

**Serbia and Montenegro: Poverty Reduction Strategy Progress Reports—
Joint Staff Advisory Note**

The attached Joint Staff Advisory Note (JSAN) of the Poverty Reduction Strategy Progress Reports for Serbia and Montenegro, prepared jointly by the staffs of the World Bank and the IMF, was distributed with the member country's Poverty Reduction Strategy Progress Reports to the Executive Boards of the two institutions. The objective of the JSAN is to provide focused, frank, and constructive feedback to the country on progress in implementing its Poverty Reduction Strategy.

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**International Monetary Fund
Washington, D.C.**

INTERNATIONAL MONETARY FUND
INTERNATIONAL DEVELOPMENT ASSOCIATION

SERBIA AND MONTENEGRO

Joint Staff Advisory Note on the Poverty Reduction Strategy Progress Reports

Prepared by the Staffs of the International Monetary Fund and the International
Development Association

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February 27, 2006

I. INTRODUCTION

1. **The governments of Serbia and Montenegro have completed the first progress reports of their poverty reduction strategies.** These reports are based on reviews of the strategies conducted between February–August 2005 with various stakeholders. They assess the implementation of the Serbian Poverty Reduction Strategy (PRS) and the Development and Poverty Reduction Strategy of Montenegro (DPRS) from early-2004 through mid-2005, and were submitted to the World Bank and the IMF in October 2005 (Serbia) and November 2005 (Montenegro). The reports set the implementation of the PRS and DPRS in the context of the overall EU accession agenda and of progress in achieving the Millennium Development Goals. This note, prepared jointly by the staffs of the Bank and the Fund, is intended to provide feedback to help strengthen the PRS and DPRS and their implementation. A Joint Staff Assessment (JSA) of the poverty reduction strategies was prepared by the staffs in February 2004.

2. **The staffs commend the governments of Serbia and Montenegro for the continued implementation of the strategies and welcome the advances made towards meeting the PRS/DPRSP benchmarks.** Progress in line with the JSA recommendations has been made in: (i) fiscal adjustment based on prioritization of sectoral programs, targeting of social spending, cuts in subsidies, rationalization of personnel costs, and significant tax policy and administration reforms; (ii) improving the business environment as a key precondition for sustainable private sector-led growth; (iii) laying the groundwork for poverty monitoring and strengthening of analytical capacity to analyze poverty issues; and (iv) reinforcing the participatory process in the PRS/DPRS implementation and oversight. The reports present detailed analyses of achievements and constraints in these areas, while recognizing limited accomplishments in aligning the PRS/DPRS with annual budgets and identifying specific pro-poor policies.

II. STAKEHOLDER PARTICIPATION IN THE REVIEW PROCESS

3. **The staffs welcome the participatory nature of the review process and encourage the authorities to maintain a similar approach to implementation.** The reports and accompanying cover letters recognize the role of different stakeholders and state that government officials and non-government bodies were consulted through various meeting, workshops and conferences. The governments should use the progress reporting mechanism to provide information on the implementation of their strategies to key domestic and external stakeholders. The information obtained in the review process, and the reports themselves, should offer an opportunity for the governments to engage further with various stakeholders in strengthening the implementation of their strategies and in better addressing the challenges ahead. The authorities and their external partners could agree to use the progress reports as instruments of donor coordination and harmonization of policies.

III. POVERTY DIAGNOSTICS

4. **While the strong economic growth in recent years in Serbia has improved average living standards, the reports note that its impact on poverty reduction remains inconclusive.** The increases in real wages and pensions have boosted household incomes and consumption, according to the national accounts statistics. However, a preliminary analysis of Household Budget Survey (HBS) data presented in the report suggests that poverty rates have not changed significantly between 2003 and 2004, staying in a range of 11–13 percent. This may reflect the fact that there was no decisive progress in reducing unemployment in line with GDP growth, and that much of the dynamism in the labor market, as demonstrated by panel data for 2002–03, is likely to have been concentrated in the informal sector. Furthermore, there are growing regional disparities, with Belgrade increasing its advantage over the rest of the country. For example, despite the recovery of agricultural output after the drought in 2003, rural areas still lag behind urban centers in improving living standards.

5. **The reliability of the observations on poverty trends in Serbia is weakened by poor comparability of survey data, which could be improved.** Despite commendable efforts in the analysis of HBS data for 2003–04 and in-depth comparison with the Survey of Living Standard of Population 2002–03 data, the assessment of poverty trends over 2002–04 remains ambivalent. This is mainly due to shortcomings with respect to the quality and consistency of HBS data. Even if quality improves in 2005 and 2006 following the ongoing efforts described in the progress report, the staffs note that the HBS in its current format remains inadequate for assessing broader dimensions of poverty, such as access to education, health, and social programs. The staffs recommend that the Serbian Republic Statistics Office (RSO) put in place a survey system that meets essential PRS and MDG monitoring goals.

6. **The staffs broadly share the assessment of poverty outcomes in the Montenegrin report, but have concerns about the representativeness and quality of the data.** The reported modest progress in reducing poverty (from 12.2 percent to 10.9 percent of population) is traced to slow economic growth. The progress report also includes new data

on the coverage of poverty outcomes among marginalized groups and, reflecting the importance of environmental concerns, an indicator linking poverty and the environment (use of dirty fuels for household heating) for future monitoring. However, the report makes use of data collected by the Institute of Strategic Studies and Prognosis (ISSP) in 2002–04, which may not be fully comparable over time. The staffs welcome plans to use the annual HBS for poverty monitoring starting mid-2006, which will improve the representativeness and timeliness of the poverty data. The HBS in Montenegro has a design identical to Serbia's and the staffs concur with the suggestion of the progress report to bridge its shortcomings (already evident in Serbia) by continuing with ISSP panel surveys. But to further improve data quality, the staffs recommend that future samples for the integrated household surveys be drawn from the most recent population census (2003) and involve the Montenegrin Statistical Office (MONSTAT) in the sampling work.

7. While the staffs commend the progress made in Serbia and Montenegro in terms of poverty monitoring, there is considerable room for improvement.

- **In Serbia, the use of the HBS and the creation of a high level unit to improve poverty monitoring are commendable, but poverty analysis needs to be further strengthened.** Monitoring poverty with HBS data collected by the RSO will ensure regular collection of data, sustainability, and ownership. Moreover, the decision to create a Working Group for Poverty Measurement (WGPM) in the Office of the Deputy Prime Minister gives the poverty reduction strategy greater visibility, better coordination, and institutional support, while improving the quality of poverty analysis. The staffs urge further strengthening of poverty monitoring by (a) building the capacity of the RSO to undertake basic poverty analysis; (b) mandating the WGPM to play an advisory role on poverty measurement and a more active role on higher level analytical activities, such as policy impact evaluation; and (c) providing adequate and reliable resources for both RSO and WGPM to perform these functions more effectively.
- **In Montenegro, the decision to use the HBS for future poverty monitoring is welcome, but the relevant responsibilities should be clarified.** Although MONSTAT will collect the HBS, the report does not make clear whether it will also be responsible for poverty diagnostics and updates. The staffs urge the government to clarify the responsibility for poverty monitoring. Furthermore, clarification is needed on how HBS and focused ISSP surveys will be integrated to provide comparable and consistent poverty data.

8. In both countries, poverty monitoring would benefit from better accessibility of relevant data to the public. The HBS and most data collected by statistical agencies in Serbia and Montenegro remain inaccessible to the public. The staffs urge the governments to take steps to address this concern. By introducing an open data access policy, the government can promote wider and deeper analyses of the survey data, as well as a more constructive and richer debate of important policies.

9. **The staffs recommend a deeper analysis of the links between economic growth and poverty reduction, and that greater attention be paid to identifying and prioritizing pro-poor growth policies.** While the progress reports agree that economic growth is key to reducing poverty, more analysis of planned policy reforms and their potential impact on poverty should be conducted. The absence of analysis of the link between economic growth and poverty reduction will complicate the identification of pro-poor policies.

IV. MACROECONOMIC PERFORMANCE

10. **The reports note that while economic growth has continued in Serbia and Montenegro, further reforms are necessary to underpin sustainable development and address macroeconomic imbalances.** In Serbia, real GDP growth was strong in 2004–05 (9.3 percent in 2004 and estimated to be close to 5 percent in 2005) led by domestic demand and exports, and was accompanied by increasing foreign direct investment. However, the current account deficit reached close to 15 percent of GDP in 2004 before narrowing to around 10 percent of GDP in 2005. Some of this reflects a shift of imports to 2004 from 2005 in anticipation of the VAT introduction in January 2005. Despite strong growth recently, the low level of exports at half of imports reflects the still slow restructuring of the economy. Continued robust domestic demand in the context of limited supply, together with pressures on prices from the introduction of the VAT and higher oil prices, resulted in a rapidly rising inflation at end-2004, which stabilized at about 17-18 percent in 2005. Consequently, demand pressures need to be further contained, while structural reforms necessary to underpin growth over the medium term should be accelerated. In Montenegro, inflation remained low in 2005 (around 4 percent), while the still large current account deficit (over 12 percent of GDP) reflects insufficient competitiveness. While growth performance is improving (3.5 percent in 2005 compared to an average of just 1.5 percent in 2000–04), containing fiscal imbalances, increasing employment, and improving competitiveness remain key challenges.

11. **The staffs recommend that the poverty reduction strategies be implemented within a realistic macroeconomic framework, based on more realistic projections and better prioritization of public expenditure.** The progress reports would benefit from a comprehensive and updated medium-term outlook, as the ones on which the PRS and DPRS were based have changed considerably. While economic growth temporarily exceeded the PRS/DPRS targets in 2004, the current account deficit remained high and inflation in Serbia was much higher than expected. The assumptions and policy priorities underpinning the projections in the progress reports are unclear, and some aspects of the medium-term outlook seem overly optimistic. The macroeconomic outlook should set the implementation of the PRS and DPRS within a context of solid economic growth (in a 3–5 percent range in the next few years), accompanied by fiscal and monetary policies designed to contain inflation and domestic demand, continued reduction in overall public spending, and further structural reforms. In this context, the implementation of the PRS/DPRS will need to include a better prioritization of expenditure and a greater focus on pro-poor spending. The PRS programs should also be better integrated with the budget within a multiyear framework. The staffs

note that the macroeconomic outlook is subject to significant risks and vulnerabilities that may require further macroeconomic adjustment over the medium term.

V. PROGRESS IN SECTORAL AND POLICY REFORMS

12. **The staffs commend the governments for their efforts to address sectoral and policy recommendations made in the JSA.** The governments have managed to improve the business environment by streamlining the registration process, reducing administrative barriers to business operations, decreasing waiting time, and building the institutional capacity for implementation of the new regulatory frameworks. Both governments have initiated comprehensive public administration reforms, involving the rationalization of the structure of the state administration and the reform of the incentive system, while beginning to address issues of governance and corruption. In social sectors, the governments continue to provide core benefits and services to the population, while increasing the focus on poverty alleviation through improved targeting and sustained access to services by the poor.

13. **However, more action needs to be taken on a number of JSA recommendations, including better prioritization and a stronger linkage of the strategies to the budget.** Specific strategies to address poverty and expand opportunities for vulnerable groups, including the Roma and internally displaced persons (IDPs), remain underdeveloped in both documents. In the Montenegrin progress report, both inter- and intra-sectoral prioritization are weak, as the report is lengthy and covers a wide range of topics with no clear prioritization. In the staffs' view, prioritization also needs to be strengthened according to the poverty profile findings and the poverty diagnosis linked with the sectoral strategies and priorities. Both progress reports also point out that neither the PRS nor the DPRS have been well-linked to the governments' budgets, and it is unclear how they were integrated into the respective 2006 budgets and medium-term expenditure frameworks.

14. **Reducing health inequalities and improving the health status of the most vulnerable groups of the population are high on the policy agendas, but these goals are not well reflected in existing programs.** Most efforts and activities in the programs are aimed at adapting the overall legal framework, reforming the organization of the sector and its financing system, and rationalizing the provision of health care. However, insufficient attention is paid to the impact of the ongoing and planned reforms on accessibility of health care services for the poor and the most vulnerable groups and on inequalities in health care service delivery. In particular, the impact of out of pocket payments, both formal and informal, should be better understood, and measures to reduce the latter should be studied. More attention should also be paid to the specific needs of the Roma and of the growing elderly population.

15. **In the education sector, while both governments have undertaken measures to improve targeting of resources to disadvantaged groups, particularly the Roma and children with disabilities, many challenges remain.** The Serbian progress report includes a plan to introduce a year of free and compulsory pre-schooling with a nine-year primary education program. It also describes progress made in implementing the government's

strategy to improve primary and secondary education through on-going teacher training, changes in curricula, and better coverage. However, the report should make better use of the results of the assessment of student performance in primary schools to identify more efficient interventions to improve education attainment of disadvantaged students. In the Montenegrin report, the goal of increasing enrollment rates is not followed by a discussion of the importance of new curricula, teacher training, and new evaluation programs, even though these are part of the government's reform program. The report presents ambitious plans for improvements in infrastructure, but fails to calculate their costs, address constraints in the education budget (which is high at above 6 percent of GDP), and identify potential savings. The need to improve the budget process and the capacity for sound investment decisions based on increased efficiency should be a priority.

16. **The staffs commend the efforts to improve targeting and access to the main social assistance program (MOP), but the identification of potential beneficiaries and assessment of the poverty impact of policies need to be improved.** In the social protection sections of the reports, the governments rely mainly on administrative data, while the use of the available survey data of the Roma and MOP beneficiaries remains limited, particularly in the Serbian report. The staffs encourage the governments to make better use of survey data to support policy recommendations. Both governments need to (i) invest additional efforts in identifying potential beneficiaries, particularly among the most vulnerable groups, including the Roma, IDPs, and the rural poor; and (ii) focus on evaluating existing social protection programs, including employment programs, and the existing program mix. Any move towards a more decentralized system, which is set as a strategic goal in the Serbian document, should take into consideration the experience from other countries. Accordingly, if the necessary financial and administrative institutions are not in place, decentralization risks undermining equity in the social welfare system, as the poorest municipalities will be least able to finance benefits and services. The authorities would need to strengthen the implementation capacity and improve the quality of data at the municipal level. The staffs encourage the governments to continue with pension and disability insurance reforms.

17. **Both reports provide an overview of progress in public administration reform and anti-corruption measures but, looking forward, priorities remain unclear.** The Serbian report would benefit from more clarity on prioritization and a more accurate description of ongoing public administration reforms, in particular the pay reform. Following the JSA recommendations, the Montenegrin government has proposed a number of important anti-corruption measures, but greater attention needs to be paid to effective implementation. The report does not sufficiently identify priorities in the area of public administration reform. In future reports, more emphasis should be placed on the activities and needs of the Human Resource Management Agency, which is taking over the leadership role in public administration reform.

18. **Both governments continue to view rural poverty as a significant problem that needs to be tackled by appropriate alleviation measures.** Serbia has taken a number of important steps in agricultural and, to a lesser extent, non-farm rural development. The

successful pilot projects aimed at overcoming existing market constraints should be expanded and replicated to create a more dynamic private sector and reduce poverty. The Montenegrin report rightly points out the need to improve basic infrastructure in rural areas, set strategic goals for rural development, and improve the legal and regulatory framework. Regarding the environment, Serbia has over the last year adopted a set of new environmental laws, while Montenegro plans to enact several key pieces of legislation in the upcoming year. Since the laws set high standards in environmental protection, the implementation and monitoring capabilities within the country will remain key challenges for both governments.

VI. MONITORING AND EVALUATION OF THE STRATEGIES

19. **Monitoring and evaluation of the PRS and DPRS are still weak.** The Serbian progress report recognizes that the absence of an adequate monitoring system of the PRS limits the assessment of achievements. The Montenegrin report does not always indicate what policies have actually been implemented since the DPRS was finalized and often reports progress in terms of processes or broad generalities. At the same time, gender is overlooked entirely, while themes such as poverty and discrimination of marginalized groups are not treated as cross-cutting. This creates the impression that the actions and sectoral priorities presented in the DPRS reflect the objectives and current needs of different line ministries, rather than a well-defined poverty reduction strategy.

20. **The monitoring and evaluation of the strategies and their implementation should be improved by including an evaluation of the impact of existing or proposed policies and programs on poverty outcomes.** Policy and program impact studies (e.g., Poverty and Social Impact Assessments, PSIA) would contribute to prioritization of policy actions, and increase the efficiency and transparency of decision making. While there was clear progress in collection and use of survey data for monitoring poverty in both Serbia and Montenegro, their use to inform policies remains limited. Several government programs or policies that have been introduced or are being proposed could benefit from a rigorous evaluation. These include active labor market programs, loans to small and medium-sized enterprises, pension and disability insurance reforms, and electricity price reforms. As poverty is largely a rural phenomenon, particular attention should be paid to rural anti-poverty programs and their evaluation. In addition, the existing mechanisms for tracking poverty-reducing expenditure should be strengthened, including by introducing specific codes in the budgetary classification system. Finally, Serbia and Montenegro are committed to the Decade of Roma Inclusion which aims at making measurable improvements in the living conditions of Roma through 2015. The PRS and DPRS are the main mechanism for measuring progress in this regard, and will have to pay more attention to ethnicity in poverty monitoring and program evaluation.

VII. INSTITUTIONAL ARRANGEMENTS

21. **While both governments have established institutional mechanisms to ensure a sustainable implementation of poverty reduction activities, coordination should be strengthened further.** In Serbia, the PRS Implementation Focal Point (IFP) in the Office of

the Deputy Prime Minister has been given responsibility for coordinating and monitoring the implementation of PRS activities, thereby affirming the commitment of the government to the principles of the PRS and its implementation. The government of Montenegro appointed the Ministry of Labor and Social Welfare (and within it the DPRS Monitoring and Evaluation Unit) to coordinate and monitor the implementation of the DPRS. However, coordination and meaningful participation need to be strengthened further.

22. **The staffs recommend that Montenegro consider anchoring the poverty reduction dialogue at a higher level and locating the central DPRS Unit closer to the Prime Minister's office.** As implementation capacity remains a major weakness and concern, such measure would demonstrate stronger government commitment and ensure greater capacity to coordinate further implementation. Following the development of multiple strategic documents in Montenegro (Economic Reform Agenda, DPRS, Sustainable Development), different agencies and donors have come to have varying interests and commitment to the implementation of the different strategic documents. In this context, the DPRS Unit has tended to be marginalized.

VIII. GOVERNMENT PLANS TO REVISE THE PRSP

23. **The staffs welcome Serbia's plan to review its PRS and encourage the government to consult stakeholders and build on the findings of analytical work in developing a new strategy.** By end-2006 or early 2007, the government of Serbia intends to develop a new forward-looking PRS policy update. Employment, education, health care, and social welfare are expected to remain key priorities in implementation, while economy and education would be the main strategic areas over the long run. The staffs urge the authorities to ensure that the new strategy is better prioritized and supported by a strong monitoring and evaluation system, and be made fully consistent with the macroeconomic and fiscal framework.

24. **The staffs encourage Montenegro to review the DPRS, with a view to improving prioritization within a multiyear framework that would facilitate better linkages to the budget process.** The staffs recommend that future reports be more focused, reviewing only those policies, actions, and strategies that are clearly outlined as priorities. Moreover, the strategy should be made fully consistent with the macroeconomic and fiscal frameworks and the budget process.

IX. CONCLUSIONS

25. **The staffs commend the governments for their efforts to address recommendations made in the JSA.** Both Serbia and Montenegro are implementing significant fiscal consolidation, public administration reform, privatization and business climate reform, and social sector reforms.

26. **The implementation of the poverty reduction strategies has been limited so far and major challenges remain.** The staffs identify the following challenges in the near term:

(i) sustaining economic growth, expanding the private sector, and generating employment opportunities; (ii) implementing the PRS in the context of a realistic macroeconomic framework and further fiscal consolidation that will require better policy prioritization within a multiyear expenditure framework; (iii) improving poverty monitoring, program evaluation, and policy analysis; and, (iv) increasing the focus on, and support for, the most vulnerable through design and implementation of pro-poor policies.

27. **The staffs recommend that future PRS and DPRS progress reports be better aligned with the governments' internal planning processes and calendars.** Aligning reporting on PRS and DPRS implementation with the budget cycle and other national planning processes would save time and improve sustainability. The staffs welcome the intention to adopt programmatic budgets that will enable a more precise presentation of budgetary resources directed at achieving PRS and DPRS goals, but urge the authorities to adopt a realistic timetable for implementation, which should be preceded by a significant strengthening of public expenditure management systems.

28. **The staffs recommend that the next progress reports be more succinct and build on the different policy documents and strategies adopted by the governments.** The progress reports should be a synthesis of implementation progress in key policy areas. They will be expected to include an evaluation of performance and analysis of outturns relative to benchmarks, an overview of the coming year's policy intentions and their poverty impact, and a discussion of how specific shortcomings identified in the past JSANs/JSAs have been addressed.