services (housing, public transport, and district heating).

10. Obviously, in addition to being a detriment to the orderly social sector development, the large and growing shadow economy is now becoming a real obstacle to continued economic reforms, attainment of fiscal transparency and introduction of market institutions. Both republics, thus, rightly identify a need to reduce and ultimately eliminate shadow economy as a *sine qua non* of a successful poverty reduction strategy and an efficient operation of reformed social sectors in the longer run. The republics also concur that poverty can only be eliminated in a growing economy with a stable macroeconomic framework such as the one developed for the 2002-2005 period and supported under the IMF's EFF arrangement.

11. In their proposed strategies both republics identify a strong need to better target social assistance and rely on enterprise restructuring and improved operation of the labor market to retrain and re-deploy the existing labor force in line with an emerging more competitive market structure. Within that, the poverty reduction strategy for Serbia identifies three broad target groups that require different types of assistance and policy actions. The first group, which comprises unemployed who recently lost their jobs, can best be assisted through policies that create new productive jobs and promote economic growth. The objective is to empower these groups to help themselves get out of poverty. Specific policy actions will include retraining programs, assistance in job search and establishing micro and small businesses. The second group comprises a large number of redundant workers (over 500,000 people) in medium or large state owned companies that will soon be privatized and restructured. The objective is poverty prevention and possible policy actions include the creation of spin-offs and other SMEs prior to or concurrently with the privatization process, the provision of severance packages that include technical and management retraining etc. The third group targets the "regular poor" and especially vulnerable groups through better social assistance, education and health services that will be achieved through better targeting of existing measures and programs. In targeting social

assistance and services the Montenegro strategy puts additional emphasis on regional aspects of poverty.

12. A sound and open participatory process was already conceived and effectively utilized in preparing this I-PRSP document, especially in involving and engaging all relevant ministries, statistical offices, research institutes and think-tanks, and the donors. The attached document describes the future plan for an even broader consultation process envisaged for the preparation of the full PRSP involving parliaments, NGOs, labor unions and the broad civil society. The government strongly believes that only a fully participatory PRSP can secure broad social ownership of difficult reforms ahead and provide a sound basis for making the right choices in selecting development priorities that would foster growth and target the most vulnerable segments of the society.

13. In short, we believe that this I-PRSP presents: (i) a solid assessment of the existing poverty situation based on available data and a good indication of what are the knowledge and data gaps that need to be closed during the preparation of a full PRSP; (ii) a good initial review and analysis of a comprehensive set of policies designed to ensure the implementation of the government's poverty reduction objectives in a stable macroeconomic medium-term framework; and (iii) a basis for a consultative process that is expected to generate strong involvement of civil society and all other major stakeholders in the preparatory process. It is clear that much remains to be done during the preparation of the full PRSP document to produce a strategy that effectively integrates poverty reduction and economic growth to achieve and go beyond the millennium development goals.

### **III. THE FULL PRSP**

14. The government is fully aware that a timely development of a full poverty reduction strategy requires more work to strengthen the database, develop coherent antipoverty sectoral strategies, understand further the roots of poverty, define priorities, further analyze the poverty implications and fiscal costs of various policy options, and build consensus among key stakeholders for implementing the strategy. The full PRSP will be firmly based on a three-year macroeconomic framework recently developed by the government. The program is fully supported through an IMF EFF arrangement and it includes a matrix of policy actions and structural reforms to be undertaken each year to promote growth and reduce poverty in a stable macroeconomic environment. As indicated in the detailed timelines, the preparation of the full PRSP should also provide an analysis of the poverty impact of past social and productive sector programs, as well as lay ground for better public expenditure management. The full PRSP is also expected to provide clear indicators for monitoring progress in the implementation of the overall poverty reduction strategy. This is an ambitious program which can be done in the coming twelve months based on existing strong ownership in both republics and sustained donor assistance.

**Government of the Republic of Montenegro**

**Interim Poverty Reduction Strategy Paper**

**Podgorica, June, 2002**

## **Montenegro I-PRSP Outline**

### **I Introduction**

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Consultative process for PRSP  
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**I Summary of Poverty Causes, Amelioration Strategies and Monitoring**

**II Plan of Economic Reform and Assistance**

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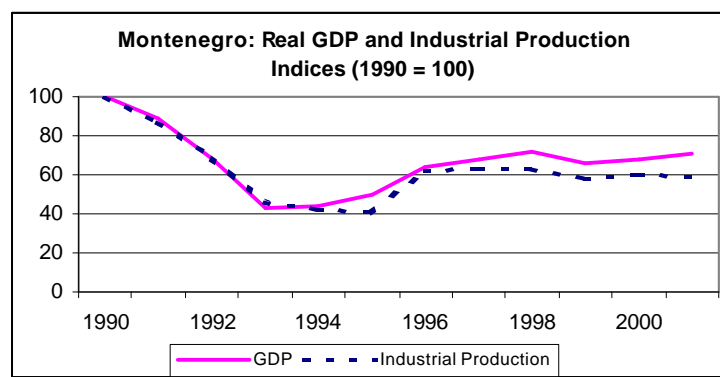
**IV Selected Economic Indicators, 2001-2005**

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## I Introduction

1. The economic disruptions brought on by a decade of conflict in the region have brought virtual stagnation to the Montenegrin economy and delayed much-needed macroeconomic reforms and enterprise restructuring. As a result, real GDP levels have dropped to about 70 percent of their pre-conflict levels and industrial production languishes at about 60 percent of the levels achieved in 1990 (Chart 1).<sup>2</sup> Any imminent recovery that emanates from new growth sectors will likely be tempered with further fallout in the old industrial sector and Montenegro will remain a low-income economy into the near future. In such circumstances, poverty levels have grown and are likely to remain high for some time.

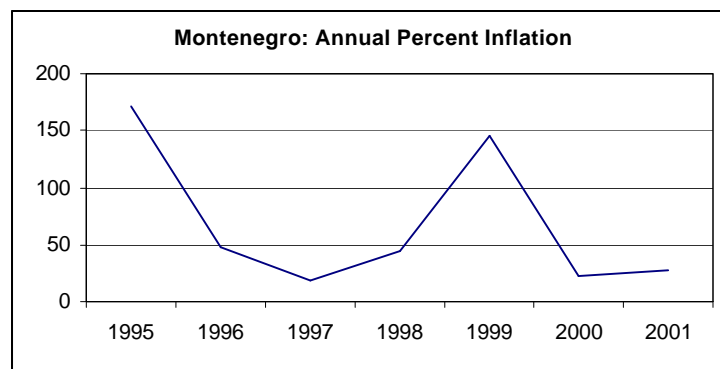
Chart 1



Source: Republic Statistics Office and *Montenegro Economic Trends*, Monet.

2. Registered unemployment is measured at almost 30 percent of the labour force but, after the inclusion of employment in the grey economy, the true unemployment rate is about half of that. At the same time, there is severe over-employment in the public and formerly state-owned enterprise sectors, with some wages in industry significantly in arrears. In such circumstances, the burden of unemployment can be expected to grow in the near term.

Chart 2

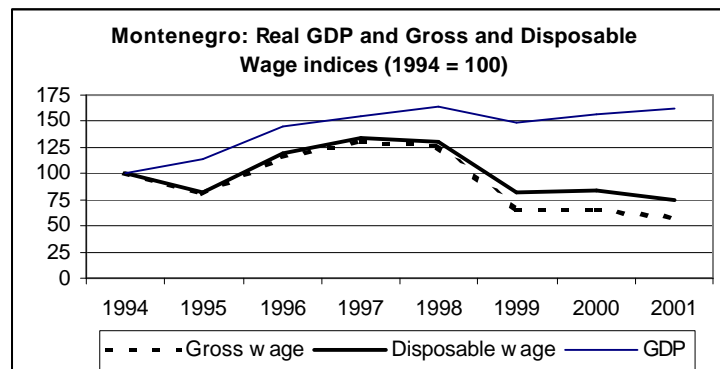


Source: Republic Statistics Office and *Montenegro Economic Trends*, Monet.

<sup>2</sup> Official GDP data remain poor, as discussed later, but some general conclusions can still be drawn.

3. In addition to the disruption caused to traditional working patterns, successive periods of high inflation (Chart 2) and banking crises have eroded personal savings and undermined the ability of the population to build a buffer against poverty. High rates of inflation are also likely to have exacerbated disparities in wealth and income, because the poor are traditionally least able to guard against inflation while wealthier individuals are more likely to have access to inflation protection through the acquisition of financial and other assets.
4. In these circumstances, the official real wage has fallen by even more than measures of real GDP (Chart 3). This phenomenon is probably mainly the result of a huge growth in unrecorded wages and the migration of many workers into the grey economy where non-traditional economic activity is able to elude official recording and taxation. The grey economy probably accounts for about 30 percent of GDP, according to most surveys.<sup>3</sup>

**Chart 3**



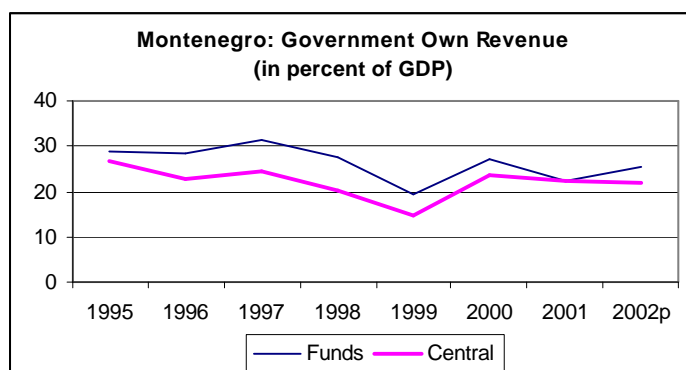
Source: Republic Statistics Office and *Montenegro Economic Trends*, Monet.

5. The economic downturn and the emergence of the grey economy have undermined the state's ability to collect revenues (Chart 4), and this applies to both the central budget and the social funds (Health, Pensions and Employment). This is despite the fact that income taxes (including contributions to the social funds) are levied at about 50 percent of gross income. At the same time, there is an ever-increasing burden on the state to provide for the disadvantaged in society (Chart 5). The erosion of the tax base presents a temptation to increase tax rates but this reaction would only continue the downward spiral into the grey economy and erode the state's ability to confront the increasing needs of the poor. If an excessive tax burden is levied on progressively weakened enterprises, the need for social support for redundant workers continually rises, and public finances are ever more strained.
6. The social burden in Montenegro was significantly increased by a large influx of refugees and displaced persons over the past decade when a wave of people from Kosovo compounded an already significant number from Bosnia and Herzegovina and other neighbouring countries. At present, the number of refugees and displaced persons appears to

<sup>3</sup> See, for example, *Income and Expenditures in Montenegro*, December 2000, OCHA (Podgorica) and The Economics Institute (Belgrade) and *Employment, the Labour Market and the Standard of Living in Montenegro*, May 2002, UNDP (Podgorica).

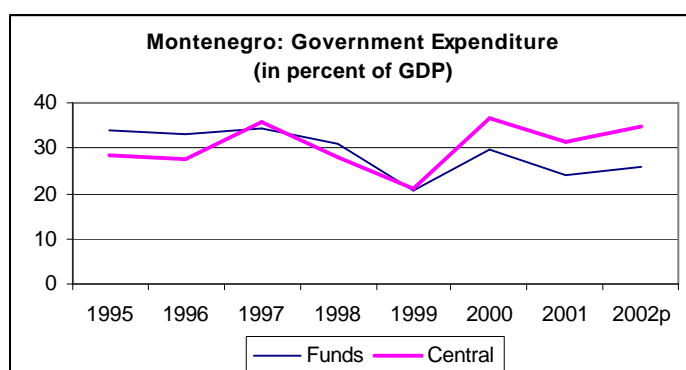
have stabilized at about 45,000 (or almost 7 percent of the population), of whom about 32,000 are from Kosovo, and the government accepts that most of these will probably never leave. Because the government accepts that refugees will probably be assimilated into the general community, most of the cost of refugees will also be absorbed within the general costs of social protection. In addition to refugees and displaced persons, about 15 percent of all households already require basic social support.<sup>4</sup>

**Chart 4**



Source: Ministry of Finance and *Montenegro Economic Trends*, Monet.

**Chart 5**



Source: Ministry of Finance and *Montenegro Economic Trends*, Monet.

- The Government of Montenegro, together with its social partners and in consultation with civil society, is determined to break out of the downward spiral of economic dislocation, increasing marginalization of the poor and unemployed, and the growing burden on the state sector for social support. In order to achieve this, radical reforms are required, and these should aim at breaking the chain of implicit subsidisation and inflationary financing that has typified economic activity for many decades. Socially owned enterprises have typically tried to maximise wages at the expense of profits, then relied on loans from related banks or government to subsidise the resulting losses, with banks and government ultimately depending on the monetary authorities to resolve accumulated debts through inflationary financing. Such inflationary financing does not resolve underlying economic weakness and

<sup>4</sup> ADE report on social security for the EU Food Security Programme.

has simply shifted the burden of financing these weaknesses to citizens who, in turn, have had little incentive to save or invest for the future.

8. Aware of the current situation, the Government of Montenegro believes that accelerated growth is the basic instrument to reduce the development gap that exists in comparison with other European countries, achieve macroeconomic stability, improve living standard and decrease poverty, and this will involve radical reforms.
9. The Government will pursue a four-prong poverty reduction strategy:
  - A stable **macroeconomic** environment that will promote saving and investment as the genesis of economic growth
  - A concerted effort to reduce the prevalence of the **grey economy** so as to maximize taxes and social protection at low tax rates
  - An **economic development** strategy aimed at restructuring the enterprise sector and promoting private ownership, and
  - Improved **targeting of social policies** on the most vulnerable groups in order to achieve the maximum alleviation of poverty without placing a non-sustainable burden on taxation
10. The development of a strategy will involve the identification of real costs associated with the proposed reforms and initiatives, and a determination of priority uses for available resources, in addition to a proper formulation of appropriate action plans.

## II Existing Poverty Levels

11. Most estimates indicate that at least one quarter of the population of Montenegro (at least 165,000 people) live below the poverty line.<sup>5</sup> The generally accepted (relative) poverty line is set at a net monthly income of Euro 50 or at household expenditure of Euro 75 per month (assuming that one person benefits from expenses made at the household level). Some 27 percent of individuals fall below the income threshold while about 31 percent of households fall below the expenditure threshold. Moreover, about one quarter of households spend more than 60 percent of their resources on food. These alarming data are confirmed by subjective poverty perceptions, and about 25 percent of people confirm that they face a difficult financial situation and do not have enough money for food.
12. Poverty levels in Montenegro are clearly correlated with a number of causative elements (a summary is contained in Attachment I):<sup>6</sup>
  - *Unemployment*: Total income for the unemployed falls well under the poverty line, even after the inclusion of income from transfers and other coping mechanisms, and the income of the unemployed in Montenegro is less than 30 percent of average income per adult. When unemployment is defined using ILO definitions, and restricted to those with no income from

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<sup>5</sup> See, for example, *Income and Expenditures in Montenegro*, December 2000, OCHA (Podgorica) and The Economics Institute (Belgrade).

<sup>6</sup> Unless otherwise stated, data are based on surveys reported in *Employment, the Labour Market and the Standard of Living in Montenegro*, May 2002, UNDP (Podgorica).

any work performed, it is measured at 14.2 percent of the labour force. This compares with an official registered unemployment rate of 28.7 percent, which includes persons who have registered as unemployed (so as to receive health benefits) but are inactive or are working in the informal economy.

- *Employment Status and Inactivity*: Some 11.0 percent of the labour force works solely in the informal sector while a further 18.3 percent work in the informal sector in addition to having formal employment. Those working in the informal economy have incomes that average 2.5 times the poverty level but, because they do not pay social contributions, are in danger of falling outside the government's social safety net in the event of illness or disability, unemployment or retirement. According to available data, the inactive population survives on the poverty line.
  - *Age*: The mean age of the unemployed is about 29 years, indicating a strong concentration of unemployment among the young. In particular, one-parent families have restricted access to employment and are especially vulnerable to poverty. Pensioners with minimum pensions (based on years of contributions) receive an income that puts them just above the poverty line, and some additional benefits and transfers from family members probably allow most to meet minimum expenditure requirements. Average pensions are about twice the poverty line.
  - *Family size*: Based on the number of applicants for means-tested government family support, families with three or more children are disproportionately included in the poorer sections of society. Large families are especially reliant on education and health services to alleviate their plight.
  - *Education level*: People with low education levels are virtually restricted to informal employment or are reduced to unemployment or inactivity. Those with low education levels earn about 49 percent of the average wage in the informal sector compared to 67 percent in the formal sector.
  - *Gender*: Women form a disproportionately high percentage of the unemployed, the inactive or the informally employed in the economy, and all of these groups are classified as vulnerable. The growth in the informal economy has caused a particular gender distortion because women in the informal sector earn just 53 percent of the average male income compared to 82 percent in formal employment.
  - *Health and Disability*: Minimum disability pensions allow people to subsist just above the poverty line of Euro 50 per month and private coping mechanisms probably permit minimum expenditure requirements. However, those working in the informal sector have little protection in the event of ill health and temporary disability.
  - *Region*: Income levels in the South and North of Montenegro fall well below the national average. The North is particularly disadvantaged, with average earnings at just 74 percent of the centre of the country, and the disparity is aggravated in the informal sector where incomes in the North are about half of the national average. Average expenditure per adult in the North is just 70 percent of the urban average.
13. The foregoing analysis points to the effects that economic dislocation has had over the past decade, with the effects of general economic decline (especially, on unemployment) being compounded by a drift into the informal economy where people are more vulnerable to economic discrimination and do not pay for social protection that they might well need. Overall, about two-thirds of household income derives from employment, with about 40

percent of this deriving from temporary employment or employment in the informal sector.<sup>7</sup> Social assistance provides about 12 percent of household income, mostly from pensions, and the remaining 22 percent derives from private coping mechanisms including rental income, income from domestic agriculture, and remittances and other transfers.

### **III Key Elements of a Poverty Reduction Strategy**

14. A summary of the key causes of poverty and of vulnerable groups, together with strategies for the alleviation of these problems and monitoring mechanisms for improvement, is presented in Attachment I. Economic reforms, in addition to the development and better targeting of social services, are the core of the government's poverty reduction strategy.

#### **A. Macroeconomic Stability**

15. The chief medium-term economic goal of the Government of the Republic of Montenegro is to increase employment and the standard of living of the Montenegrin population. It is already implementing, an economic reform program for 2001-2005 that seeks to achieve sustainable high rates of economic growth with price stability. These objectives will be pursued by a judicious combination of improved fiscal control, wage restraint and structural reforms in the context of the operation of the euro as the single monetary unit and medium of payment. Economic liberalization and privatisation should combine with a restructured banking system to spur investment and productivity in the private sector-the basis for future increases in the standard of living. Key reforms to the economic system, that have recently been undertaken or are planned, are summarized in Attachment II, while Attachment III details medium-term structural measures and Attachment IV provides a macroeconomic framework.
16. Because Montenegro has adopted the Euro as its currency, there are strict limitations on macroeconomic policies. In particular, the government is prevented from printing money to finance permanent fiscal deficits, such that fiscal balance must eventually be achieved. In addition, because a change in the exchange rate vis-à-vis external competitors is not possible, a strict wage policy is necessary in order to ensure that wage increases do not undermine the competitiveness of the economy. These must be the essential tenets of macroeconomic policy, and a strong banking sector (based on a sound currency) and an open foreign trade and investment regime must be developed as the engines of investment and economic growth.
17. All but one of the banks in Montenegro now meet the regulatory standards set by the Bank for International Settlements, and the last should soon meet these standards. The largest commercial bank has been taken over by the government for resale to a foreign strategic investor. In these circumstances, the Central Bank has begun to gradually reduce reserve requirements on deposits at banks and this should allow the banks to begin lending.

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<sup>7</sup> Based on surveys reported in *Employment, the Labour Market and the Standard of Living in Montenegro*, Podgorica, UNDP, May 2002.

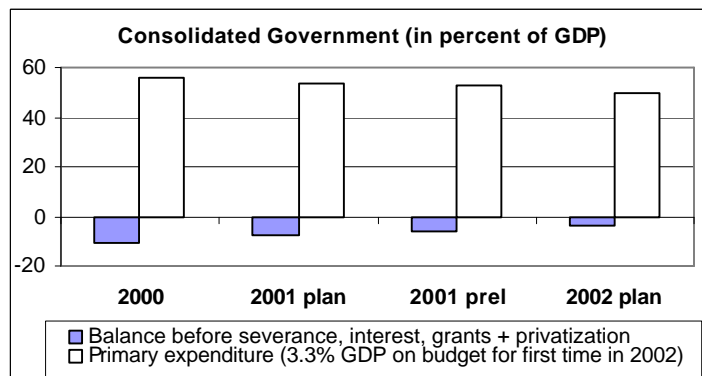
However, further reductions in reserve requirements will be cautiously introduced, and only as balance of payments conditions permit.

18. The government has developed a four-year fiscal plan that envisages a gradual and significant reduction in fiscal deficits. In the meantime, the government will be heavily dependant on donor funding and borrowing from international financial institutions to both secure budget stability and to provide for much-needed investment and growth. In particular, it is worth noting that the planned resumption of servicing of old foreign debt will place a significant burden (of about 2.5-3.0 percent of GDP) on the annual budget for the foreseeable future, and it may be possible (and appropriate) to finance most of this through new borrowing from the international financial institutions. This would allow the government to adapt to its renewed international burden with international assistance.
19. The fiscal plan envisages a gradual reduction in consolidated government<sup>8</sup> expenditure (in percent of GDP) while the central budget would have an initial increase in expenditure because of the resumption of debt servicing and the incorporation of some previously off-budget expenditure. The plan also envisaged a gradual reduction in the tax burden over time. Already, a set of six new tax laws on tax administration, excises, personal income, corporate taxes, VAT and property tax have been approved for implementation over the next two years and aim to reduce the overall tax burden, introduce a marginal tax system to relieve the burden on the lower paid, and to broaden the revenue base. In tandem with this, budget expenditure reductions for 2002 have been agreed with the IMF in the context of embarking on a three-year Extended Fund Facility.
20. Overall, the fiscal stance was constrained in 2001 and plans for 2002 envisage further contraction. The underlying fiscal stance is probably best measured by the deficit that would exist if there were no grants or privatisation revenues (neither of which will last for very long), no foreign interest payments (which will probably be financed by new borrowing for the foreseeable future), and no transitional expenses for reform (in particular, severance payments for workers). According to this measure (see Chart 6), the consolidated government deficit declined from 10.5 percent of GDP in 2000 to 5.8 percent of GDP in 2001 (against a target of 7.2 percent) and will decline further to 3.5 percent of GDP in 2002. The adjustment in 2001 was largely the result of a public sector wage freeze in the context of continued high inflation and a similar tight wage policy would be required to produce further adjustment in 2002.

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<sup>8</sup> The consolidated government incorporates the central budget in addition to the extra-budgetary funds.

**Chart 6**



Source: Ministry of Finance

21. A major set of improvements to public expenditure planning and control began implementation with the budget for 2002 and most budget units have now been incorporated into the new Treasury System. This will permit the improved expenditure control that will allow government expenditure to be focussed where it is most required. The social funds have remained in balance in 2001 and into 2002, although this is mainly the result of significant grants to the Pension Fund and the fact that the central budget makes transfers to the Funds if, and when, they are needed. As a result, any deficits in the extra-budgetary funds are actually reflected in the central government budget. This ad-hoc financing of the extra-budgetary funds is a source of significant concern and there is an urgent need to formalize financial relations between the central budget and the funds. This should be helped by an imminent reform of the pension system, to ensure its long-term sustainability, and by a new Labour Law, both of which have recently been agreed with the World Bank. The World Bank is also likely to turn its attention to health reform in 2003, and it will be necessary to stop the substantial arrears in payments have likely emerged in the Health Fund in the recent past.

## **B. Tackling the Grey Economy**

22. The government launched a major assault on the grey economy in mid-2001, including increased penalties for the non-registration of business premises, the introduction of stamps for excisable goods, and increased powers of inspection and seizure. Illicit exchange of commodities in the wholesale and foreign trade is under strengthened inspection and supervision for the purpose of prevention. An intensive and consistent inspection of the goods which are in transit through Montenegro is also applied. Measures to combat illegal activity should be significantly bolstered by the imminent arrival of a permanent customs monitoring and training mission from the European Union, enhanced bank supervision and the passage of a new Law on Money Laundering, and the introduction of the new tax system (which will reduce incentives for evasion and opportunities for tax avoidance).

23. A Law on Extra Profits and a general Law on Tax Amnesty were approved in by the government in January 2002. The general intention is to provide an opportunity for taxpayers to regularize their relations with the revenue authorities before the introduction of a new tax system. The Law on Extra Profits would tax assets acquired through irregular economic

activity during the period of UN sanctions and hyperinflation. Any assets in excess of a certain threshold would be subject to a 20 percent rate of taxation unless the asset holder can prove that the asset was acquired through regular and recorded economic activity. Assets that are discovered after a limited reporting period would be taxed at a penal rate. A companion Law on Tax Amnesty will provide a limited and once-off opportunity for taxpayers to become current on taxes from regular economic activity. Taxpayers will have to pay the regular rate of taxation without being subject to interest penalties, fines or criminal activity. Non-taxed income that is discovered after the expiration of the amnesty period will again be subject to full penalties, which have been increased under the new Law on Tax Administration.

### **C. Economic Development and the Labour Market**

24. The growth of the Montenegrin economy requires a business environment that will facilitate the private sector development. The legislative framework for the market economy, in which private ownership and initiative have a key role in the development of economic and social sector is already created. In addition to tax and foreign trade reforms, price liberalization, privatization and financial sector reform, the Montenegrin parliament adopted a set of new laws: Law on Accounting and Auditing, Law on Business Organizations, Labor Law, Law on Business Organizations Insolvency, while the creation of the new pension insurance and secured transactions systems is in process. The Government considers that the efficient implementation of the legal rules is necessary in order to improve the legal basis and institutional capacities for the creation of the firm and stable business environment.
25. The process of privatization, as one of the basic assumptions for the accomplishment of the development goals, is in the process of consolidation of the solutions reached through the finalization of MVP process. More significant effects in the process of privatization are missing and options for the privatization of large companies and business systems are being studied, with the intent to obtain the needed capital to stimulate the economic activities and new employment. Batch Tender Plan (for selling shares in almost 30 companies with over 300 employees on an average) and Strategic Privatization Plan (for 15 companies employing about 24,000 persons) are in process.
26. Sectoral strategies and policies, especially in tourist trade, agriculture, environmental protection and small and medium business development, will help to achieve the objectives of the Poverty Reduction Strategy and facilitate balancing between the economic and social sector in the process of the Strategy development.
27. In January 2002, the Government launched an Enterprise Restructuring and Labour Transformation Initiative aimed at (i) helping to restructure and rejuvenate previously state-owned enterprises and (ii) dealing with the inevitable short-term increase in unemployment through active labour market schemes. The initiative was designed to combat certain difficulties associated with efforts at enterprise restructuring and privatisation, partly associated with the fact that it will take time for the privatisation process to create effective ownership blocks.

28. Displaced labour will be absorbed into already ongoing active labour market schemes being carried out by the Employment Fund. Based on an ongoing assessment of the profile of redundant labour and of the success of these programmes, funds could be provided for

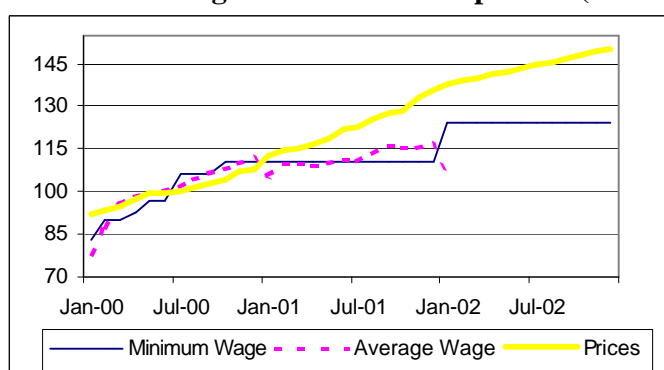
- Micro-credit schemes for the entrepreneurial unemployed (typically, 5 percent of the total)
- Training schemes for the younger unemployed
- Temporary wage subsidies for older or uneducated unemployed
- Public work programs for the severely disadvantaged, and
- Job search assistance for the remainder.

Most of the costs will be borne by the government budget, but an existing revolving micro-credit scheme at the Employment Fund should provide half of the funds needed for further credits, and foreign donors will provide market-driven, performance-based financing to selected intermediaries (both banks and NGOs) to on-lend to target clients. Donor funds would likely focus on the low-end of the market, targeting rural and poorer areas

29. The new Labour Law, to be introduced at mid-year as agreed with the World Bank, will greatly improve labour market flexibility and reduce costs associated with hiring and firing workers. Severance payments will be reduced from 24 months to a maximum of 6 months and this will, in addition to enhancing labour flexibility, make it possible for the government to secure labour shedding from formerly state-owned enterprises. Restrictions on temporary and short-term employment contracts will be removed, mandatory special leave entitlements will be reduced and maternity leave will be shortened to 6 months.

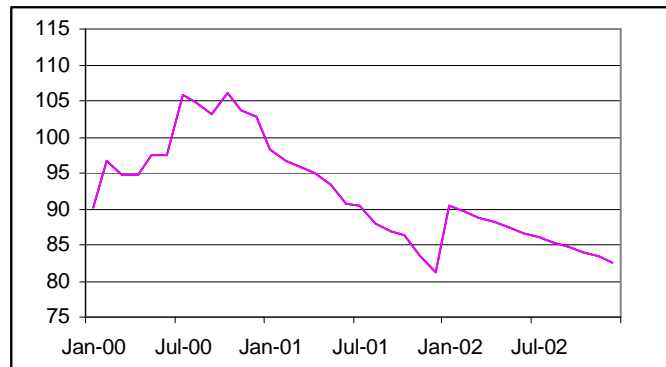
30. As regards wage policy, some large wage increases granted in 2000 have been more than reversed by a 15-month wage freeze in the context of continuing inflation (see Charts 7 and 8). The minimum wage acts as a very powerful wage-setting mechanism in Montenegro

**Chart 7. Recent Wage and Price Developments (2000 = 100)**



Source: Republic Statistics Office and *Montenegro Economic Trends*, Monet.

**Chart 8. Recent Real Minimum Wage Developments (2000 = 100)**



Source: Republic Statistics Office and *Montenegro Economic Trends*, Monet.

and the rate of change is closely mirrored by developments in the average wage (Chart 7). The minimum wage was frozen for 15 month from October 2000 and this freeze, in the context of continuing inflation in the region of 25 percent annually, served to reduce the real minimum wage below the level of early 2000 (Chart 8).

#### **D. Targeting Social Welfare Assistance and Social and Regional Development**

##### **i Targeting Social Welfare Assistance**

31. The government has already embarked on a program of better targeting social welfare support and this drive will continue. The government liberalized milk and bread prices in 2001 and, at the same time, significantly increased eligibility requirements for child allowances. A compensatory increase in levels of family income support (MUP) was provided instead and this vastly improved the targeting of social welfare payments to those most in need. Overall, the effect of these measures was to both better target social welfare support and save about Euro 10 million in the annual budget. MUP now provides assistance to some 16,000 individuals and will be expanded by the end of 2003.

##### **ii Educational Development**

32. The education sector in Montenegro suffered heavily under the disruption and economic deprivation of the past decade and the influx of refugees has seriously strained education capacity. Most schools are run down and have had almost no new educational materials for the past number of years. In such circumstances, school attendance also suffers, and the average participation rate in secondary education has stagnated at roughly the same level as 10 years ago. Clearly, further investment in the development of schools and educational material is required, based on a comprehensive review of the existing system.

33. Montenegro devotes about 7 percent of GDP to education, and the Ministry of Education is developing its recovery and reform program in close collaboration with advisors who developed the recent education reform in Slovenia. The program will include measures to: a) improve teaching and learning conditions in schools through improved educational materials, strengthened in-service and pre-service teacher training, and improved textbooks; b)

decentralize education management; c) streamline the curriculum and make it more student centred; d) expand preschool education to make it available to all children; and e) introduce effective monitoring and evaluation—including participation in international assessment studies.

### **iii The Development of Health Services**

34. On the surface, the quality of health in Montenegro appears to be at an acceptable level and life expectancy averages over 73 years. However, the rapid deterioration in services in recent years threatens to quickly undermine health care levels, especially for an ageing population. This applies both to the day-to-day running of the health service, which is incurring ever-increasing deficits, and to the need for reconstruction and reinvestment in run-down buildings and outmoded equipment. Such investment will be undertaken in line with a comprehensive review of the existing system.
35. Wage contributions provide 80 percent of the total revenues of the Health Fund and place a large burden on the population with total contributions (of employer and employee) amounting to 15 percent of gross salaries. The proliferation of the grey economy and rising unemployment have greatly undermined the collection of contributions and the system requires radical overhaul, with technical assistance from abroad. The central government budget covers the administrative costs of the Ministry of Health and the Institute of Public Health.

### **iv Regional Development**

36. In Montenegro, approximately 40 percent of the population live in rural areas where average earnings are only one quarter of those in coastal regions. The migration of younger cohorts out of rural areas in the last several decades has led to a significant aging of the rural population and accounts for the high percentage of farms owned by urban residents (23 percent). Full-time farm households account for just 4 percent of all households, while 22 percent of households have some farming income. Local and regional development, the protection of the environment, and the provision of ancillary services to tourism, are all inextricably linked to the revitalization of agriculture.
37. The majority of agricultural land is privately owned and 80 percent is used as meadows and pasture. Because natural conditions favour extensive livestock production, cattle and sheep farming predominate, but yields are low due to poor animal nutrition and the predominance of low-production animals and farm restocking is one aim of government policy. The government also intends to promote the full development of grain-producing potential and this will require a radical upgrading of farm machinery. In addition, fruit, vegetable and grape production has been an important source of farm income, but production has decreased in recent years due to lack of working capital for fertilizer and other inputs. Montenegro has a long Adriatic Sea coastline, and sea fishing used to provide considerable income, export earnings and employment, also acting as a coping mechanism for the unemployed. Now the local catch is limited due to obsolete facilities.

38. Until recently, agricultural price and trade policy, together with the activities of the State Institute for Commodity Reserves (SICR), caused severe distortions in producer and consumer prices and in the composition of processed output. Trade policy used the system of tariffs, quotas and licenses extant in FRY, but additional import subsidies were used to lower consumer prices. Producer prices were raised to levels above import parity by a combination of administratively controlled floor prices and subsidies, and consumer prices were then lowered by further subsidies to processors for bread and milk. Montenegro now has a very open and liberal trade regime. Considerable progress has been made towards liberalizing the prices of bread and milk, removing production quotas and rationalizing the activities of the SICR.

#### **IV Development of a Poverty Reduction Strategy**

39. In finalizing the Interim Poverty Reduction Strategy, the government sought comments from a wide range of civil society, including representatives of research institutes, NGOs, and donor agencies. Unfortunately, the time available for the preparation of the I-PRSP precluded the establishment of working groups at this stage, but the government intends to rectify this omission and to establish such groups and to commission local experts to better investigate various aspects of poverty, in the process of the development of a full PRSP.

40. In the preparation of the Poverty Reduction Strategy, the Government will contribute, through educational and public campaign and intensive consultation process with civil society members, to better understanding of the process of poverty reduction and, if found necessary, and modify certain policies and programs. The consultative process for a full PRSP would probably establish working groups to concentrate on six areas, as chaired by representatives of the relevant government ministry:

- The effects of macroeconomic stabilization policies (Ministry of Finance)
- Health sector development (Ministry of Health)
- Education sector development (Ministry of Education)
- Targeting social welfare assistance (Ministry of Labour and Social Welfare)
- Labour redeployment schemes (Ministry of Labour and Social Welfare)
- Regional development strategies (Ministry of Agriculture and Fisheries)

These working groups would consist of members of government institutions and ministries, NGOs, experts from specialized institutions, local authorities, business community and media and would be constituted by end July 2002. Their reports would be submitted by end 2002 to the Civil Society Forum for Poverty Reduction to be made of key members of the working groups. The Forum would, in turn, be expected to report its findings to the Government by March 2003. The Government would finalize its Poverty Reduction Strategy, based on the report prepared by the Civil Society Forum for Poverty Reduction, by not later than June 2003. (This process is summarized in Attachment V).

41. Data deficiencies are a particular concern. Significant improvement in data on gross domestic product and its components, in addition to improved data on balance of payments

developments, will be necessary in order to better measure economic activity. Such improvements will also permit the more informed development of economic policies.

42. The government intends to introduce a social card system for all families. This system would integrate existing databases in an effort to clearly identify vulnerable sections of the population, prevent abuses of the social welfare system, better target existing resources, and act as a guide to future development of social welfare policies. They would also help to strengthen the tax base by providing a further tool in identifying tax avoidance. The system would, moreover, allow the government to monitor the relative success of various poverty reduction schemes, because it will track the graduation of families to self-sufficiency.
43. Before the introduction of the social card system, the government will need to undertake a comprehensive household budget survey. This survey will identify income levels and their distribution, enabling a more formal identification of poverty lines. The survey would also identify property holdings and other sources of wealth and would provide a more thorough identification of regional economic disparities.
44. The household budget survey would also provide a better profile of family size and its relationship to poverty levels. Improved health profiles should permit a more accurate elaboration of health protection needs and education levels and the need for vocational training would be more closely identified.
45. Because many of the improvements planned in the course of the poverty reduction strategy take many years to come to fruition, the government will concentrate on monitoring the implementation of policies to measure progress in its strategy. Therefore, as outlined in Attachment I, progress in macroeconomic reform and stability will be measured by the successful implementation of IMF programmes and unemployment alleviation will be measured by the successful implementation of labour redeployment schemes as much as by actual measures of unemployment. Developments in the grey economy will be closely watched and there will be an expectation of initiatives in Health, Education and Regional development. Of course, well-targeted social welfare support will be closely monitored.

## Summary of Poverty Causes, Amelioration Strategies and Monitoring

<b>General causes</b>	<b>Amelioration strategy</b>	<b>Monitoring</b>
Economic stagnation	Sound macroeconomic policies	IMF programme
Fiscal and banking crises	Sound macroeconomic policies	IMF programme
Unemployment	Enterprise restructuring and active labour market policies	Unemployment rate and active labour policies
Grey economy	Grey economy initiative and new taxation policies	Activity in grey economy and tax revenue
Youth	Education and vocational training	Education enrolment and active labour policies
Family size	Family income support and health services	Scope of family income support
Education level	Educational development	Education enrolment and achievement
Gender	Education and vocational training	Education enrolment and active labour policies
Health and disability	Health service development	Health profile and services
Regional poverty	Regional development	Regional initiatives

## Montenegro: Plan of Economic Reform and Assistance I

	2001	2002			
	Completed	Quarter I	Quarter II	Quarter III	Quarter IV
<b>International Financial Institutions</b>					
World Bank					
Debt Consolidation Loan					
Structural Adjustment Credit					
Export Credit Facility					
IMF					
Stand-by Arrangement					
Extended Fund Facility					
EU Macro-Financial Assistance	Tranche I	Tranche II		Tranche III	
Paris Club					
London Club					
<b>Macroeconomic planning</b>					
Macroeconomic Assistance	EU				
Economic Development Strategy				EU	
<b>Ministry of Finance</b>					
Reorganization	USAID	USAID/EU	USAID/EU		
Expenditure control					
Organic Budget Law	USAID/EU	USAID/EU			
Interim Treasury system	USAID/EU	USAID/EU			
Permanent Treasury System	USAID/EU				
Macro-Financial Planning Unit	EU	EU	EU		
Budget Execution Oversight	US Treasury				
Public Procurement Law	USAID/EU	USAID			
Public expenditure review			World Bank		
Internal audit			EU		
Public Investment Plan				EU	EU
Debt Unit		USAID			
Grey Economy Initiative	EU				
<b>Tax Laws</b>					
Tax Administration	USAID/EU	USAID/EU			
Income Tax	USAID/EU	USAID		USAID/EU	
Corporation Tax	USAID/EU	USAID/EU			
Property Tax	USAID	USAID			
VAT	USAID/EU	USAID			
Excise Tax	USAID		USAID		
Customs Administration				EU	
Customs Law	USAID	USAID			
Law on Extra Profits	EU				
Tax Amnesty	EU				
<b>General Audit Office</b>					GTZ

**Key:** Preparation Approval Implementation

Lead donor agencies identified.

# Montenegro: Plan of Economic Reform and Assistance II

	2001	2002			
	Completed	Quarter I	Quarter II	Quarter III	Quarter IV
<b>Pension System Reform</b>		WB/USAID	WB/USAID	WB/USAID	
<b>Health System Reform</b>					WB
<b>Central Bank</b>					
Central Bank Law	USAID				
Law on Banks	USAID				
Bank Bankruptcy Law	USAID				
Regulation and Supervision	USAID/EU	USAID			
Euro conversion	USAID	USAID			
Bank restructuring and licensing	USAID/EU	USAID/EU/DFID			
Research and statistics	USAID	USAID			
<b>Payments System Reform</b>	USAID	USAID		USAID	
<b>Business Environment and Legislation</b>					
Price liberalization	EU				
Enterprise Law	USAID	USAID			
Bankruptcy Law	USAID	USAID			
Securities Law	USAID	USAID			
Foreign Trade and Customs Law	USAID				
Law on Foreign Investment	USAID				
Telecommunications Law	USAID	USAID			
Accounting and Auditing Law	USAID	USAID			
Secured Transactions Law			USAID	USAID	
Foreign Trade Law			USAID	USAID	
Restitution Law			USAID	USAID	
Anti-Corrupt Practices Law			USAID	USAID	
Anti-Money Laundering Law			USAID	USAID	
Electronic Commerce Law			USAID	USAID	
<b>Enterprise Restructuring and Privatization</b>					
MVP privatization	USAID				
Tender and Batch Privatization	USAID	USAID			
Enterprise Restructuring	EU				
Large enterprise		EU	EU	EU	
Pilot SME project		EU	USAID	USAID	
Other turnaround		EU/EBRD	EU/EBRD	EU/EBRD	
SME Development	EU/Germany/Austria				
<b>Statistics office</b>	EU				

**Key:** Preparation Approval Implementation

Lead donor agencies identified.

## Republic of Montenegro: Structural Policy Matrix, 2002-2005.

Policy Area	Objective	Strategies and Measures	Implementation Period
<b>1 Fiscal Policy</b>			
A Transparency	Broaden coverage	Include extrabudgetary funds in budgetary process	2003-2004
	Improve reporting	Establish GFS-consistent reporting system at all levels	2003
	Strengthen monitoring	Establish Internal Audit Office	2003
	Strengthen monitoring	Improve model of external audit	2003
B Planning	Improve planning	Establish fiscal planning unit at Ministry of Finance	2002
	Improve planning	Establish centralized accounting division	2003
	Improve planning	Improve debt management capacity	2003
	Improve planning	Adopt Policy on Donor Funding	2003
C Tax policy	Administrative efficiency	Introduce new guidelines to simplify tax administration	2002
	Tax efficiency	Implement new laws on income tax, excises, property tax	
	Tax efficiency	and corporate income tax	2002
	Tax efficiency	Introduce VAT	2003
	Tax efficiency	Plan for resolution of inter-republic trade relations with Serbia	2002
D Public expenditure	Expenditure control	Introduce Treasury and Single Treasury Account	2002
	Administrative efficiency	Reorganize Ministry of Finance along functional lines	2002-2004
	Reduce expenditure	Downsize public sector and reform salary scales	2003-2004
E Social security	Reduce expenditure	Modify benefit formula for pensions	2002-2003
	Reduce expenditure	Change pension indexation formula	2002-2003
	Reduce expenditure	Introduce phased increase in minimum retirement age	2002-2003
	Reduce expenditure	Tighten eligibility requirements for disability pensions	2002-2003
	Improve planning	Undertake comprehensive review of Health system	2003
	Control expenditure	Redefine contracting criteria and drug list in health service	2003
	Control expenditure	Draft new laws on health insurance and clarify health system	2003
	Control expenditure	Extend Treasury services to all social funds	2003-2004
	Improve planning	Undertake comprehensive review of education system	2003

Continued

**Republic of Montenegro: Structural Policy Matrix, 2002-2005 (concluded).**

<b>Policy Area</b>	<b>Objective</b>	<b>Strategies and Measures</b>	<b>Implementation Period</b>
<b>2 Monetary and Financial Policies</b>			
A Money and banks	Monetary control	Prepare consolidated balance sheet for banking system	2002
	Bank soundness	Empower Central Bank to supervise offshore banks	2002
	Bank soundness	Adopt Law on Anti-Money Laundering	2002
B Financial	Develop markets	Adopt Law on Secured Transactions	2002
<b>3 Private sector development</b>			
A Privatization	Improve governance	Sell majority shares in enterprises to strategic investors	2002-2003
B Legislation	Improve registration	Implement registration procedures for new enterprises, in accordance with the Law on Business Organizations	2002
	Streamline insolvency	Implement the Law on Business Organization Insolvency, including through training judges, bankruptcy administrators, attorneys and accountants.	2002
	Improve pledging	Establish and staff a Republic Pledge Registry	2002
C Labour market	Improve labour flexibility	Adopt Labour Law to improve labour market flexibility and reduce severance payments to a maximum of 6 months	2002
		Adopt Employment Law with a flat rate unemployment benefit and with duration of benefits depending on contributions	2002
		Assess existing active labor market programs	2002
<b>4 Sectoral policies</b>			
	Improve cost recovery	Increase average electricity prices and reduce subsidization	2002
	Improve regulation	Introduce framework for independent energy regulator	2002-2003
		Further increase ratio of electricity collections to billings	2002
<b>5 Trade policy</b>	Liberalize trade regime	Remove import quotas for agriculture, iron and appliances	2003-2004
<b>6 Statistics</b>			
	Improve statistics base	Nominate GDDS coordinator	2002
	Improve statistics base	Undertake multi-sector GDDS review of statistics	2002
	Improve statistics base	Conduct household survey and poverty assessment	2002

## Montenegro: Selected Economic Indicators, 2001-2005

	2001	Projections			2005
		2002	2003	2004	
(in percent change)					
Real economy					
Real GDP	3.5	5.0	5.0	5.0	5.0
GDP deflator	16.7	10.3	8.8	5.5	4.5
Consumer prices					
Period average	22.7	18.2	8.8	5.5	4.5
End of period	26.6	12.0	6.0	5.0	4.0
(in percent of GDP)					
Consolidated Government accounts					
Revenue	53.2	50.3	44.0	41.9	40.4
Expenditure	55.3	53.5	47.7	44.5	43.0
Balance	-2.1	-3.2	-3.8	-2.7	-2.6
Excluding grants 1/	-6.1	-6.3	-3.8	-2.7	-2.6
Structural balance 2/	-5.8	-3.5	-2.1	-1.2	-1.3
Central Government accounts					
Revenue	30.2	32.1	26.4	24.6	23.4
Expenditure	32.3	35.3	30.2	27.3	26.0
Primary	32.1	32.8	28.5	25.8	24.6
Balance	-2.1	-3.2	-3.8	-2.7	-2.6
Excluding grants 1/	-4.0	-6.3	-3.8	-2.7	-2.6
(in millions of US\$)					
Balance of Payments 3/	20	42	41	65	60
Current account	-135	-127	-122	-66	-72
Trade balance	-379	-489	-545	-558	-603
Exports	201	225	252	305	330
Imports	580	714	797	863	932
Services and income	181	297	353	417	450
Current transfers	63	65	70	75	81
Capital and other flows 3/	155	169	163	131	132

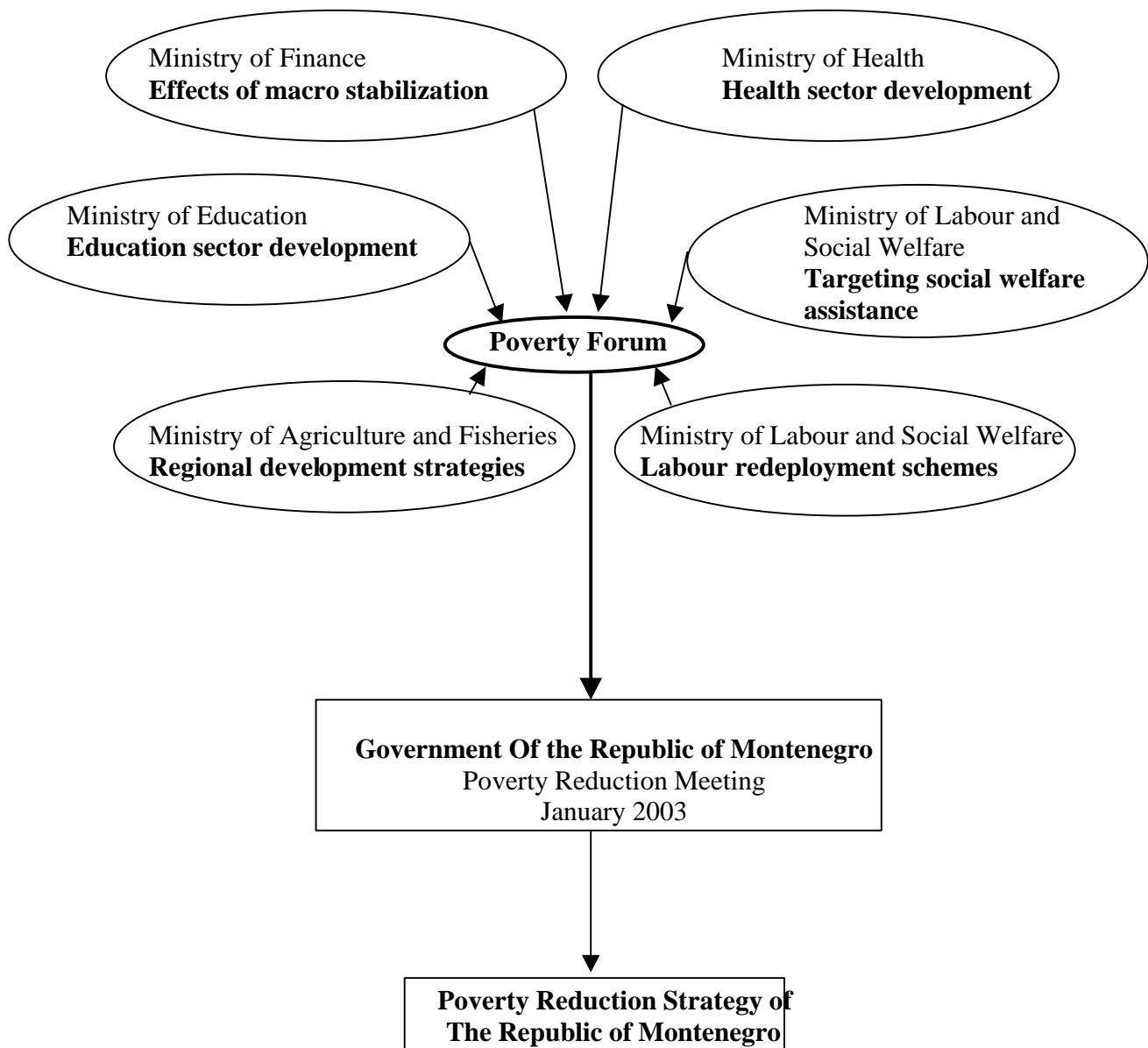
1/ For planning purposes, grants assumed to be zero after 2002.

2/ Balance after excluding grants, privatization receipts, interest payments and reform expenditure.

3/ Estimated.

## Poverty Reduction Strategy

### Participation plan



**INTERIM**  
**POVERTY REDUCTION STRATEGY PAPER**  
**FOR**  
**THE REPUBLIC OF SERBIA**

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June 18<sup>th</sup>, 2002

*In the development and implementation of the Poverty Reduction Strategy for the Republic of Serbia a wider definition of poverty will be used. This definition includes not only income poverty - the lack of income to satisfy basic food and non-food needs, but also human poverty as the lack of basic human capabilities (illiteracy, malnutrition, etc.) and the lack of access to goods, services and infrastructure (energy, sanitation, health, education, communication) necessary to sustain basic human capabilities.*

## 1. THE COMMITMENT OF THE GOVERNMENT TO FIGHT POVERTY

The Serbia of 2001 has emerged from the past burdened with the inheritance of a dissolved SFRY and ten years of centralised and erratic rule under the Milosevic regime. The legacy of the last decade, successive wars, international isolation and the NATO bombardment, can be seen in the now shambolic remains of the once relatively well developed economy and social security system and a legal and physical infrastructure badly distorted by neglect and abuse of power.

During the 1990s, the poverty rapidly gained ground in Serbia as the result of these crises, which reduced the GDP in 2000 to 45 percent and per capita income to less than 40 percent of the levels recorded in the late eighties.<sup>9</sup> In addition, the accommodation and support of more than 600.000 refugees and internally displaced persons<sup>10</sup> has put additional pressure on the already strained social and poverty situation in Serbia. This combination of factors has rendered both the social and economic systems in urgent need of rehabilitation.

Available statistics for 2000 indicate that approximately one third of the Serbian population lives in poverty, defined according to national criteria, with an income of less than US \$30 per month, and 18% live in absolute poverty with monthly income less than US \$20<sup>11</sup>. Additionally, a considerable group lives close to the poverty line and can easily fall below it if well targeted measures are not speedily put in place.

The poverty situation in Serbia is atypical of most IDA countries. Yugoslavia used to be considered a moderately developed society in the middle-income bracket with fairly equal distribution of income and good provision of education, health and other public services. In most cases social exclusion and lack of access to public services has not been the main cause of the recent increase in poverty, although the deteriorating situation in the health sector has had a negative influence on access to health care by vulnerable groups.

There is a risk that the number of people exposed to poverty in Serbia will continue to increase. The main reason for this will be an increased number of unemployed due to the ongoing restructuring of the economy. Low average salaries and wages, pensions and social support, combined with limited fiscal capacity and an inevitable liberalization of all prices to market levels could push a larger number of households below the poverty line. The depth of the inherited economic crisis and the tight fiscal situation, have made it impossible for the government to increase the transfer of funds to social programs. As a result, until key structural reforms are completed and economic growth takes hold some social groups may become even more vulnerable than before.

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<sup>9</sup> World Bank's Transitional Support Strategy (Report No. 22090, June 2001) estimated that "as of end-2000, recorded GDP had contracted to about 45 percent of its 1989 level, with per capita income falling to about US\$840-990" (page 3). If the population figure is adjusted upwards to include 600,000 refugees, many of whom are expected to become citizens of FRY in the near term" (page 3, footnote 6), the resulting per capita income (US\$800-940) represents less than 40% of the level recorded in 1989.

<sup>10</sup> UNHCR and ICRC data

<sup>11</sup> "Poverty in Serbia and reform of Governmental Support for the poor", B. Bogicevic, G. Krstic and B. Mijatovic, Center for Liberal-Democratic Studies, 2002. The study is based on pre-reform data from the first half of 2000 and does not take into consideration the approximately 600.000 refugees and internally displaced persons currently accommodated in Serbia.

Since late 2000 the economic performance of Serbia has been encouraging. Inflation during 2001 declined by two-thirds to 39 percent by the year-end (core inflation 15 percent). Real GDP grew by an estimated 5,5 percent in 2001, reflecting primarily strong recovery in agriculture as well as firm implementation of macroeconomic and structural reform policies.

The importance the Government of Serbia gives to poverty reduction is well reflected in its first comprehensive statement on reform "A Reform Agenda for Serbia", prepared for the first donor conference in June 2001. It features the following three broad themes, which are all crucial for modern and effective poverty alleviation:

- The establishment of a modern state based on the rule of law including fight against corruption, reform of public administration, etc.;
- Revitalization of the economy; and
- Fighting poverty and improvement of the social protection system for vulnerable groups.

Through the PRSP process the Government of Serbia is reconfirming its commitment to restoring strong and sustainable economic growth with equity. As a result the PRSP for Serbia will place heavy emphasis on how development and economic growth should be promoted and directed to ensure that the poor and the near poor gain full access to economic opportunities and participate fully in the distribution of the anticipated benefits from future economic development.

The Government intends to fight poverty by: giving high priority to the restructuring of the economy and the creation of new jobs; developing new products and services resulting in better wages and higher profits; widening the net of SMEs and creating many new employment and income opportunities. This will also lead to an improved fiscal situation which will in turn make it possible for the government to improve public services.

A successful PRSP must therefore be an integral part of a global development strategy, a determined implementation of market reform and integration into international development, technological and information trends. The success in implementing the development strategy will not only be measured by GDP growth rates, but primarily by the level of achievement of key development goals, of which the reduction of poverty and increase of living standards are among the most important. In addition, issues related to the reform of the public administration, good governance, accountability and anti corruption work are important in this context.

Having in mind the available data, public reform and policy actions in support of the poverty reduction strategy might be based on a three-pronged approach targeting different social and economic groups.

- The first component of the approach will be based on policies that create new productive jobs and promote economic growth. It will target the whole Serbian population but will have a specific focus on individuals that have become unemployed or have fallen into the low income group due to decade mismanagement, economic sanctions or the ongoing transition process. The objective is to empower these groups to help themselves get out of poverty. Specific policy actions will include retraining

programs, assistance in job search and establishing micro and small businesses. These policies will help to minimise the cost of transition and generate new jobs and economic growth.

- The second component will be aimed at poverty prevention as a large number of redundant workers still hold jobs in medium or large socially or state owned companies that will soon be privatized and restructured. A carefully thought out sequence of reforms and policies will be put in place to ensure that this group of at least 500.000 does not fall below the poverty line. Preventive measures will include the creation of spin-offs and other SMEs prior to or concurrently with the privatization process and the provision of severance packages that would include technical retraining and acquisition of basic business and management skills, etc.
- The third component will be based on classical social policies and instruments. It will target the “regular poor” and especially vulnerable groups through better social assistance, education and health services that will prevent social exclusion and through basic job creation measures like micro credits, SMEs support, etc. Retargeting of existing measures and programs within the current budget framework seems inevitable.

Although the majority of the poor population can expect that economic development and a higher income will elevate them from poverty, this will not be an answer for specific groups. Available data indicate that certain groups are more at risk of falling into poverty than the rest of the population: children, single parents, refugees, displaced persons, Roma, the elderly, etc. Both causes and characteristics of poverty will greatly vary from group to group. Consequently each of these groups will require different poverty alleviation strategies.

The government recognises that poverty is multidimensional and that in addition to poverty in terms of income, social inclusion, access to education, health and other public services as well as equal access to opportunities are crucial. Participation in social and political processes, protection of human rights, no gender and ethnic discrimination are also important dimensions of a wider poverty definition. Since it is difficult to separate the economic, social and political factors that contribute to poverty a holistic / comprehensive approach is needed to fight poverty effectively.

Recognising the multidimensional nature of poverty, the Government of Serbia will through a participatory process develop, strengthen and put in place pro-poor policies aimed at:

- promoting social inclusion and empowerment
- developing equal access to markets, assets, opportunities and public services like health, education, water, etc.
- improving and protecting the rights of the poor and the vulnerable,

In addition to the fact that certain categories of the population are more vulnerable than others, there are also large regional differences in Serbia both in the level of development and in the level of poverty. Hence one of the many challenges of the PRSP will be to foster balanced regional development.

The core steps underpinning the Government's PRSP efforts are:

1. A review of the strategies and policies of **each sector**, as well as the on-going reforms in the context of poverty reduction;
2. **Policy discussions** and formulations within all sectors aimed at developing better reform and poverty alleviation strategies.
3. Integration of different partial poverty reduction strategies in a **comprehensive and result oriented long-term strategy**;
4. The clear formulation of **priorities**;
5. An on-going **comparison of the changes and policies** being effected under the PRSP by the current government and by future governments (monitoring and sustainability).

The Government of Serbia recognises the multi-dimensional nature of poverty and is firmly committed to putting together a carefully selected and prioritised mix of public actions designed to have the highest poverty reduction impact bearing in mind the current economic and fiscal constraints. The government acknowledges the importance of designing and prioritising effective and targeted public actions that will create the necessary balance between shorter term and longer term needs and challenges and between economic, social and democratic reforms. To facilitate this, the Government is planning to prepare a PRSP based upon a broad participatory process that involves different parts of the government, civil society and development partners.

All levels (central, local) and all branches (executive, legislative) of Serbian government will be included in the PRSP process. The following ministries will have a crucial role in the development of the PRSP: Social Affairs; Finance and Economy; International Economic Relations; Privatisation and Economy; Labour and Employment; Education; Health and Environment; Trade and Tourism. In addition, support from the Federal and the Republic Office of Statistics will be of key importance. The work of the Government will be led by a high-level inter-ministerial steering committee that will be chaired by the Prime Minister and co-ordinated by the Ministry of Social Affairs.

The Government recognises that the PRSP process provides an opportunity to further improve analytic, strategic and policy efforts across the government. It also provides a possibility to improve inter-ministerial communication and to put in place mechanisms and systems that the government will benefit from long after the initial PRSP phase.

The PRSP process also provides an opportunity for the government to initiate a new partnership with the NGO community and with wider civil society, including the labour unions and the media. The government also realises the importance of involving Serbian parliamentarians in the process, both as representatives of the electoral body and to ensure long-term political commitment to the strategy.

The government intends to develop policies and priorities which are conducive to and aligned with international efforts defined by International Development Targets (IDT), Millennium Development Goals (MDG), UNDP, WHO, UNICEF, WB, OECD and IMF. The government of Serbia also sees the fight against poverty as an important part of bringing Serbia into mainstream European development and integration. Hence the PRSP must

take into account processes linked to the EU's stabilisation and association agreement, WTO accession, relationship with the Montenegro and the federal level, etc.

To achieve these goals the government invites the international community to support the fight against poverty. Having in mind the current fiscal, economic and human constraints, assistance is needed both in the form of technical assistance and financial support both for the development and the implementation of the PRSP. The backing of the international community and international development partners is one of the critical elements in accelerating economic growth in Serbia and facilitating the re-integration of Serbia into the world economy.

## 2. POVERTY IN SERBIA – NATURE AND EXTENT

Poverty in Serbia has increased dramatically in the last ten years. The middle class has disappeared, the number of poor has increased two and a half times and there are an increasing number of people living just above the poverty line. Simultaneously, an increasing number of people became poor as a result of social exclusion, lack of access to public services, opportunities and markets, discrimination, etc.

Poverty has increased mainly because GDP sharply declined during the past decade. At the end of 2000 total GDP amounted to 45 percent and per capita GDP to less than 40 percent of the levels recorded in 1989, the greatest GDP fall in Central and South-East Europe. This situation has had negative effect on all aspects of life in Serbia and might be illustrated by the deteriorating situation in the health and education systems.

The deterioration of the **population's health** status (the increase in infant mortality rate, decrease in life expectancy for women, increase in incidents of cancer diseases, prevalence of infective disease, mental health has been severely endangered, increase of unknown morbidity causes... ) is a result of the cumulative influence of internal and external factors and critical events in the last decade, including ageing of the population, the extra burden caused by refugees and internally displaced persons, the deteriorating living and working environments, unemployment, social misery and a decrease in self-responsibility for personal health especially among the younger generation.

The resources available to the health sector have declined significantly during the last ten years with spending falling from US \$200 per capita in 1990 to around US \$60 per capita in 2000. Official HIF (Health Insurance Fund) data for the first six months of 2001 record health care expenditure of US \$250 million (approximately US \$32 per capita).<sup>12</sup> As a consequence, investment has declined, resulting in much of the sector's equipment becoming obsolete, and recurrent costs have been under funded. This was accompanied by dramatic decline in the quality of health services, fall in their utilization rate, shortage of medicines and medical supplies, all of which contributed to the decline in the health status of the population, especially of vulnerable categories. Even though the expenditure on public health care services in the absolute terms (US \$ per capita) was very low, in relative terms (percentage of GDP) it was constantly growing. During the past ten years, it ranged from 7.4 percent in 1990 to 10.4 percent in 1999.<sup>13</sup> This trend becomes even more disturbing when one takes into consideration that "out of pocket" payments have increased during the previous decade. This has resulted in reduced access to health services for vulnerable groups.

The dramatic decrease of total and per capita GDP during the nineties, in addition to all the other effects noted above, resulted in an extreme deterioration in the field of **education** as well. In 2000 public expenditure on education decreased by 70 percent compared to 1990 (from US \$889 million to US \$247 million). In this period, expenditure

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<sup>12</sup> Accurate information is difficult to obtain since official HIF data only include expenditures made by the Fund, humanitarian assistance for drugs or medical consumables have not been accurately recorded, and patients' informal payments, although substantial, especially for the drugs and hospital treatment, have not been recorded at all

<sup>13</sup> S. Simic, *Health Care and the Health Status of the Population in the Federal Republic of Serbia*, 2002; Statistical Yearbook of Yugoslavia, 2001

per student fell from 554 USD to 148 USD. Share of GDP expenditures on education was reduced to the level of 3% in 2000<sup>14</sup>. This situation has resulted in a large number of negative consequences in the field of education: lower quality of teaching, poor incentives for teachers due to low salaries, etc. At the same time, the number of children failing to complete elementary (compulsory) and secondary schools has increased.

The reduction in GDP and wages contributed to a substantial decline in the standard of living and real incomes and a significant increase of unemployment. According to official data of the Labour Market Bureau of Republic of Serbia for 2001, the registered number of **unemployed** was 767.509, giving an unemployment rate 26,8 percent<sup>15</sup>. During the past decade the total number of employed declined at a much slower pace than the real GDP and stood at 2,101,020 people at the end of year 2001<sup>16</sup>. This gave rise to hidden unemployment (the difference between the number of actually employed and the necessary number of employed). According to estimates from 2001 there were approximately 640,000 employees within this category.<sup>17</sup>

On the other hand, if one bears in mind the size of the grey economy it can be noted that employment is higher and unemployment lower in comparison with the statistical data. The total number of people engaged in grey economy activities was estimated to be at least 1,000,000 people<sup>18</sup>.

This situation on the labour market generated drastic impoverishment and social inequality. State support available to vulnerable groups through social protection programmes was negligible in comparison with the number of recipients. Even though important humanitarian aid was available to the most vulnerable part of the population it had only a limited impact due to the size of the needs.

In addition, levels of poverty have been aggravated by 600,000 **refugees and displaced persons**. Among this population the majority are vulnerable due to inadequate housing (only 18% of registered refugees and 7,6% IDPs has its own accommodation) and a much higher unemployment rate than the local population. Around 20,114 refugees and 11,486 IDPs accommodated in collective centres represent an extremely vulnerable part of this group.<sup>19</sup> Among this extremely poor section of the population, living, hygienic and sanitary conditions are the worst and economic and social cases (the unemployed, the elderly, single parents, orphans and those who are unable to care for themselves) are concentrated.<sup>20</sup>

In the first half of 2000, according to the national poverty criteria, approximately one third of the **population in Serbia** (2.8 million) was considered poor, owing to the fact that the average income was less than US \$30 a month. Of that, 18.2% of the population (1.4

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<sup>14</sup> M. Dinkic, "Economic aspects of education in Serbia", HDR 2001, (draft version)

<sup>15</sup> Without agriculture sector

<sup>16</sup> M. Dinkic, Labour Market, HDR 2001, (draft version)

<sup>17</sup> M. Dinkic, *Labour Market*, 2002

<sup>18</sup> G. Krstic et.al, *The Grey Economy Reintegration and Private Sector Development in Serbia*, Economics Institute, Belgrade, 2001

<sup>19</sup> UNHCR and ICRC data, 2001

<sup>20</sup> UNHCR and the ICRC data.

million) lived in absolute poverty, their monthly income being less than US \$20 on average (table 1, Annex).<sup>21</sup>

The substantial increase in poverty occurred in the past decade (figure 1). In the year of 2000, the number of the poor more than doubled in comparison with 1990. In the past decade, the poverty index was higher only in the hyper-inflationary year of 1993 in relation to 2000. Figure 1 also indicates the negative correlation between the changes in the GDP and the increase of the poverty index.

The poor needed increasingly higher incomes in order to only attain the poverty line. Thus, 3.1 percent of GDP was needed in 2000 to bring the income of the poor to the poverty line provided that the social welfare of the poor was perfectly targeted (table 2, Annex). This is much more than in 1990, when the poverty gap was 1 percent of GDP, which was much higher at the time.

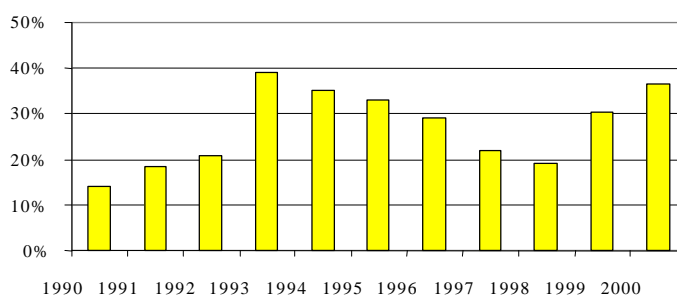


Figure 1: Poverty according to national criteria 1990 – 2000<sup>22</sup>

The categories of the population that were most susceptible to the poverty threat include:

1. Urban population, which during the intensification of the economic crisis suffered more from the fall in living standards and the spread of poverty than rural population (table 4, Annex). Although there is a considerable difference in poverty incidence between these two categories of population (39.7 percent in relation to 29.4 percent), both lacked approximately the same quantity of income in order to reach the poverty line.
2. Households with three or more dependent members had a 51.4 percent poverty index according to the standard poverty line, and a 29.9 percent index in the relation to the of absolute poverty line.
3. Households with children and a total of four or more members faced a 49,2 percent probability of falling below the poverty line and a 28.1 percent below the absolute poverty line.
4. Among the youngest (children up to the age of 18), 46 percent were poor, while a quarter lived in absolute poverty.

<sup>21</sup> The poverty analysis was done by using the household income from the Household Budget Survey (HBS) as the main aggregate for measurement of poverty and the poverty line. The FBS consumer basket was used as the higher poverty line (30 US\$ a month), whereas the World Food Programme (WFP) represents the absolute poverty line.

<sup>22</sup> For the period of 1990-1999 according to the SMMRI (Strategic Marketing and Media Research Institute), on the basis of the HBS (household budget survey) for Serbia (Bogicevic et al., 2002).

5. Households where the head was unemployed faced the highest probability of falling below both the standard (55.1 percent) and the absolute (41.7 percent) poverty line.
6. Population in households whose head was an industrial worker saw a poverty index of 45.5 percent and index of absolute poverty of 24.7 percent).<sup>23</sup>

The low and relatively stable Gini coefficient (0,28 in 2000.) for most of the ten-year period shows that the decrease in the real income of the population is a much more important factor in explaining the increase of poverty than is the increase in the income dispersion.<sup>24</sup>

The results of empirical research show that the main survival strategies of households in Serbia in the year 2000 were the reduction of needs, subsistence economy, a decrease in savings or sale of property, as well as an increase in grey economy activities.<sup>25</sup>

The official household budget survey does not include refugees and internally displaced persons. In addition, the survey does not include data on specific vulnerable groups such as Roma population, disabled persons etc.

Although the presented poverty profile shows the main aspects of poverty in Serbia, there is insufficient data on the regional distribution of poverty. However, there is no doubt that poverty is much higher in some regions as compared to others. The available data are also inconclusive regarding the effect of social exclusion on poverty (data does not include access to education and/or health services for specific groups - refugees, Roma, disabled, single mothers, rural women, elderly and other vulnerable groups).

Data on regional distribution of poverty as well as data on specific vulnerable groups should be tackled by an additional poverty survey that will give more specific information on the extent and nature of poverty in Serbia.

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<sup>23</sup> Due to the fact that the HBS does not contain data on the education of household members, classification of occupations can serve as a substitute for data on education.

<sup>24</sup> B.Bogicevic, G. Krstic and B. Mijatovic, *Poverty in Serbia and Government Support to the Poor*, Center for Liberal Democratic Studies, 2002

<sup>25</sup> According to the grey economy survey of 2000, at least 30% of the economically active population was involved in activities of the grey economy, with monthly incomes that were higher than the ones in the regular economy.

### 3. MACROECONOMIC FRAMEWORK

- The macroeconomic framework for three year period (2002-2005)<sup>26</sup> consists of the following main policy areas: fiscal transparency; improvement of tax system efficiency and modernizing of tax administration; public expenditure strengthening; pension and health system reform and further trade regime liberalization.
- In 2001 a substantial progress toward macroeconomic stabilization and price and trade liberalization has been achieved. Inflation during 2001 declined by two-thirds to 39 percent by the year-end (core inflation, due to administered prices adjusting, is estimated at 15 percent). Real GDP grew by an estimated 5.5 percent in 2001. The foreign exchange reserves of the NBY more than doubled to US\$1.2 billion (2.6 months of projected imports of goods and services) by end-2001, while the exchange rate became stable and the YUD internally convertible. The current account deficit (before grants), estimated at US\$ 1.1 billion in 2001 (10.2 percent of GDP), was lower than originally projected owing mainly to buoyant inflows of remittances. The fiscal deficit was contained to an estimated 1.22 percent of GDP in 2001, against an original target of 6.1 percent of GDP, as a result of revenue over performance as well as spending compression.

Structural reforms have generally proceeded at a fast pace. The closure in early January 2002 of the four biggest insolvent banks represented an important step toward building a healthy banking system. In addition, a promising start to the privatization program began in late December 2001, with the sale of three cement companies to foreign investors for a total amount of US\$140 million. Prospects for external sustainability were enhanced by the Paris Club decision to reduce the NPV of debt to official bilateral creditors by 66 percent. In May 2002, the Yugoslav Dinar became externally convertible.

- The economic policy objectives for 2002-2005, are the continuation of the firm implementation of macroeconomic and structural reform policies. Real GDP is projected to grow by 4 percent in 2002, while the medium-term growth rates are expected to increase to about 5 percent as a result of the implementation of reforms and a projected rise in the level and efficiency of investment, both foreign and domestic. The projected growth rate and macroeconomic stability are partly based on foreign financing.

Inflation is targeted to 20 percent by end-2002 (10 percent would correspond to a core inflation rate accounting for further large adjustments in administered prices); 12 percent by end-2003; and 8 percent by end-2004. Monetary policy will remain tight. The exchange rate will be monitored closely and exchange rate policy will be assessed regularly with a view to safeguarding competitiveness. The foreign exchange market will be further liberalized.

The current account deficit is expected to widen to US\$1.6 billion (12.9 percent of GDP) in 2002 reflecting resumption in external debt service as well as higher project-related imports. In 2002, the current account deficit will be financed largely by official

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<sup>26</sup> The framework has been positively appraised by the International Financial Institutions.

grants and loans that have already been pledged. For 2003-05, besides grants and concessional loans, FDI inflows will play an increasing role as the privatization program and other economic reforms reach an advanced stage.

Most of the remaining trade barriers will be removed during the mid-term period. In the areas of trade in services and foreign investment, a liberal regime will be maintained.

For the increase of direct foreign investments and mobilization of domestic savings it is essential to create an attractive business environment. This, inter alia, includes removing the existing trade barriers, establishing an effective and transparent financial sector, implementation of an anti-corruption law, full protection of private property and the rule of law. Good governance and public sector reform are also needed.

For attracting foreign investment and creating new jobs, it is also essential that concessional loans be used for modernising key infrastructural sectors (electricity, highways, railroad, airports...). An emphasis on SMEs and agriculture are also important not only as the main engines for growth but also as coping mechanisms for the poor.

Fiscal policy over the medium term will aim to support economic recovery and reform while ensuring progress toward further disinflation and fiscal sustainability, as well as the reintegration of the grey economy. The overall expenditure/GDP ratio - which is projected to reach 48.5 percent in 2002 - will be targeted to decline by about 3 percent of GDP over the next 3 years period, although allowances will be made for increased debt servicing and capital spending. Thus, the fiscal deficit will remain high, mainly owing to the investment needs of the country's dilapidated infrastructure, external debt service requirements, and the importance of maintaining broad support for the reform through an adequate social safety net. Governments will embark on a major overhaul of subsidies, the civil service, healthcare, pensions, and other social benefits. On the revenue side, the policy effort will focus on improving tax administration to widen the tax base and, to the extent permitted by the fiscal situation, lower tax rates. The deficit will be financed mostly by foreign grants and concession loans, as well as projected privatization receipts.

Implementation of PRSP implies higher public expenditure: first, for classic (passive) measures targeting the »regular poor« and dependent categories; second, for financing the Social Programme aimed at poverty prevention, for a large number of redundant workers in the large socially-owned enterprises that will be privatized through a process of restructuring; third, for supporting the Republic Labour Bureau in creating job opportunities, through active measures (training and re-training, ...) for newly unemployed persons without regular incomes. Bearing in mind that the fiscal burden is already too high for the economy, and that fiscal deficit is already to a large extent financed to by concessional loans, there are only two ways for financing the full PRSP implementation: first, through improving the revenue and expenditure structure of the budget and by improving public expenditure management; second, by additional foreign funds, mainly through grants. It is essential that the full PRSP clearly delineates all priorities, however it is also evident that some trade-offs will have to be made.

- Transferring the grey economy into legal channels is one of the most important and greatest challenges of economic reform in Serbia and is also a key element in the fight against poverty. The existence of a large grey economy that does not pay taxes leads to a deep inequality of tax burdens and is an important source of inequality in income distribution. For the formalisation of the grey economy, the first step must be a comprehensive tax administration reform coupled with the strengthening of the budget inspection units in the public administration. Furthermore, there is a need to change the structure of fiscal revenues and rates in order to stimulate the formalisation of economic activities. A key step in this direction will be the introduction of VAT planned for January 1, 2004.

Further structural reforms in the fiscal area will involve tax policy, tax administration and public expenditure and social spending management. In light of the wide-ranging tax reforms adopted last year, the introduction of a VAT is the key remaining tax policy reform in Serbia.

- Structural reforms followed by development and sustainable economic growth are the main economic goals. Rapid and sustainable growth and socio-economic development, generating higher employment and job creation and rising wages and incomes, is the main instrument for improving the living standards of the population and reducing poverty. Although the achievement of sustainable economic growth is the ultimate goal, poverty reduction measures are still required. Hence, especially throughout the transitional period, economic policy besides being development and growth oriented should also be redistribution and pro-poor oriented.

## 4. EXISTING STRATEGIES, POLICIES AND PROGRAMMES TO REDUCE POVERTY

### Introduction

Due to the high priority the new government has given to the fight against poverty,<sup>27</sup> a number of actions have been taken to prepare the ground for a wide number of reforms that will have a positive impact on poverty. These actions are based on the belief that poverty must be reduced through the growth and diversification of the economy, provision of gainful employment to larger sections of the population and establishment of a basis for sustainable funding of the necessary social protection systems. As a result economic reforms are a priority and will in future be the core of the Government strategies to fight poverty. The strong belief in the importance of establishing an efficient market economy and economic growth is partly based on an acknowledgement that Serbia is an atypical country in IDA context and that the main cause of poverty in Serbia is not inequality and social exclusion.

Necessary preconditions for successful recovery of economic activities in Serbia are the creation of a stimulating environment and removal of barriers for both existing and newly established companies and foreign direct investments. This will be achieved through a package of macroeconomic policy measures and regulatory reforms (deregulation, modification of the legislative framework and creation of new regulations).

The Government of Serbia has moved swiftly and has initiated a number of key structural reforms, notably streamlining the price, exchange, trade, and tax regimes; liberalizing the labour market; reintegrating grey economy and establishing new legal and institutional frameworks to guide the restructuring of the economy.

With the aim of better assessing and monitoring the standard of living of the population, in January 2002, the Government has established a Committee for Monitoring the Standard of Living of the Population. Two consumer basket indicators have been established for monitoring purposes: the minimum consumer basket and the average consumer basket. A methodology for monthly monitoring, analysis and reporting on the trends in the living standards has been functioning since January 2002.

However, existing strategies, policies and programmes to reduce poverty are still fragmented. It is expected that the process of developing and implementing the full PRSP will lead to a coordinated approach linking ministries and other governmental bodies and will also, initiate and institutionalize a broad consultative process of all the relevant stakeholders.

### **Privatization and SME development in Serbia: instruments for poverty reduction**

Bearing in mind the importance of development of entrepreneurship and the private sector for economic growth, the privatization process is the pre-requisite for further development and therefore poverty reduction. The privatization process will contribute not only to better governance and management performance, but also to foreign investment and to overall economic growth. Although in the short term privatization will generate a large number of redundant workers within privatized companies, at the same time it will establish a sound

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<sup>27</sup> "Reform Agenda of Serbia" – Strategy document prepared by Government for the Donor Conference, June 2001

basis for their future growth and development. Future growth will generate new job creation both within privatized companies and new companies established in order to cooperate with them.

**The privatization process** started in 2001 in accordance with the new Privatization Law, the Law on the Privatization Agency and the Law on the Share Fund adopted in June 2001. A promising start of the privatization program took place in late December 2001, with the sale of three cement companies. The process has been successfully followed by the privatization of several enterprises by auction. It is expected that some 27 large enterprises will be privatized through a tender procedure by the end of 2002. So far, around 60 enterprises have started a process of privatization by auction and it is expected that several hundred more will join them in 2002. In addition, around 40 large, non-viable socially-owned enterprises are to be privatized through a process of restructuring.

Recognizing **the SME sector** as one of the most important generators of accelerated economic growth, new employment opportunities, GDP increase and improved living standards and bearing in mind the specific problems of this segment of economy, the Ministry for Privatization and the Republic Agency for SME Development have created a concrete plan of affirmative measures directed towards development of this sector. This plan involves the development of network of institutions whose goal is to support the development of entrepreneurship and SMEs as well as the development of programs of financial and non-financial support. Guidelines for the future development of this sector will be determined in the Strategy of Entrepreneurship and SME Development which is currently in the final phase of elaboration.

### **Poverty Alleviation – Reducing Registered and Hidden Unemployment**

Equitable economic growth is one of the key priorities of the Government of Serbia. A precondition to achieve this is an effective and liberal labour market which will support the creation of new sustainable jobs and contribute towards the fight against the grey economy. In order to achieve this, a **new Labour Law** was adopted in harmony with the laws of the European Union and international conventions. The Government of Serbia is currently undertaking measures towards encouraging employers to fully legalize the activities of their companies and thus combat the grey economy and increase the amount of tax and contributions to the budget<sup>28</sup>.

The unfavourable effect of the above mentioned process is the growth of the registered unemployed (the expected number of people who will lose their jobs in 2002 is approximately 100,000 including those jobs lost in the process of bank liquidation). The Ministry of Labour and Employment has adopted a **Social Programme** for alleviation of the effects of these redundancies. The Program outlines: identification of redundant workers; the rights of redundant workers and measures for their employment; the funds and resources for the realisation of the Program and conditions and methods for use of these resources. There are two main components of the program: passive (severance payment, unemployment benefit) and active (retraining of personnel, self-employment) measures. These are being exercised in the process of privatisation and restructuring of enterprises and liquidation of banks. The Ministry of Labour and Employment has

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<sup>28</sup> The grey economy in 1997 is estimated to have accounted for an additional 34,5 % of GDP. The total number of people engaged in grey economy was estimated to be at least 1,000,000 people

established a Transition Fund aimed to finance the above mentioned measures with funds both from the Republic budget and international assistance. Unfortunately until now, 80 percent of people who have been made redundant have chosen compensation (passive measures) without any incentives for the creation of new jobs. Under the programme specific measures and benefits are included for vulnerable groups (workers close to retirement, families where two or more members will lose their jobs, etc).

Following the initiative by the Ministry of Labour and Employment, the **Employment Council** of the Republic of Serbia was established. The Council's role is to propose: a national employment policy and strategy; legal reform in the field of employment and harmonization with international legislation and standards; labour market reforms and labour market and active employment policies and programmes. In addition, for particularly vulnerable categories the council will propose analyses and suggest measures.

### **Education as a Mechanism for Poverty Alleviation**

Education is one of the priority areas for the development of Serbia and facilitation of its economic recovery, creation of a democratic society and re-integration into the international community. Also, since it is proven that giving children access to education and integrated package of basic social services of good quality is one of the most effective and efficient steps in combating poverty the government will prioritise these types of activities.

Through education reforms two important issues must be addressed:

- Significant improvements in the existing skill base are required having in mind that unskilled workers constitute a third of the total number of registered unemployed<sup>29</sup>.
- Reverse the last decade alarming trend of decrease in the percentage of pupils completing primary and secondary education by improving access to education.<sup>30</sup>

The aims of the reformed education system with regard to the poverty reduction have been identified as:

- Reorganisation of **Vocational Education and Training (VET)** and Adult Education (training of those who can help themselves reintegrate, providing a second chance for those who have dropped out of formal education).
- Restructuring of the education system to ensure greater efficiency and more relevant and sustainable learning outcomes (acquisition transferable knowledge, analysis skills, decision-making, problem-solving and effective communication skills).
- Improvement of amenities for school pupils and university students and of the quality of education and increase of scholarships for students from low-income families.
- Creation of possibilities for encouraging especially vulnerable groups into mainstream schooling (Roma, children with special needs)

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<sup>29</sup> M. Dinkic, Labour Market, 2002

<sup>30</sup> *Breaking with the Past*, WB, 2001

Such reform requires a focus on improving the quality of education at all levels as well as coordination between the education and economic sectors to ensure that education meets social and economic needs (especially in respect of VET, Higher Education and Adult Education, training/retraining of the unemployed or recently redundant). In line with the reform of education system, the Amendments to the Law on Primary Schools and the Amendment to the Law on Secondary Schools were adopted in May 2002. The main aims of the Amendments are decentralization and reorganization of governance in education making it more sensitive to local needs.

### **Immediate Challenges in the Health Sector**

Evidence from countries that have already undergone transition indicates that the transition period has a dramatic impact upon living standards and has immediate adverse effects on the health status of a significant portion of the population<sup>31</sup>. Economic distress and poverty are coupled with bad health and those most affected will be the poor and other vulnerable groups.

The implementation of the '**Health Policy of Serbia**' that was adopted by the Government on February 1<sup>st</sup> 2002 is a key task for the Ministry of Health. The main challenge is to ensure a basic level of access to good quality care despite a decade of neglect and under-investment. The impact of health care reform on vulnerable groups must be monitored and any negative consequences limited wherever possible.

Until the systematic implementation of health care reforms can take effect, public health care services will continue to be increasingly inaccessible to the vulnerable elements of society. The Government has therefore identified the following immediate priorities:

- **Improved access to appropriate drugs.** The Government has improved availability and distribution of drugs and developed better and more cost effective prescription procedures and approved essential drug list. Nevertheless, patients are still deprived of a number of essential drugs especially in hospitals. At the same time the price of certain types of drugs are very high and therefore inaccessible to certain economically disadvantaged groups.
- **Increasing the supply of medical consumables.** There is still a lack of consumables for basic diagnostics and surgery. Many of these are supplied by patients at their own expense which limits access to services for the poor segments of population.
- **Support to selected health institutions.** In the future, particular attention will also be given to those institutions providing services to the most vulnerable groups (children, adolescents, women and the elderly). It is also necessary to address the issue of financing health care for the refugee and IDP population.

Plans for the reform of the health sector include the **reform of financing mechanisms** to secure its sustainability. Existing mechanisms will be revised to allow some decentralisation. New procedures will be introduced to improve the effectiveness and efficiency of the service contracting process, including provision for private sector participation. A National Health Account system is being developed to enable health

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<sup>31</sup> *Health in Europe*, WHO Regional Publications, European Series N<sup>o</sup>56

officials and managers to monitor patients' financial contributions and public health expenditure. In addition, a national health investment plan will be developed.

The Ministry of Health is currently developing a **Health Master Plan** that will define the optimal use of human and physical resources with a specific focus on improving the quality of health care and physical condition of vulnerable social groups.

It is also clear that considerable rationalisation in the use of existing resources and continuous donor assistance will be necessary during the transition period.

### **Social Assistance to the Poor**

Both accumulated and new social problems pose a formidable challenge to Serbian society and the Government, which has the responsibility to guarantee basic civil, social, economic, and other rights and to create the necessary basis for an enabling economic and institutional framework.

During the year 2001, social welfare policy has undertaken the initial steps towards poverty alleviation. For the first time in ten years, all **regular social benefits** were paid. In order to reduce dependence on international relief, efforts were made to finance social assistance from the Government budget. In recognition, however, that budget funds were unlikely to be sufficient, a **One-off Payment Fund** was created in order to channel donor funds to cover social benefit arrears and one-off benefits to the most vulnerable groups. Arrears for all categories of social payments were between 26 and 36 months. During the previous year these arrears were paid and additional payments were made to families with children, the disabled and to pensioners on low incomes. Furthermore, a category of 'new poor' was identified. This included poor families that were excluded from the system of social assistance because the current law uses decentralized eligibility criteria. The 'new poor' received assistance via the donor supported One-off Payment Fund.

The Ministry **Working Group for Poverty Alleviation** established in 2001 has completed research, Poverty in Serbia and The governments support to the poor, based on available poverty studies and household budget survey data and formulated concrete proposals for short-term reform: a new definition of the poverty line (financial) and a poverty line index based on the cost of living. In addition to this, a Poverty Survey is currently ongoing and will serve as a key tool in the 2002 social welfare policy revision, creating a comprehensive poverty profile.

Policy changes in the family protection area have been formalised through the new **Law on Financial Support to Families with Children** adopted in April 2002. This new law separated demographic policy measures from social policy measures. The law introduced new, improved eligibility criteria for child allowances and unified criteria for the whole Republic of Serbia, resulting in improved targeting of poor families with children. The universal right to child allowance for the third child has been discontinued and indexation has been linked to living costs (as opposed to wages in the previous law) with the aim of providing sustainable financial support to poor families with children. An additional element of increased social protection is the option to apply for assistance as soon as it is required, without having to wait for a specific date in the year as was the case previously. For the especially vulnerable children, e.g. children without parental care and children with

development problems, the law prescribes additional rights. All these changes have been made within the existing budgetary framework and the indexation based on living costs will preserve the real value of the assistance provided while simultaneously decelerating the increase in overall expenditure in relation to GDP and budget growth in the following years.

Changes in **pension** legislation were introduced in December 2001; the new indexation based on a combination of living costs and wages, the extension of retirement age and introduction of one minimum pension. These measures will ensure sustainable pension funding and regular payment of pensions which is especially important for the poor pensioners. In the end of 2002 further changes in restructuring of the pay-as-you-go system (first pillar) and introducing of voluntary pensions scheme (third pillar) is expected.

- In addition to legislative changes, measures have been implemented for improving **control of contribution payments** and for finding **systemic solutions** for preventing evasion of contribution payments. The first steps have been taken towards the reorganization of the pension registration and contribution monitoring system.
- Policy changes in the area of social services will also contribute to the overall poverty alleviation strategy. A set of reform projects are under way for developing foster care, transforming social care institutions, implementing new professional standards in social institutions and introducing integrated social care at the local level. A new Family Law is currently being prepared that will provide better protection, particularly for vulnerable groups.

### **Social Housing**

The social events of the last decade and the economic situation following uncontrolled inflation have resulted in a multitude of social and economic problems linked to the housing crisis. In order to solve these problems, in 2002 the Government of Serbia adopted in 2002 an Outline of the National Housing Policy of the Republic of Serbia, including an action plan to establish a basis for the complete NHP.

### **National Strategy for Solving the Problems of Refugees and IDPs**

There are around 600,000 registered refugees and internally displaced persons (IDPs) in Serbia today. In comparison to other countries in the region, Serbia hosts the largest number of refugees.

In adopting the National Strategy, the Government confirms its firm determination to offer assistance and concrete solutions to the refugees and IDPs. A comprehensive and transparent policy will also assist the IDP and refugee population to make their own decisions regarding the future: to integrate into local communities or to return to their homes in Kosovo and Metohija, Croatia and Bosnia - Herzegovina.

The basic aim of local integration is to help refugees achieve self-sufficiency and a financial and social position equivalent to other citizens in the country. Therefore, the National Strategy proposes institutional and legal solutions, mechanisms and measures designed to resolve a variety of refugee and IDP problems.

Local integration of refugees and IDPs encompasses three main areas: the gradual closing of collective centres, housing and employment. The main aim of the National Strategy is to reduce and gradually close collective centres providing alternative, durable solutions for this group, being the most vulnerable among the refugee population. In the housing area, the emphasis is on social housing and programmes for extremely vulnerable refugees requiring support from social welfare/health care institutions. Regarding employment, the priority is to ensure funds for employment of the extremely vulnerable refugees through in-kind grants, scholarships and re-training programmes.

The full PRSP and the National Strategy will be linked in the sense that poor refugees and IDPs will be fully incorporated in programmes foreseen under PRSP.

## 5. INSTITUTIONAL ARRANGEMENTS AND THE PARTICIPATORY/CONSULTATIVE PROCESS

### A. Institutional arrangements, organizational structure and the consultation/participatory process in the preparation of the full PRSP

One of the key requirements for successful design of the full PRSP and an efficient consultation/preparatory process in preparation of full PRSP process is a clear and well defined organizational structure at national and local levels that is strongly supported by the Prime Minister, the Serbian Government and the wider civil society. At the same time, the PRSP process needs to remain open and flexible in order to develop qualitative consultations between all relevant stakeholders including central and local governments, labours unions, parliamentarians, the wider civil society (including the representatives of the poor), international development partners, etc.

The suggested institutional and organizational arrangements for carrying out the PRSP preparation have an open structure and are as follows:

1. **An INTER - MINISTERIAL STEERING COMMITTEE coordinated by the Ministry of Social Affairs and chaired by the Prime Minister** will be responsible for policy guidance and strategic decision-making regarding the full PRSP.

The Inter-ministerial Committee will consist of **Ministers** from the Ministries of Social Affairs, Labour and Employment, Education, Health, Economy and Privatization, International Economic Relations, Trade, Tourism and Services, Finance and Economy. In addition, other ministries e.g. the Ministry of Public Administration and Local Government, Ministry of Agriculture, etc. will be also involved when required.

Within the Ministry of Social Affairs, a new **Management Unit** will be established in order to coordinate the Inter-ministerial Steering Committee. This Unit will be responsible for the programme and organizational matters regarding the preparation of the full PRSP. The Management Unit will provide technical support to the Inter-ministerial Committee and will coordinate the consultation process with civil society and local communities.

The Inter-ministerial Steering Committee will make strategic decisions regarding the preparation of the full PRSP preparation and will formulate guidelines for its elaboration. The steering committee for the PRSP will build upon and be connected to the SC for Development and Aid co-ordination that was established in connection with Donor conference 2001.

2. A broad based **ADVISORY BOARD** will be established to coordinate, consolidate and present the recommendations and conclusions given by the different advisory committees regarding the preparation of the full PRSP. This Board will meet regularly throughout the process and communicate on a regular basis with the **Inter-ministerial Steering Committee** and the **Expert task force**. This Board will also play a crucial role in the development of monitoring strategies and procedures. The Advisory Board will consist of representatives of five Advisory Committees and experts. The Advisory Board will coordinate the consultative/participatory process with five Advisory Committees:

- **Parliamentarian Advisory Committee** will be comprised of representatives of a number of specific committees such as, the Committee for Social Issues, Development and Environment, Health, Education, etc. Through field work, the Parliamentarian Advisory Committee will meet regularly with society and with vulnerable groups in particular. The Parliamentary Advisory committee will thus be the vehicle for the participatory element of the process through ongoing interaction and consultation with the public and civil society organizations.
- **The Local Government Advisory Committee** will consist of local community representatives with interaction and consultancy on daily basis at the local level, this Committee will channel local level PRSP action into the design of the full PRSP
- **The Inter - Ministry Advisory Committee** will consist of senior representatives from the ministries included in the preparation and implementation of the full PRSP. Through the simultaneous consultative process this Committee will coordinate activities with local authorities.
- **The International Development Partners' Advisory Committee** will consist of representatives of the World Bank, UNDP and all donors that have expressed interest in contributing to the elaboration of the full PRSP. In addition to financial support, expertise in the development and monitoring of the full PRSP process will be very valuable.
- **The Civil Society Advisory Committee** will consist of several sectoral advisory boards, composed of respective national/international actors. The Civil Society Advisory Committee will establish working groups for particular problems. Individuals can be included in all phases of the process. The communication among civil society structures will be a two-way process (top-down and bottom-up). The activities of the structures will be organized according to a territorial principle. Working groups established by associations of citizens will select representatives who will articulate the interest of all categories of the poor and will communicate their recommendations to the Civil Society Advisory Committee. The civil society will elect the representatives to be delegated to the Civil Society Advisory Committee.

The sectoral advisory boards will regularly meet within the Civil Society Advisory Board to exchange views and information on the 'sectoral' achievements and constraints and to define and coordinate future roles and activities.

The model suggested above outlining the interaction and composition of the Parliamentary, Local Government, International Development Partners and Civil Society Advisory Boards is not pre-determined and the establishment, constitution and modus operandi lies with the individual boards and their members.

The Advisory committees will also provide inputs to the sector / expert working groups that will be established by the **Expert Task Force** to facilitate the discussions and drafting of different specific policies and public actions.

3. For the immediate elaboration of the full PRSP a professional **EXPERT TASK FORCE (ETF)**, consisting of local experts and professionals supported by international consultants, will be established and supervised by the Advisory Board. The main task of this Expert Task Force is to design a first draft of the full PRSP, based on consultations with and instructions from the Advisory Board and the above mentioned consultative process, using the capacities of the governmental sector, civil society, academic bodies and think tanks and with the support of international organizations. The Expert Task Force will suggest necessary institutional and legislative changes for implementing the full PRSP, calculating financial needs and resource gaps, organizing training, media campaigns etc. The Expert Task Force will establish **(technical) working groups** on specific topics regarding poverty reduction and sector policies. These working groups will closely cooperate with civil society, including experts from various fields in the organization of round tables, seminars and consultative meetings. Through these activities, the Expert Task Force will be included in the ongoing consultative process with the Advisory Committees.

Within the Advisory Board, ongoing consultation/participatory process will take place among the five Advisory Committees and therefore among all participants (line ministries, local governments, parliamentarians, civil society, the private sector and donor community). At the same time, the Advisory Board will establish links between the state and civil society as the focal point for the Inter-ministerial Steering committee and the Advisory Committees.

This basic institutional arrangement will enable the preparation of an open, multidimensional PRSP in close cooperation between the state and civil society. In the implementation phase of the full PRSP a similar institutional approach can be used to ensure efficient implementation and monitoring.

A Communication/information strategy will be developed through the PRSP process and used for dissemination of information, providing regular information to the general public, especially the poor and marginalized groups.

The proposed institutional arrangements might prove too ambitious. However, since the PRSP process is completely new, it will undoubtedly be a learning process for all participants.

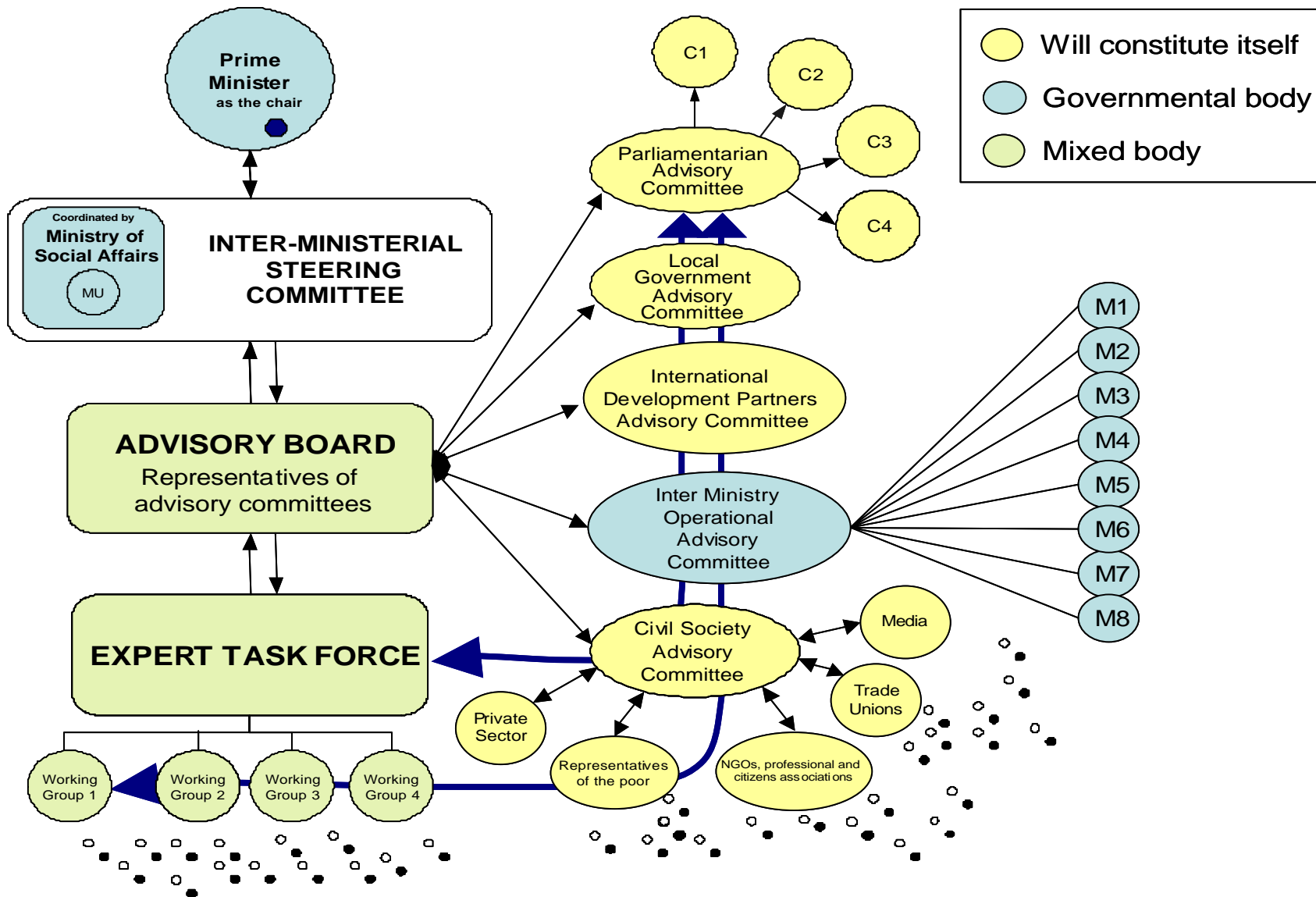
## **B. Preparation of the PRSP through participatory process**

To ensure the preparation of the PRSP is a participatory process, the following steps will be taken by the government.

- Key government ministries and institutions of importance for developing full PRSP will be selected and their roles and responsibilities clearly defined. A series of meetings will be initiated and carried out throughout the PRSP process, to build ownership and consensus among lead and line ministries.
- Reputable national/international organizations/individuals will be selected to carry out a comprehensive stakeholder analysis together with representative of the civil society

and identify a set of feasible mechanisms for consultation, benchmark indicators and an effective monitoring system. The organizations will define clear selection criteria for participants in the participatory process and will also identify criteria to measure the overall impact of the consultation activities on the PRSP process.

- A management unit will be established within the coordinating PRSP ministry and key contacts and communication channels will be identified to ensure good information flow between all stakeholders including: a) line ministries, b) local governments and parliamentarians c) civil society and media e) the World Bank and other donors, etc.
- The government will seek to establish local structures composed of representatives of local government, civil society, media, and the private sector to facilitate their involvement in the design of the full PRS and to define institutional mechanisms and arrangements.
- Methodology will be developed to determine how (for example through workshops, seminars, focus groups, public debates) local level PRSP action will feed into the design of the PRSP at national level, and also how local associations (the poor, elderly, disabled, refugees, IDPs, women, Roma) will participate in design of the PRSP process.
- Communication strategies will be defined to explain the various national level activities to local communities.
- Public information campaigns will be conducted at national and local levels to inform the public about the PRSP. Civil society groups and representatives of the poor will be a priority target of the campaign to ensure that they are better informed and can better articulate their views and interests.
- Several national level workshops will be held where representatives of local and national government, academic and research institutions, civil society organizations, associations of the poor, and the business and donor community will attend to provide information, share knowledge and build ownership of the PRSP process.
- National and local level research and statistical capacities will be developed to ensure more accurate poverty related data. Based on poverty analyses, state projects that have the highest poverty reduction impact will be selected and conducted jointly by different stakeholders at both national and local level.
- A clear schedule for the consultation process and for the input of findings into the full PRSP document will be established.
- Monitoring mechanisms at national and local levels will be developed to evaluate the effectiveness and overall impact of the consultation process on the PRSP document.



## 6. BRIEF INVENTORY OF CAPACITY NEEDS AND INFORMATION GAPS

### 6.1. Existing institutional arrangements and capacity gaps

#### Constraints:

- **Current public action for poverty reduction is fragmented and does not add up to a comprehensive and co-ordinated policy.**
  - The Ministry of Social Affairs provides social support to vulnerable groups primarily through passive measures.
  - Measures and support provided to the unemployed by the Republic Labour Market Bureau tend to perpetuate passivity among the unemployed.
  - Refugees and internally displaced persons (IDPs) are still to a high degree dependant on non-governmental humanitarian assistance.
  - The prevailing perception is that poverty reduction is a social sector issue, rather than a developmental problem related to economic, political and social structures.
  
- **The full PRSP will require extensive activity at local levels but the institutional and organizational capacity necessary to support the process is lacking.**

The well developed local level network of social welfare centres, affiliates of the Republic Labour Market Bureau and newly established network of Republic Agency for SMEs, needs to be further developed and better inter-linked in order to meet the requirements demanded by the PRSP process.

  - Links between national and local governments are relatively weak: consultations between the two are fragmented and micro-information and data on poverty is often disregarded as unimportant in the formulation of national policy.
  
- **The lack of experience in involving civil society** in the resolution of key economic, social and political problems. However, there have been positive examples of cooperation between NGOs and local authorities at the local level.
  - Cooperation between the state and civil society needs to be strengthened at national and local levels.
  - There is a lack of information flow between stakeholders at different levels.
  
- **The capacity of the Government/ministries to develop and implement the full PRSP is insufficient.** To large extent this is the reason for limited inter-sectoral and inter-ministerial cooperation necessary for the preparation and implementation of the full PRSP in the next 3 years period.
  - The Government has limited capacity available to facilitate the laid out bottom up process.
  - Appropriate communication channels do not exist to manage the consultative process between state and civil society required for the PRSP.
  - The government has limited experience in involving the civil society in the type of policy dialog required for the PRSP.
  - In some specific fields the government lacks the required expertise, especially in data and poverty statistics, but also in public administration reform, etc.
  - Some of the ministries that will be engaged in preparing and implementing the full PRSP lack expertise in introducing poverty aspects in their sectoral policies.

- **Limitations of Civil Society.** There is a lack of broad-based policy formulation skills and the level of information about governmental policy-making processes is limited.
- Links between different civil society sectors are limited: relations between local and national media are weak, as are links between the media and NGOs and CBOs. Professional associations are in most cases isolated, while trade unions rarely establish relations with other civil society organisations.
- NGOs often have weak capacities and limited knowledge about core issues such as poverty alleviation.
- Even when dealing with poverty at the local level, NGOs fail to sufficiently explore the role of the media in the fight against poverty reduction.
- The issue of NGO legitimacy remains unresolved, especially with regard to representation of the poor.

**For preparation and implementation of the full PRSP the following is needed:**

- A Focal point in the Cabinet of the Prime Minister
- A Special management unit exclusively responsible for full PRSP based within the Ministry of Social Affairs.
- Focal points in all ministries participating in the Steering Committee with responsibility for linking the activities of each ministry with the PRSP.
- Co-ordinators appointed at the local level to act as focal points for interaction with local authorities, civil society, private sector and donors.
- Extensive capacity development at local level is required in order to maximise the impact of PRSP.
- Local and international expertise.
- During the process of preparation of the full PRSP, training seminars and consultative meetings needs to be organised for employees of the Republic labour Agency, the Agency for SMEs, the Centres for Social Work, Statistical Agencies and relevant research institutions and the media in order to prepare for working groups, composed of governmental, academic and civil representatives who will hold regular consultations with different categories of the poor.
- A proactive, capable and representative civil society.

Due to the lack of institutional capacity there is a need for additional support in this area. Bearing in mind the mentioned budget limitations, international assistance would be essential for carrying out the full PRSP process efficiently.

**6.2. Statistic data – drawbacks and limitations**

The statistic data that can be most directly applied to the poverty analysis are Household Budget Survey (HBS) and Federal Bureau of Statistics (FBS) consumer basket data. As the HBS was designed more than 20 years ago and its conception has changed little since then, with the concept of consumer basket remaining unrevised for over 13 years, the survey has serious basic flaws and limitations.

The artificial synchronization of household income and household expenses precludes the inclusion of important information on income from the grey economy, data which is usually not reported but can be observed through expenditure.

Income and expenses are not recorded through registration in official diary. The consequent reliance on the memory or 'good will' records of the individuals surveyed casts doubt on the reliability of the recorded values and amounts.

Data on household members are insufficient. There is no data on education levels, as one of the main indicators of poverty as well as on individuals' engagement in the regular and grey economies.

Family income is presented together with social transfers (pensions not included) which preclude precise targeting of aid to the most vulnerable.

The list of durable consumer goods is out dated and contains some items that are very rarely used today, while omitting more modern durable consumer goods as useful potential indicators of poverty.

In addition to the drawbacks noted above on the contents of the questionnaire, the sample of this survey is extremely out dated as it is based on the population census done in 1991.

The basic flaw of the FBS consumer basket is its definition of the minimal consumer basket of food and beverage for a four-member household. The definition of the minimal needs for food in accordance with nutritional demands comprises a somewhat broader list of food and beverage articles than is necessary for the existence minimum. On the other hand, the basket definition does not contain expenses for clothing, providing minimal housing requirements, as well as elementary hygienic, health and educational needs. As a result alternative consumer baskets have been formulated, (for example, those developed by the World Food Program) which aim to redress the abovementioned flaws. However, none of the consumer baskets developed take into consideration regional differences in prices, a consequence of inadequate price statistics.

Alternative statistic data also fail to show the real picture of the living standards of the Serbian population, as they mostly exclude the formal private sector. GDP per capita as one of the main aggregates for measuring living standards is based on the GDP which is still calculated according to the old concept of material production which does not encompass services. In addition, monthly data on earnings do not include the private sector. The Labour Force Survey is the only relevant source of the data on earnings in all sectors. The Labour Survey is only conducted on an annual basis and the HBS on quarterly basis. Moreover, both surveys need improvements in questionnaire content and sample, particularly as analysis of the labour market is essential for poverty analysis. The statistics of retail prices and living costs is based on an old methodology using out dated weighting system. Harmonization of the weights of retail prices and living costs with EU standards will enable the calculation of the GDP according to the purchasing power parity (PPP). In sum, the whole system of statistics has to be radically over hauled, not only in terms of methodology, but also with regard to a more user-friendly approach, particularly for individual data resulting from surveys.

The first step towards providing the data necessary for poverty analysis was made by the Ministry of Social Affairs which initiated a pilot survey on household poverty.<sup>32</sup> The pilot survey will encompass a sample of 7,000 households in Serbia and will be repeated with a secondary survey sample of 3,500 households. The survey will be representative on the territories of Belgrade, Vojvodina and Central Serbia, and it will be conducted in urban and rural areas in all three regions. The pilot is intended to provide a template for future official statistical surveys.<sup>33</sup>

Civil society already has some experience in carrying out research with regard to vulnerability of different categories of poor. Their research is often of local character and can be valuable in providing a better geographical identification of the poor. The experience of the civil society organizations at the local level will also be valuable for identifying adequate representatives of the poor to be included in the PRSP process. In addition, because of their mobility and familiarity with the local communities, civil society organizations can also assist in updating data and subsequently in the monitoring process of the PRSP.

## 7. TIMELINE FOR COMPLETION OF THE FULL PRSP

1. The ongoing household survey on poverty will enable more qualitative evaluation of the level and causes of poverty in Serbia. The Survey will be representative of the territories of Belgrade, Vojvodina and Central Serbia, and on the urban and rural level in all three regions. The Survey will also serve as a template for future official surveys of poverty statistics. Even though data from the survey will be ready in August initial analysis will not be available before the end of September beginning of October.

**Responsibility:** The Ministry of Social Affairs and Task Force

**Deadline:** Initial analysis available end September August 2002

2. Establishment of institutional arrangements for the full PRSP preparation. It is expected that both the Government of Serbia and all other PRSP stakeholders will establish adequate institutional arrangements with respect to the consultative/participatory process.

**Responsibility:** Government of Serbia, civil society

**Deadline:** September 2002

3. On the basis of poverty diagnosis and a re-adjusted macroeconomic framework, strategic goals and main directions of public action for poverty reduction will be defined along the following lines:

- a) Economic development generating new employment and enabling higher private and public consumption;
- b) Preventive action against further poverty created by ongoing economic transition;
- c) Better targeting of poverty groups for efficient implementation of passive social policy measures.

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<sup>32</sup> The survey is being financed by the Dutch Trust Fund in cooperation with the WB, and conducted by the SMMRI.

<sup>33</sup> The survey will be used for defining a new poverty line for Serbia

The process of policy and public action definition will have to go through several rounds of consultations and discussions.

**Responsibility:** Steering Committee and Advisory Board through consultation with primary participatory bodies / advisory committees

**Deadline:** February 2002

4. Preparation of the first version of the full PRSP

- a) determination of priorities and operative goals for poverty reduction;
- b) definition of institutional and legal frameworks, instruments and measures, fiscal capabilities and external financial support;
- c) Development of monitoring and evaluation methodology for the implementation of the full PRSP.

In this phase, the consultative and participatory process with all stakeholders will be intensified. The PRSP must be 'alive' and this will only be possible with full and constant interaction between all state institutions, civil society and academic institutions.

**Responsibility:** Steering Committee, Advisory Board, Expert Task Force

**Deadline:** March 2003

5. The first version of the full PRSP will be assessed by the Advisory Board and returned to the Expert Task Force for revision on the basis of comments and suggestions from all participants. In this phase, consultation with, and the participation of all stakeholders, particularly the WB and donors, will be intensive. The revised version will be presented to Steering Committee and Prime Minister.

**Responsibility:** Steering Committee, Advisory Board, Expert Task Force

**Deadline:** April 2003

6. The final version of the full PRSP will be adopted by the Government of the Republic Serbia as a strategic document.

**Responsibility:** Government of Republic Serbia

**Deadline:** June 2003



# **ANNEXES**

## ANNEX 1 – Poverty indicators

**Table 1. Indicators of poverty in Serbia in the first half of the year 2000, in %**

	Poverty line		
	FBS consumer basket (8328 dinars)	WFP Consumer basket (5570 dinars)	50% of total income median (5281 dinars)
Poverty index*	36.5	18.2	10.1
Poverty gap**	3.1	0.9	0.4
Average income deficit***	25.4	22.7	20.4

Notes: The FBS consumer basket for four-member households was calculated into consumer units.

The WFP consumer basket is per capita. Household income in the first case was calculated by consumer units, and in the second case per capita. The third poverty line represents 50% of the median of total household income by consumer units.

\* The poverty index represents the percentage of the poor in the total population

\*\* The poverty gap represents the percentage of the GDP that is necessary for the income of the poor to be equal to the poverty line, assuming perfectly targeted social assistance for the poor.

\*\*\* The average income deficit represents the average deficit of the income of the poor as a percentage of the poverty line.

Source: Calculated on the basis of the Survey on Household Consumption, Federal Bureau of Statistics.

**Table 2. Poverty indicators according to the poverty line, in %**

	1990	1995	I-VI 2000
Poverty index	14.1	28.9	36.5
Poverty gap	1.0	4.1	3.1
Average income deficit	18.7	23.2	25.4
Gini coefficient	0.28	0.25	0.28

Note: Poverty indicators are presented in relation to the poverty line. The data for 1990 and 1995 applies to FRY according to A. Posarac: Human Development Report Yugoslavia (1997), and for the first half of 2000 the data applies to Serbia without Kosovo and Metohija. (Bogicevic et al., 2002)

**Table 3. Poverty by gender and social-economic status of the head of the household, %**

	Poverty line	
	FBS consumer basket	WFP consumer basket
	Poverty index	
Total	36.5	18.2
Gender		
Men	37.3	18.1
Women	32.0	18.9
Social-economic status		
Employed	34.1	17.2
Farmer	36.8	14.2
Self-employed or employer	0	0
Unemployed	55.1	41.7
Person with personal income	33.3	17.5
Supported person	31.2	12.8
	Average income deficit	
Total	25.6	22.7
Gender		
Men	25.2	22.6
Women	26.9	23.0
Social-economic status		
Employed	24.3	22.5
Farmer	25.8	21.2
Self-employed or employer	0	0
Unemployed	33.5	29.8
Person with personal income	23.8	22.5
Supported person	24.1	24.1

Source: Calculated on the basis of data from the Survey on Household Consumption, Federal Bureau of Statistics. (Bogicevic et al. 2002)

**Table 4. Poverty by source of household income\*, in %**

	Poverty line	
	FBS consumer basket	WFP consumer basket
	Poverty index	
Total	36.5	18.2
Urban	39.7	21.5
Rural	29.4	12.6
	Average income deficit	
Total	25.4	22.7
Urban	25.7	22.9
Rural	24.5	21.7

\* Urban population is that which does not have income from agriculture in its income structure, while rural population has income from agriculture.

Source: Calculated on the basis of data from the Survey on Household Consumption, Federal Bureau of Statistics

## ANNEX 2 – Macroeconomic indicators

**Table 1. Republic of Serbia: Selected Economic and Financial Indicators, 1998-2002**

	1998	1999	2000	2001	2002 Proj.
<b>Real economy</b>					
GDP, in billions of YUD*	139.0	183.2	340.1	687.9	929.9
GDP, in millions of U.S. dollars*	13,195	9,703	7,667	10,317	12,199
Average net real wage, 1997 =100	80.1	46.7	36.9	96.1	...
Average net wage in \$	94.6	55.1	43.6	113.6	...
	(Percent change)				
Real GDP	2.5	-18.0	5.0	5.5	4***
Industrial production	4	-26	12	0.1	3***
Retail prices (annual average)	30	41	70	91.8	26,3***
Retail prices (end of period)	44.4	45.4	111.9	40.7	20***
Unemployed (thous.)	769	736	722	769	...
Employed (thous.)	2367	2153	2097	1751**	...
Unemployment rate (in percent) 2/	24.6%	25.5%	25.6%	30.5%	...
	(Percent change)				
<b>Money supply (end-of-period) 5/</b>					
M1	...	47.3	85.2	114.3	52.9
M2	...	67.6	61.4	79.0	45.1
<b>Balance of payments</b>					
	(In billions of U.S. dollars)				
Merchandise exports	2.7	1.3	1.5	1.7	2,2***
Merchandise imports	4.4	2.8	3.3	4.2	5,6***
Trade balance	-1.7	-1.5	-1.8	-2.5	(-3,3)***
Current account balance, after grants	-0.7	-0.8	-0.3	-0.6	-1.1
(In percent of GDP)	-4.8	-7.5	-4.2	-5.5	-8.2
Current account balance, before grants	-0.7	-0.8	-0.6	-1.2	-1.6
(In percent of GDP)	-4.8	-7.5	-7.6	-10.9	-12.8
Foreign debt (year-end) 6/	10.5	10.7	11.4	11.9	8.6
Gross official reserves	0.3	0.3	0.5	1.2	1.6
(In months of imports of goods and services)	1.1	0.9	1.2	2.4	3.0

Sources: Federal Statistical Office; National Bank of Yugoslavia; Federal and Republican Ministries of Finance; and IMF staff estimates.

1/With the exception of foreign debt, data for 1999-2002 exclude Kosovo. GDP excludes Kosovo throughout

2/ Excludes workers on "forced holiday".

3/ Fiscal operations of all levels of government, except for Montenegro where it excludes local governments.

4/ Excludes arrears of local governments and most interest payments on foreign debt due but not paid.

5/ From 1999 onwards excludes Montenegro.

6/ For 2002, figures reflect the first phase of the Paris Club debt reduction, and comparable treatment from other official bilateral and commercial creditors

\*estimation

\*\* Number of employees in socially-owned and state enterprises without those employed in the private sector

\*\*\* projection for YU

**Table 2. Republic of Serbia:  
Consolidated public sector (2001-2005) - in a % of GDP**

	2000	2001	2002	2003	2004	2005
<b>Total Revenue</b>	38.7	41.3	43.2	42.8	41.6	40.6
<b>Tax revenue</b>	38.7	41.3	42.9	42.5	41.3	40.3
<b>Capital revenue</b>	0.0	0.0	0.3	0.3	0.3	0.3
<b>Total expenditure</b>	38.9	42.7	47.5	46.8	45.4	44.2
<b>Purchases of goods and services</b>	18.5	18.4	18.6	18.0	17.1	16.5
<i>of which: wages and salaries</i>	10.0	9.5	9.7	9.4	8.9	8.6
<b>Interest payments</b>	0.6	0.9	1.8	2.1	2.5	3.1
<b>Subsidies</b>	2.2	3.8	4.3	3.3	2.7	2.3
<b>Transfers to households</b>	14.3	17.1	18.1	17.7	16.9	16.6
<b>Capital expenditures</b>	3.3	1.2	3.0	3.8	4.5	4.6
<b>Overall balance</b>	-0.2	-1.4	-4.3	-4.0	-3.8	-3.6
<b>Financing</b>	0.2	1.4	4.3	4.0	3.7	3.6
<b>Domestic financing</b>	0.2	1.0	0.7	0.6	0.5	0.5
<b>Foreign grants</b>	...	0.4	0.9	0.8	0.7	0.7
<b>Foreign debt financing</b>	...	...	1.2	1.1	1.1	1
<b>Privatization receipts</b>	...	...	1.5	1.5	1.4	1.4

Summary and Timetable for Potential Structural Measures 2002-2005<sup>1</sup>

Policy Area	Objectives and Targets	Selected Strategies and Measures	Implementation	Lead agency/ Technical Assistance	National Agency Responsible
<b>1. Fiscal Sector</b>					
<b>1.1 Fiscal transparency</b>	(a) Broaden the coverage of government	(1) (F, S, M) Bring all extrabudgetary funds—notably the social security fund—into the annual budgetary preparation and approval process.	2003-04	IMF/World Bank (F, S) EAR, USAID (M)	Federal, Serbian, and Montenegrin MoF
	(b) Strengthen internal audit of budget	(1) (F, S, M) Set up an internal audit office and prepare a plan for annual audits.  (2) (F, S, M) Issue internal audit manuals and standards and complete internal audit.	2003  2004	IMF/World Bank/ Bilateral Donors	Federal, Serbian and Montenegrin MoF
	(c) Improve fiscal reporting	(1) (F, S) Reconcile monetary and fiscal data on budget financing.  (2) (F, S, M) Establish a GFS-consistent fiscal reporting system from all levels of general government.	2002 (April)  2002-2004	IMF/World Bank	Federal and Serbian MoF  Federal, Serbian, and Montenegrin MoF
<b>1.2 Tax policy</b>	(a) Improve the efficiency of the tax system by broadening the tax base and, as appropriate, reducing tax rates	(1) (F, S, M) Decide on how to resolve the issue of inter-republic trade relations regarding customs, excises, and VAT.  (2) (S) Further reduce substantially the financial transactions tax.  (3) (S) Convert the schedular personal	2002 (June)  2003 (January)	IMF	Federal, Serbian and Montenegrin MoF  Serbia and Montenegro MoF

<sup>1</sup> Please note that *italicized* measures are proposed to be designated as structural performance criteria or structural benchmarks under the envisaged Extended Arrangement

Policy Area	Objectives and Targets	Selected Strategies and Measures	Implementation	Lead agency/ Technical Assistance	National Agency Responsible
		income tax to a global tax and reform corporate income tax	2005		Serbian MoF
<b>1.3 Tax administration</b>	(a) Modernize tax administration to improve collection and compliance while reducing compliance costs	<p>(1) (S) Secure financing for PRA modernization projects.</p> <p>(2) (S, M) Introduce new guidelines to simplify tax administration procedures, including those in assessment and payment, taxpayer services, and compliance control.</p> <p>(3) (S) <i>Adopt the law on tax administration organization and the law on tax administration procedures.</i></p> <p>(4) (S) <i>Create a unified taxpayer identification number.</i></p> <p>(5) (S, M) Establish LTUs in Belgrade and regional offices.</p> <ul style="list-style-type: none"> <li>• <i>Belgrade office</i></li> </ul> <p>(6) (S, M) Introduce a VAT.</p>	<p>2002 (May)</p> <p>2002 (December )</p> <p>2002 (end-June)</p> <p>2002 (December)</p> <p>2002-2003</p> <p>2002 (June)</p> <p>Montenegro 2003 (January); Serbia 2004 (January )</p>	IMF/bilateral donors	<p>Serbian PRA</p> <p>Serbian and Montenegrin PRA</p> <p>Serbian PRA and MoF</p> <p>Serbian PRA</p> <p>Serbian and Montenegrin PRA</p> <p>Serbia and Montenegro PRA</p>
<b>1.4 Public expenditure</b>	(a) Strengthen government financial management and capacity for budget planning, preparation and execution	<p>(1) (S) <i>Establish a Treasury within MoF with cash and debt management functions.</i></p> <p>(2) (S, M) Reorganize MoF and strengthen capacity along functional lines corresponding to its mandate and responsibilities .</p>	<p>2002 (September)</p> <p>2002-2004</p>	World Bank/US Treasury and other bilateral donors	<p>Serbian MoF</p> <p>Serbia and Montenegro MoF</p>

Policy Area	Objectives and Targets	Selected Strategies and Measures	Implementation	Lead agency/ Technical Assistance	National Agency Responsible
		(3) (S, M) Develop fiscal and budget planning functions and build capacity for policy analysis.  (4) (S, M) Establish a Centralized Accounting Division; develop comprehensive accounting of budget operations.  (5) (S, M) Establish a system of commitment control, unify system of making payments, and strengthen control processes and procedures.	2002 (late) - 2004 (early)  2003 (March)  2003 (mid)		Serbia and Montenegro MoF  Serbia and Montenegro MoF  Serbia and Montenegro MoF
	(b) Civil service reform	(1) (F, S) Reduce overlap between federal and republic agencies and activities.  (2) (F, S, M) Downsize public sector employment and reform the public sector pay scale.	2002 (mid)-2004  2003 - 2004	World Bank	Federal and Republican Governments
	(c) Repay frozen foreign currency deposits in a fiscally sustainable manner	(F, S) Amend the law that guides the repayment of frozen forex deposits so as to ?? contain total repayments of such deposits—including debt service on bonds that will be issued to repay the foreign exchange deposits exceeding DM 10,000—to the equivalent of 0.9 percent of GDP in 2005-2010 and 1 percent thereafter.	2002 (June)	IMF	NBY, Federal and Serbian MoF
<b>2. Social Security</b>					
<b>2.1 Social welfare</b>	(a) Improve equity, targeting, and administration of social welfare provision	(1) (S) Means-test the third-child allowance, i.e., grant on the same basis as the allowance for the first two children.  (2) (S) De-link child allowance from the	2002 (June)  2002 (June)	World Bank	Serbian Ministry of Social Affairs, and Ministry of Labor

Policy Area	Objectives and Targets	Selected Strategies and Measures	Implementation	Lead agency/ Technical Assistance	National Agency Responsible
		average wage.  (3) (S) Design a Serbia-wide comprehensive welfare provision framework with unified eligibility criteria and standardized approval procedures.	2004		
<b>2.2 Pensions</b>	(a) Reform the pension system to improve long-term financial viability and facilitate a lowering of payroll taxes	(1) (F, S, M) Modify the benefit formula to improve the link between contributions and benefits, and make redistribution more transparent and consistent with available resources. (Specifically, benefits will be based on lifetime wage history instead of the best 10 years.)  (2) (F, S, M) Redesign and tighten eligibility requirements for disability pensions.  (3) (F, S) Assess the need for further measures to strengthen the financial position of the pension fund.	2002 (late)-2003 (early)  2003 (February)  2003-2004	World Bank	The Federal and Republican Governments, and Ministry of Social Affairs in Serbia.  Serbian and Montenegrin government and Ministry of Social Affairs  Federal government and Serbian MOF
<b>2.3 Health</b>	(a) Rationalize and provide cost-effective public health services	(1) (S, M) Improve commitment and spending control by redefining the criteria for contracting medical services, redesigning the drug prescription form to reduce fraud, and adjust the positive drug list to minimize costs.  (2) (F, S, M) Draft new laws on health insurance, healthcare provision and on	(S) 2002 (September) (M) 2003  (F,S) 2002 (December) (M) 2003	World Bank	Serbian and Montenegrin Health Fund  Ministry of Health, Health Fund in Serbia

Policy Area	Objectives and Targets	Selected Strategies and Measures	Implementation	Lead agency/ Technical Assistance	National Agency Responsible
		<p>pharmaceuticals, to reduce overlap, clarify roles of the public health institutions, and to set a framework for more efficient public health system.</p> <p>(3) (S) Eliminate excess capacity, duplication, and other structural problems with the delivery system.</p>	2003-2004		<p>and Montenegro</p> <p>Serbian Ministry of Health, and Health Fund</p>
<b>3. Financial Sector</b>					
<b>3.1 Monetary instruments</b>	(a) Improve monetary policymaking	<p>(1) (F) Reform the reserve requirement by extending the reserve base to foreign exchange deposits (other than individuals' foreign exchange deposits accumulated since July 1, 2001), while holding foreign exchange reserves against foreign exchange deposits, lowering the reserve ratio, and adopting monthly averaging.</p> <p>(2) (F) Create a formal body within NBY (monetary policy committee) that sets the monetary policy.</p> <p>(3) (F) Unify the reserve requirement by extending the reserve base to all foreign exchange deposits.</p>	<p>2002 (March)</p> <p>2002 (June)</p> <p>2003</p>	<p>IMF</p> <p>IMF</p> <p>IMF</p>	<p>NBY</p> <p>NBY</p> <p>NBY</p>
<b>3.2 Foreign exchange market</b>	(a) Liberalize foreign exchange market	<i>(1) (F) Pass a new Foreign Exchange Law and implement associated by-laws to remove all restrictions on current transactions consistent with Article VIII of the Fund's Articles of Agreement, liberalize capital transactions with the exception of investing and lending abroad and short-term capital movements; allow banks to conduct foreign exchange operations on their own account; repeal surrender requirements for banknotes; permit legal persons to trade freely outside</i>	2002 (May)	IMF	NBY/Federal MOF

Policy Area	Objectives and Targets	Selected Strategies and Measures	Implementation	Lead agency/ Technical Assistance	National Agency Responsible
		<i>the interbank market; and regulate banks' short-term foreign exchange liabilities and open positions.</i>			
<b>3.3 Payment system</b>	(a) Upgrade payments system to international standards	(1) (F) Reduce the price of payment services and adjust pricing (currently an amount-based tariff) to better reflect actual per-transaction processing costs.	2002 (May)	IMF	NBY
		(2) (F) Approve by-laws for RTGS & GCC.	2002 (April)	IMF	NBY
		(3) (F) Finalize the strategy for dividing the functions of ZOP between the Ministry of Finance (treasury ), Public Revenue Agency (tax collection), NBY (payments) and new private organizations.	2002 (June)	IMF	NBY, Serbian MoF
		(4) (F) Restructure NBY internal organization by creating a Payment System Department in the NBY (comparable to other central banks) and shifting dedicated technical support for PLATNET, RTGS, GCC, and other payment-related services from ZOP to the NBY.	2002 (June)	IMF	NBY
		(5) (F,S) Have in place laws and regulations to allow the operation of a modern payments system. Permit commercial banks to initiate and settle payments among themselves on behalf of enterprises and individuals without the mandatory intermediation of ZOP or any other agency.	2003 (January)	IMF	NBY, Serbian MoF
		(6) (F) Privatize retail services of ZOP (e.g. foreign exchange bureaus, IT services	2003	IMF	NBY

Policy Area	Objectives and Targets	Selected Strategies and Measures	Implementation	Lead agency/ Technical Assistance	National Agency Responsible
		for NSB)			
<b>3.4 Central bank structure and organization</b>	(a) Strengthen internal audit and accounting	<p>(1) (F) Strengthen the Internal Audit Department and commission an independent assessment of the department.</p> <p>(2) (F) Adopt the new Law on the National Bank of Yugoslavia to provide for a Supervisory Board.</p> <p>(3) (F) Amend the Accounting Law to adopt the IAS as the permanent accounting framework for all financial institutions, including the NBY.</p> <p>(4) (F) Publish IAS-based financial statements of the NBY.</p>	<p>2002 (March)</p> <p>2002 (June)</p> <p>2002 (September)</p> <p>2002 (June)</p>	<p>IMF</p> <p>IMF</p> <p>World Bank IMF</p> <p>IMF</p>	<p>NBY</p> <p>NBY</p> <p>Federal MoF</p> <p>NBY</p>
<b>3.5 Banking supervision</b>	(a) Ensure soundness of banking system	<p>(1) (F) Prepare a comprehensive Supervisory Development Plan outlining medium- to long-term objectives, and legislative and institutional changes necessary to achieve these objectives.</p> <p>(2) (F) Adopt the new Law on the National Bank of Yugoslavia and amendments to the Law on Banks and Other Financial Institutions to establish a regulatory framework in line with international standards.</p> <p>(3) (F) Introduce prudential regulations covering capital adequacy, large credit exposures, exchange rate risk, liquidity, lending to connected parties and shareholders, loan classification and provisioning, internal control and audit functions, risk management, credit</p>	<p>2002 (April)</p> <p>2002 (June)</p> <p>2002 (June)</p>	<p>World Bank, USAID</p> <p>IMF, World Bank</p> <p>IMF, World Bank, Bundesbank</p>	<p>NBY</p> <p>NBY</p> <p>NBY</p>

Policy Area	Objectives and Targets	Selected Strategies and Measures	Implementation	Lead agency/ Technical Assistance	National Agency Responsible
		activities, and investment in fixed assets as well as other bank and enterprise capital.  (5) (F) Implement regulations governing reporting by financial institutions of suspicious and/or large cash transactions, and defining responsibilities of the NBY, in line with the Law on Anti-Money Laundering.	2002 (July)	IMF, World Bank, Bundesbank, USAID	NBY
<b>3.6 Bank restructuring</b>	(a) Establish a competitive banking system	(1) (F) <i>Decide on(a) privatization plans for banks under NBY enhanced supervision and administration and (b) resolution of banks under control of the BRA.</i>	2002 (June)		NBY
<b>3.7 Non-bank financial sector</b>	(a) Developing financial markets	(1) (F) Adopt a Federal Law on Secured Transactions and regulations on a Pledge Registry.  (2) (F) <i>Enact Law on Securities Market</i>  (2) (F) <i>Enact Law on Investment Funds</i>  (4) (F) Adopt legislation to eliminate restrictions on leasing operations.	2002 (September)  2002 (June )  2002 (December)  2002 (December)	World Bank, EBRD, USAID  IMF  IMF  World Bank	Federal Ministry of Justice  NBY/Federal MoF NBY/Federal MoF  Federal Min. of Justice & Center for Legal Reform under Serbian MIER
<b>4. Private Sector Development</b>					
<b>4.1 Enterprise privatization</b>	(a) Expedite privatization through tenders	(1) (S) Privatize some 100 large socially-owned companies through tender procedures: <ul style="list-style-type: none"> <li>• Launch competitive investment tenders for at least 4 groups of the six World Bank pools.</li> </ul>	2002-2005  2002 (June)  2002 (September)	World Bank  World Bank  World Bank	Serbian Ministry of Privatization/ Privatization Agency

Policy Area	Objectives and Targets	Selected Strategies and Measures	Implementation	Lead agency/ Technical Assistance	National Agency Responsible
		<ul style="list-style-type: none"> <li>• Launch competitive investment tenders for one more group of the World Bank pools.</li> <li>• Launch competitive investment tenders for the last groups of the World Bank pools.</li> <li>• Sign contracts with financial advisors (hired through competitive international tender) for investment tenders for privatization of 20 companies (including Beopetrol, Boza Tomic and sugar factories);</li> <li>• Launch competitive tender for this group of 20 companies.</li> </ul>	<p>2002 (November)</p> <p>2002 (September)</p> <p>2003 (February)</p>	<p>World Bank</p> <p>World Bank/Dutch and Swedish grants</p> <p>World Bank/Dutch and Swedish grants USAID</p>	
<b>4.2 Enterprise restructuring</b>	(a) Create viable companies that can be privatized	<p>(1) (S) Restructure some 40 conglomerates prior to privatization under either tender or auction procedures:</p> <ul style="list-style-type: none"> <li>• Start implementation of restructuring plans in the first 3 conglomerates;</li> <li>• Start implementation of restructuring plan in the remaining conglomerates.</li> </ul>	<p>2002-2006</p> <p>2002 (October)</p> <p>2003-04</p>	World Bank, EAR	Serbian Ministry of Privatization/ Privatization Agency
<b>4.3 Legal and regulatory framework</b>	(a) Strengthen creditor rights	<p>(1) (F) Implement new bankruptcy law</p> <ul style="list-style-type: none"> <li>• draft new law;</li> <li>• adopt new law;</li> <li>• establish Bankruptcy Agency to license individual administrators.</li> </ul>	<p>2002-2003</p> <p>2002 (June)</p> <p>2002 (December)</p> <p>2003 (December)</p>	World Bank	Federal Ministry of Justice/ Serbian Ministry of Privatization
	(b) Development of small and medium-sized enterprises	(F, S) Submit to Parliament proposed amendments to the Federal Enterprise Law and the Republican Law on Private Entrepreneurs to simplify the process of business registration.	2002 (April)	World Bank	Federal and Serbian Ministry of Justice and Ministry of

Policy Area	Objectives and Targets	Selected Strategies and Measures	Implementation	Lead agency/ Technical Assistance	National Agency Responsible
					Economy and Privatization
<b>5. Sectoral Policies</b>					
<b>5.1 Energy sector</b>	(a) Establish financial viability	(1) (S) Increase average electricity price to cost recovery levels by the middle of 2004: <ul style="list-style-type: none"> <li>increase the price to 3 US\$ cents per kWh;</li> <li>increase the price to 4 US\$ cents per kWh;</li> <li>increase the price to 4.5 US\$ cents per kWh.</li> </ul>	2002-2004  2002 (June) 2003 (June) 2004 (June)	World Bank	Ministry of Energy and EPS
	(b) Improve profitability	(S) Contain the growth in the wage bill for electricity companies to no more than the rate of inflation.	2002-2005	IMF/ World Bank	Republican Ministries of Finance and Energy and electricity companies
	(c) Prepare for privatization after completion of the program	(S, M) Design and introduce a legal and institutional framework for an independent energy regulator.	2002-2003	World Bank	Republican Ministries of Energy
<b>6. Trade Policy</b>					
<b>6.1 Merchandise trade</b>	(a) Further liberalize foreign trade regime	(1) (F) Remove import quotas for steel products and export quotas on agricultural products, wood and raw hides: <ul style="list-style-type: none"> <li>Eliminate all export quotas;</li> <li>Eliminate all import quotas.</li> </ul>	2002-2004  2003 (December) 2004 (December)	World Bank	Federal Ministry of Trade

Policy Area	Objectives and Targets	Selected Strategies and Measures	Implementation	Lead agency/ Technical Assistance	National Agency Responsible
<b>7. Statistical issues</b>					
<b>.1 Collections of statistics</b>	Improve the statistical base for macroeconomic decision-making	<p>(1) (F, S, M) Make a decision with regard to participating in the GDDS, and nominate a GDDS coordinator.</p> <p>(2) (F, S, M) Macroeconomic statistics will be reviewed in the context of a data ROSC mission, as a basis for further technical assistance.</p> <p>(3) (F, S, M) Conduct household survey and poverty assessment.</p>	<p>2002 (April)</p> <p>2002-2005</p> <p>2002 (December)</p>	<p>IMF</p> <p>Data ROSC mission scheduled for mid-2002</p> <p>World Bank</p>	<p>The Federal and Republican Statistical Offices</p> <p>Federal and Republican Statistical Offices</p> <p>Republican Ministries of Social Affairs and Federal and Republican Statistical Offices</p>
<p>Notes:</p> <p>F – Federal; S – Serbia</p> <p>EA – Extended Arrangement;</p> <p>EPS – Electricity company of Serbia.</p> <p>GCC – Clearing and Settlement Service;</p> <p>GDDS – Generalized Data Dissemination Standard</p> <p>IAS – International Accounting Standards;</p> <p>LTU – Large Tax Payer Unit;</p> <p>MOF – Ministry of Finance;</p> <p>NBY – National Bank of Yugoslavia;</p> <p>PAYG – Pay-as-you-go pension system;</p> <p>PRA – Public Revenue Agency;</p> <p>ROSC – Report on Standards and Codes;</p> <p>RTGS – Real-time Gross Settlement system.</p>					