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Staff Country Reports

Serbia and Montenegro: Joint Staff Assessment of the Poverty Reduction Strategy Paper

The attached Joint Staff Assessment (JSA) of the Poverty Reduction Strategy Paper Progress Report for **Serbia and Montenegro**, prepared by the staffs of both the World Bank and IMF, was submitted with the member country's Poverty Reduction Strategy Paper (PRSP) or Interim PRSP (IPRSP) to the Executive Boards of the two institutions. A JSA evaluates the strengths and weaknesses of a country's poverty reduction objectives and strategies, and considers whether the PRSP or IPRSP provides a sound basis for concessional assistance from the Bank and Fund, as well as for debt relief under the Enhanced Heavily Indebted Poor Countries (HIPC) Debt Initiative. The Boards then decide whether the poverty reduction strategy merits such support.

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THE INTERNATIONAL MONETARY FUND AND
INTERNATIONAL DEVELOPMENT ASSOCIATION

SERBIA AND MONTENEGRO

Joint Staff Assessment of the Poverty Reduction Strategy Paper

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

Approved by Carlo Cottarelli and G. Russell Kincaid (IMF) and
Shigeo Katsu and Gobind Nankani (IDA)

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I. INTRODUCTION

1. Economic performance in Serbia and Montenegro (SAM)¹ has been solid since the end of the Milosevic regime in late 2000; however, with exceptionally difficult initial conditions, a lot remains to be done in order to achieve strong sustainable growth and a viable external position. Real GDP rebounded from a sharp decline in 1999 stemming from the Kosovo conflict—growing at an annual average rate of 4.5 percent in 2000–03—but remains at a low level by historical standards; inflation declined from over 100 percent at end-2000 to a single-digit level by end-2003; and official foreign reserves rose to the equivalent of 4 months of imports from a negligible level 3 years ago. Despite political turmoil and delays related to the constitutional transition, the structural reform record has been impressive, with significant progress in dealing with the main problem banks and in implementing the privatization and enterprise restructuring program. Nonetheless, part of the financial system remains fragile, the enterprise sector is still largely unstructured and inefficient, and unemployment remains a concern. Key challenges include creating an enabling business environment, improving governance, and addressing poverty. Meanwhile, the European Union has begun preparation of a Feasibility Study for starting negotiations on a Stabilization and Association Agreement (SAA).

¹ The new Constitutional Charter of the State Union of Serbia and Montenegro became effective on February 4, 2003, and as a result, the Federal Republic of Yugoslavia changed its name to Serbia and Montenegro as of that date.

2. The PRSP for Serbia and Montenegro (SAM) comprises a union-level overview and a PRSP for each of the two republics.² It builds on the Interim PRSP for the Federal Republic of Yugoslavia presented to the Boards of the International Development Association and the International Monetary Fund (IMF) in August 2002 (Report No. 24490-YU and EBD/02/118, 7/24/02). The Montenegrin PRSP is broadly in line with the Agenda of Economic Reforms, the key government document setting priorities. The Serbian PRSP is also broadly consistent with other Government strategies and plans, including “*Serbia on the Move*,” a document presented at a donor coordination meeting in November 2003. The republican strategies share many strengths. They:

- support macroeconomic stability and market-oriented reforms;
- through the Stabilization and Association Process (SAP), look to *harmonization with EU standards for trade* and other areas; and to *eventual accession to the EU as well as WTO membership*;
- are based on strong *poverty diagnostics*;
- affirm the continuation of the *privatization of financial and productive assets*;
- envisage *improvements in the business environment* to facilitate private investment and growth, including judicial and legal reform;
- emphasize that the most *critical poverty is in rural areas* (southeastern Serbia, northern Montenegro), and among excluded groups (Roma, IDP, refugees, disabled), and pledge to do more for these vulnerable groups;
- are based on *extensive consultation*—both republics established comprehensive frameworks and collaborative partnerships with NGOs;
- *emphasize employment-generation programs*, especially for small and medium-sized enterprises (SMEs), with Serbia in particular allocating considerable amounts for SMEs;
- focus on improved *social protection*, and better targeting of programs in health and education;
- include a set of *goals, which are quantified and linked to the Millennium Development Goals (MDGs)*; and
- contain *costed programs*, which place the bulk of the spending in education, employment, health and social protection.

Key areas for improvement include:

² The individual PRSPs contain detailed policy matrices indicating the timeframe for implementing reforms in various areas.

- the Serbian PRSP is up-front on the issue of *crime/corruption*, while this issue is barely mentioned in the case of Montenegro despite its prominence in the consultations;
- the Montenegrin PRSP has an extensive discussion of *infrastructure* needs, while the discussion of this issue in the Serbian PRSP is limited;
- the Serbian PRSP provides an extensive analysis of the links between *agriculture and rural development and poverty*, which is missing in the Montenegrin document;
- both reports are excessive in length and coverage of topics, rendering it difficult to assess how priorities have been determined. Inter-sectoral prioritization emerges more clearly in the costing tables. Intra-sectoral prioritization is less clear;
- the estimates of *poverty program costs for 2004–06* are inconsistent and, especially for Montenegro, excessive (€400 million for Montenegro equivalent to 9 percent of GDP per annum, compared with €1.1 billion for Serbia, equivalent to about 2 percent of GDP per annum);
- *financing plans for poverty programs* are vague and somewhat unrealistic. Serbia’s plans are vague, while for Montenegro 60 percent of the costs are assumed to be covered from foreign sources, although this would mean an additional resource transfer equal to 5½ percent of GDP annually. The Montenegrin PRSP lists an additional set of electricity and other infrastructure projects that are not in the PRSP program and would be undertaken if financing were available, over a longer period if needed. While some of these projects might be undertaken by private investors, their inclusion confuses the sense of priorities;
- *plans for institution-building and PRSP implementation* will require further elaboration. The governments must ensure that sufficient financial, advisory and technical support is available to support PRSP realization. This is critical both in Serbia with the recent changes of government and in Montenegro where capacity is thin and stretched.

II. PARTICIPATORY PROCESS

3. The SAM PRSP is based on an extensive and inclusive consultative and participatory processes. A partnership with Catholic Relief Services serving as an NGO umbrella coordinator was established to facilitate dialogue and develop the strategies. Although the institutional structures set up by each republic to oversee the PRSP development were large and complex—involving the governments and numerous representatives of civil society, the business community, local governments, and academia—they proved quite workable. A series of consultations were organized over the year. Parliamentary committees were actively engaged in both republics (although only in the later stages in Serbia). Both republics also engaged in formal dialogue with labor unions, a unique undertaking in Serbia and

Montenegro's history. Sustaining these important channels of communication will be a key challenge for PRSP implementation.

4. The PRSP process, through its high visibility, has succeeded in raising awareness of the scope of poverty and its dimensions. As a result, there is a new openness to discussion of formerly sensitive topics in both republics, which the PRSP summarizes well. For the first time, statistics on poverty were available to public scrutiny and dialogue. It will be important to ensure that statistics are accurate and accessible and that the government continues discussing them in public fora as PRSP implementation continues. In Montenegro, the PRSP has played a limited role in raising issues of corruption and governance to national and local audiences. In Serbia, where the creation of a national Anti-Corruption Council preceded the PRSP, the PRSP opened the dialogue to a broader group of constituents. It is hoped that, as the PRSP implementation is realized, there will be greater candor about corruption and governance, with more sustained and tangible attention paid to these crucial issues. Finally, building on the strong participatory approach to date, as the PRSP is realized, sustained dialogue with stakeholders will be necessary in order to maintain momentum, manage expectations and strengthen understanding of, and commitment to, common goals.

III. POVERTY DIAGNOSTICS

5. The poverty diagnostics in the republican PRSPs are well done, sharing a number of common strengths. Both present a detailed poverty analysis based on representative, recent, and technically sound data. This represents impressive progress since the I-PRSP, for which no reliable data on poverty were available. Both strategies exhibit solid analysis of the vulnerability of specific groups—poorly educated individuals, rural population, elderly, children, large households, unemployed, disabled, IDPs and refugees, Roma—and regional dimensions of poverty. Poverty profile findings are used in the development, justification and prioritization of policies proposed in the PRSPs. The data collection and analysis were truly participatory and open processes with technical assistance from the World Bank and other donors.

6. As the PRSPs are implemented, it will be important to maintain the positive momentum in poverty analysis while addressing new issues, such as the links between poverty and public expenditure allocations, integration of qualitative data in the poverty diagnostics, and poverty and social impact analysis of on-going reforms. This work will be supported under the Poverty Assessment Program of the World Bank and by technical assistance from other donors.

7. In addition to common strengths, the PRSP for Serbia provides a concise policy-focused summary of the causes of poverty. It offers consistent poverty projections linking the future evolution of poverty with specific macroeconomic scenarios. The analysis provides a coherent framework for strategic choices, such as emphasis on economic growth, job creation and upgrading of human capital, more efficient social protection, a more decentralized approach to development, and the targeting of the marginalized groups with focused interventions. The strategy pays attention to inequality in well-being and provides in-depth

analysis of its level, sources and implications. It offers a fully integrated analysis of social protection and poverty, with a thorough assessment of coverage and options for reform. The Serbian PRSP distinguishes between factors of rural and urban poverty and links poverty with the state of infrastructure and housing. Finally, the PRSP offers a detailed analysis of the particularly high poverty in southeastern Serbia.

8. For the first Progress Report, the Serbian strategy should encompass: (i) follow-up work on risk and vulnerability (using the 2002–03 Survey of Living Standards of the Population panel data); and (ii) full integration of the marginalized groups (IDPs, refugees, Roma) into the poverty profile using the most recent data.

9. Montenegro's PRSP has a number of strong aspects in addition to general strengths mentioned above. These include: (i) a solid, fully integrated poverty profile, with IDPs, Roma, and refugees represented, using the most recent data (June 2003); (ii) detailed and disaggregated (by gender, region, factors of vulnerability) multidimensional indicators of poverty, including health, housing, education, social inclusion, with the document making a serious attempt to integrate human rights and discrimination issues into the poverty diagnostics; and (iii) collaboration between the Government and NGOs in poverty diagnostics with NGOs taking the initiative and filling the official data gaps.

10. As the Montenegrin PRSP is implemented, attention should be paid to: (i) strengthening prioritization of the poverty profile findings and links of the poverty diagnosis with the strategy and priorities; and (ii) providing analysis of environmental aspects of poverty (with environment being one of the key priorities of PRSP) in the set of multidimensional indicators of poverty. The programmatic Poverty Assessment work, with donor support, will produce such indicators and propose the mechanism for monitoring.

IV. POVERTY REDUCTION STRATEGY

A. Macroeconomic Framework

11. Serbia's macroeconomic framework is consistent with sustainable growth and the authorities' poverty reduction goals, while achievement of the same objectives in Montenegro would require stronger fiscal consolidation than currently envisaged. Both PRSPs include appropriately ambitious macroeconomic objectives: real GDP growth of 3–5 percent per annum through 2010, inflation convergence toward EU levels, and a narrowing of the external current account deficit, in line with the program supported under the IMF's 2002–05 Extended Arrangement. A key component of the policy strategy in Serbia is fiscal adjustment, supported by prudent monetary and wage policies geared to containing the growth in domestic demand while stimulating investment and exports. In Montenegro, the policy framework should envisage stronger fiscal adjustment, in line with available nonconcessional foreign financing, with a view to freeing financial resources for the private sector and safeguarding external competitiveness. In addition, some assumptions in the macroeconomic frameworks of both republics—notably the rapid rise in Serbian domestic

savings, large increases in foreign financing in Montenegro, and sustained high FDI inflows in both republics—appear optimistic.

12. Strict policy implementation will be essential if macroeconomic stability and the poverty reduction goals are to be achieved but will face important challenges. In part owing to new poverty reduction programs—which in some instances have not been adequately costed and aligned with the budgets—fiscal adjustment in both republics will hinge critically on strict prioritization in sectoral programs, efficient targeting of social spending, aggressive cuts in subsidies, a streamlining of personnel costs, growth-oriented tax policy reforms, and further improvements in tax administration. In Montenegro, the use of the euro as legal tender raises the importance of prudent fiscal policy, wage discipline, and resolute structural reforms in achieving the poverty reduction goals. With external debt service scheduled to rise in the coming years with the expiry of grace periods under obligations to official creditors, it is important that both republics increase further their official reserves to guard against possible shocks while ensuring fulfillment of international financial obligations.

13. The continued support of the international community is important for the success of the authorities' policy efforts. The macroframework relies heavily on foreign financing to support poverty-reducing reforms and finance much-needed public investment. While the projected financing is in line with donor indications in November 2003, it has not been pledged yet, pointing to significant risks to the strategy. In the event of a shortfall in financing, the Government would need to follow tighter fiscal policy which may have an adverse impact on economic activity in the short-run. To ensure medium-term debt sustainability, the authorities must continue to follow prudent debt management policies, obtain debt relief from private creditors on terms comparable to those secured from the Paris Club, and implement structural reforms to boost productivity and FDI. Moreover, support from the international community needs to be largely on concessional terms.

B. Structural and Sectoral Policies

Social Sectors

14. In *health*, both republican PRSPs: (i) highlight the relationship of poverty and vulnerability with health and access to health care, drawing on recent household survey data; (ii) acknowledge data limitations and commit to the development of improved and regularly collected data; (iii) highlight the relationship of economic performance and general social conditions with access to the health system and its quality; (iv) draw out important intersectoral linkages; and (v) acknowledge that HIV/AIDS prevalence may be much higher than available statistics indicate and could rise further, and commit to combat the spread of the disease.

15. Most measures in the strategies are intended to enhance efficiency in the health sector rather than target the most vulnerable. Mechanisms to reduce barriers to access (such as informal payments, and corruption) and redistribute resources need to be elaborated. It will be important to embed such measures in the budget process and to monitor public and private

expenditure since progress would involve a reallocation of public expenditure and a reduction in out-of-pocket payments for basic health care, particularly by the poor and vulnerable. The PRSPs acknowledge the problem of direct payments, corruption and bribes but do not include specific measures to tackle these problems.

16. With respect to **education**, the PRSPs for both Serbia and Montenegro appropriately stress the relationship between poverty and education, and call for better targeting of resources on disadvantaged population groups. There is a well justified focus on pre-school education, which currently serves only urbanized and relatively affluent populations, and on adult training, which is important in view of the large, disproportionately poor population without marketable skills. The strategies acknowledge that many secondary programs lack relevance to the demands of the economy but the relationship between types of secondary education and poverty is not addressed adequately. Both papers propose useful indicators for monitoring poverty reduction through education, although more work needs to be done to set benchmarks for some indicators.

17. The Montenegrin and, to a lesser extent, the Serbian PRSPs, support a model in which secondary programs should provide specialized skills on the premise that the demand for them can be predicted, rather than general skills, competencies and learning tools which would allow children to adapt to a dynamic labor market. As the PRSP is realized, some discussion of potential efficiency gains in secondary education will be needed. Success in achieving the PRSP goal of increasing secondary enrollments and secondary completion will significantly expand demand for higher education, pointing to the need to deal with inefficiency and repetition in higher education as a priority. The Serbian PRSP acknowledges problems with the relevance and efficiency of higher education, but the Montenegro paper does not. There is limited discussion of financial constraints, the financial sustainability of proposed policy measures, as well as and the lack of efficiency as a constraint to introducing pro-poor measures in education. This is particularly problematic in the education sector for which the largest single funding request has been made for support in both republican strategies. Questions on the financial sustainability of the proposed recurrent expenditure and the capacity to expand and improve the system rapidly should be addressed in the first Progress Report.

18. The **social protection** sections of both republican PRSPs make excellent use of the available data, and support the policy recommendations in the analysis. The Montenegrin PRSP integrates the results of the recently completed survey of Roma, Ashkali and Egyptians. In Serbia, a household survey on Roma has just been completed. Its findings will inform PRSP implementation. Both republics accurately describe the reform challenges for the pension systems and the need to advance the systemic reforms outlined in the recently passed pension laws. The labor market discussions also correctly identify the constraints to employment growth.

19. The discussion of specific strategies to address poverty and expand opportunities for vulnerable groups, including Roma, IDPs and refugees are underdeveloped in both documents. For both republics, the new household data sources which were completed in Fall

2003 should provide the basis for further refinement during implementation. Coordination between implementation of the PRSP and the new federal strategy for Roma should be a priority. In the case of Montenegro, further analysis of benefit incidence and the impact of these benefits on living standards would be important to assess whether benefits contribute to poverty reduction. More reliable unemployment data can be obtained from the Montenegro labor force survey (11.9 percent in 2002) and from the living standards survey (8.4 percent), than the official registration data cited in the text. In the case of Montenegro it is unclear how arrears in social transfers will be addressed.

Private Sector Environment

20. The PRSPs rightly emphasize that improvements in *the business environment* are key preconditions for sustainable private sector-led growth. The strategy for Serbia acknowledges the need for streamlining the registration process, reducing administrative barriers to business operation, improving corporate governance, and establishing a modern bankruptcy regime. Likewise, the Montenegrin authorities should build on their early progress in the area of business entry and operation by further streamlining the rules and procedures for getting licenses, decreasing waiting time and removing inconsistencies among procedures. In both republics, the authorities are encouraged to focus on building adequate institutional capacity for implementation of the new regulatory framework. In particular, high priority should be given to the *reform of commercial courts* in order to ensure the protection of property rights and enforcement of contracts. The authorities are also encouraged to build on their commendable early progress in the area of *enterprise privatization* by accelerating the restructuring and subsequent divestiture of large problematic socially- and state-owned enterprises. The restructuring process could be greatly facilitated by the creation of an effective mechanism for debt workout that would minimize moral hazard and involve all major state and state-controlled entities.

21. Comprehensive reform of the *financial sector* represents an important cornerstone of governments' growth strategies. For Serbia, the PRSP correctly identifies the short- to medium-term actions needed to strengthen bank supervision, restructure and privatize remaining state-owned banks, and develop efficient capital markets. With proper implementation, these reform steps should help significantly in allowing the Serbian financial system to play its proper role in channeling resources into productive investments. The timing and modality of bank privatization would directly affect the authorities' ability to attract the much needed capital and technical know-how essential for building a robust banking sector. The PRSP also notes the importance of expanding the coverage of microfinance programs, given the vital role of micro and small enterprises in Serbia's economy. Nonetheless, there is an undue emphasis in the PRSP on improving access to credit through government-sponsored institutions (e.g., Development Fund, Guarantee Fund), while more attention could be given to improving financial infrastructure (credit bureaus, collateral legislation) to allow banks to cater to business needs more readily. The PRSP also lacks a well-defined agenda to develop non-bank financial institutions, including the development of an effective insurance sector. For Montenegro, the strategy emphasizes the necessary instruments for lowering and standardizing interest rates, introduction of the deposit

insurance scheme, closure of the Office for Payment Operations, reform of the government treasury operations system, and adoption of a comprehensive regime for prevention of money laundering. In fact, Montenegro has taken a number of important steps in most of these areas as well as in restructuring and privatizing the banking sector. Key next steps should include: finalizing privatization of the remaining state-owned bank, withdrawing Government deposits from the commercial banks, and resolving bad assets carved out of privatized banks.

22. The Serbian strategy extensively diagnoses rural poverty patterns and appropriately links them to alleviation measures. Its balanced emphasis on both ***agricultural and non-farm rural development*** is welcome, especially as integration with the regional, European and world economies will increase competitive pressures on agriculture, and require increases in agricultural productivity, including integration of poorer farmers into the market. The consequent exit of some farmers from agriculture will also create the need to improve prospects for rural non-farm activities. In implementing the Serbia PRSP, additional emphasis could be given to specific investment activities that would raise farm productivity, such as irrigation, extension, and land market development. Completion of farm privatization is an important step toward increased growth. The Montenegro strategy lacks a rural poverty diagnosis and its limited discussion of rural development is almost entirely focused on agriculture rather than non-farm activities. For these reasons, it is not clear how the actions mentioned in the section of the strategy, and the significant resources envisaged to finance agriculture-related activities, will reduce rural poverty.

Infrastructure

23. In ***energy***, as the PRSP notes, Serbia needs to move to a more cost-reflective tariff structure. To this end, the current first block in the block tariff structure will be reduced and offsetting measures will be taken to improve the targeting of subsidies. For Montenegro, there is a need to introduce a power sector social safety net to support poor groups in society. In this regard, monitoring of power affordability will provide the basis for designing a targeted subsidy, perhaps by introducing a block tariff for an interim period or through targeted subsidies. The ***water sector*** strategies of the Governments of the Republics of Serbia and Montenegro appropriately take into account the needs of the poor and address the main challenges the sector is facing. During the implementation of the PRSPs the programs need to become more specific in addressing these challenges and it is expected that the monitoring of the service delivery to the poor, especially in rural and semi-urban areas, will help to further define the programs for the water supply and sanitation sector. Such efforts will contribute towards the attainment of environmental Millennium Development Goals. In ***transport***, the strategies appear to understate the importance of the road transport sector in infrastructure investment. In addition to efforts to improve the operations of railways, ports and marine transport and rural roads, the condition of the main and secondary road networks also require considerable improvement. As the PRSPs are implemented, more attention needs to be given to the role of ***information communications technologies*** (ICT) as the sector has not made its full contribution to poverty reduction and the development of Serbia and Montenegro. This is particularly important given the significant disparities in access to ICT between rural and urban populations and between costs and prices charged.

24. The republican PRSPs appropriately link poverty with ***environmental and natural resource management*** concerns. They emphasize the need for sustainability of natural resource use, noting that environmental and natural resource degradation do not occur in isolation and have to be considered as part of any policy and investment intervention that aims at economic growth and poverty reduction. As PRSP implementation is realized it will be also important to monitor: (i) public health risks posed by industrial pollution (air, soil and water); (ii) health risks faced by the Roma from scavenging municipal waste which often contains hazardous industrial and medical waste, in addition to lack of utility services; and (iii) the potential impact on forests through increased cuts for fuel wood as a result of energy price increases. Both PRSPs also appropriately emphasize the need to improve the legal framework and its enforcement and build institutional capacity. While both strategies identify priority actions, in Serbia only some of them were included in the costing. As shown by the experience of EU candidate countries in Eastern Europe, even a gradual harmonization with EU standards will require a significantly higher commitment of budgetary resources.

Public Administration Reform (PAR), Governance and Corruption

25. The Serbian PRSP reflects the approach and stated priorities of the government towards ***public administrative reform***, on which there is broad agreement among the reformist political parties. Priorities include the rationalization of the structure of the state administration and the reform of incentive systems to reflect European best practice, with particular emphasis on (i) reforming the overly complex pay system in the state administration, (ii) modernizing the legislation governing civil service and public administration management, and (iii) improving the policy management system, in particular by strengthening the capacity of the Government Secretariat. A comprehensive strategy and action plan for reform are under discussion. Altogether, these measures should create a slimmed down and more competitive system of public administration. The objectives and actions are generally well captured in the matrix and are appropriate to achieving these objectives. However, the related policies/strategies matrix column does not make reference to the actual adoption of the strategy and action plan on PAR, even though its principles are well reflected in the actual PRSP. This is a missed opportunity. In the implementation and monitoring phase, the objectives and outcome targets should contain a specific reference to the creation of a merit-based and impartial civil service.

26. Montenegro's significant progress on many PAR related issues is not done full justice in its PRSP. Montenegro has adopted a comprehensive PAR strategy and has over the last year adopted several key pieces of legislation on Public Administration, and also has started the process of rationalizing administrative structures. The Montenegrin strategy would benefit from a similar matrix with specified policy actions to make the document more concrete, and allow the effective tracking of PAR implementation.

27. As noted, the consultative process was particularly useful in putting the subject of ***governance and corruption*** into the public arena. However, despite this progress, the

strategies do not address these issues frontally. Given their importance to the revitalization of the economy, greater attention will need to be paid to these issues during PRSP realization.

V. COSTING, IMPLEMENTATION, MONITORING AND EVALUATION

28. **Costing.** The authorities have made considerable efforts to begin to cost the PRSP programs but this is clearly still a work in progress, especially in Montenegro. Both strategies give preference to education, health and social protection and, in the case of Serbia, also to SMEs. Montenegro has a much larger allocation for agriculture and rural development, despite the relatively weak discussion on this part of the strategy (some of these funds, however, are for paying rural pensions). Nonetheless, in general, program costs are inconsistently derived and in some instances, appear excessive. Tables in both documents include some measures that are not discussed in the text.

29. Beyond costing, the PRSP programs will need to be increasingly aligned with the budget process. Serbia has initiated this process in the FY04 budget but much work remains to be done to fully integrate the process, including: (i) further elaboration on the link between the envisaged budget allocations and the policy priorities; and (ii) identification of specific policy actions along with target dates for their implementation within the priority PRSP sectors. Montenegro should undergo a similar process of prioritizing and sequencing reforms consistent with medium-term fiscal consolidation and with realistic assumptions on foreign financing. The Bank may provide additional technical assistance in this area to both republics over the coming year.

30. **Implementation.** While significant organizational infrastructures were established, some with donor support, for the development of the PRSPs in each republic, plans for their institutionalization are not fully developed and capacity constraints are serious. Both republican strategies will need to devote considerable attention to strengthening plans for implementation and sustaining the requisite institutions and channels of communication. This is all the more critical given that there have been personnel changes in both governments. It will be important for the new Serbian Government in particular, to reaffirm its commitment to the principles of the PRSP and to take on its implementation immediately. As external financing for PRSP development comes to an end in Montenegro, the government will need to ensure adequate financial and institutional support for its implementation. Finally, public expenditure management needs to be enhanced in both republics to support effective PRSP implementation.

31. **Monitoring and evaluation.** The setting of achievable and measurable outcome benchmarks aligned with MDGs receives adequate attention in the PRSPs, with baseline data provided for all selected indicators. This represents commendable progress since the I-PRSP and reflects a cross-sectoral effort and collaboration by government agencies and NGOs. The PRSPs provide few details on how the Government is planning to improve administrative data within key programs directly impacting the welfare of the poor. This issue will need to be discussed in the first Progress Report. Public access to data (including survey data) should be explicitly mentioned as a key element of the participatory process for monitoring the

PRSP, and needs to be treated seriously in PRSP implementation to foster transparency and broad acceptance of the findings. The strategies offer a wide range of indicators but few details are provided on plans to carry out evaluations or Poverty and Social Impact Assessments of the policy actions and programs. There is also only limited focus on public expenditure incidence analysis and impact assessment. These issues will need to be addressed during implementation and discussed further in the Progress Reports.

32. In the area of monitoring and evaluation, the strengths of the Serbian PRSP include: (i) justification for core indicators, and explicit and clear alignment with EU Accession agenda and MDGs; (ii) plans to produce core indicators disaggregated by region, household type, gender, age and vulnerability characteristics; and (iii) a detailed M& E institutional set up including budgeting. However, it also shows: (i) a lack of prioritization among 160 process indicators (input and outcomes) monitored through sectoral systems; and (ii) development and reporting of target values only for some key indicators (such as poverty rate or GDP growth rates). During 2004, this should be refined and improved with results to be discussed in the Progress Report.

33. The Montenegrin PRSP presents indicators that appropriately include key data related to public expenditure. However, the strategies lack discussion of the institutional arrangements for monitoring and evaluation and do not provide costing for producing indicators and monitoring them, while financing arrangements are vague. The strategies also fail to specify a feedback process through which monitoring and evaluation results will be disseminated and used to decide future courses of action. It would be important to know more details on the ongoing reform of the official household survey (HBS) and targets related to the transfer of poverty indicators from MONSTAT. These aspects could usefully be detailed in the first Progress Report.

34. **Support for the PRSP.** The World Bank Group, with support from the IMF and other donors, has launched a number of initiatives and events to support PRSP development in SAM. Serbia and Montenegro each received grants from DFID (UK) and the Multi-Donor Trust Fund administered by the Bank to support PRSP development. The Governments are developing a proposal for a second tranche of the Multi-Donor trust fund to support PRSP implementation. The Bank, together with other donors, notably DFID, the EU, Sweden (SIDA), the Netherlands, Eurostat TA, the EC Food Security Program and the UNDP, is helping to improve the collection of statistics and develop capacity-building training programs in Serbia and Montenegro. The IMF is also providing continuing technical assistance for improvement in statistical methods. The Serbian Government, the Republican Statistical Office, the World Bank and SIDA plan to organize a joint workshop in 2004 on statistical capacity for monitoring poverty. The multi-year programmatic approach to the Bank's poverty work in SAM helps to ensure that the results of the poverty analysis and monitoring are used in the process of policy making. A number of analytical papers, including the SAM Poverty Assessment and republican poverty notes have been completed and others are in progress. A regional PRSP workshop and a regional training of trainers seminar were organized by the World Bank Institute (WBI) in Baden, Austria and Budapest, Hungary. Bank staff organized workshops on poverty-environment linkages in each republic.

The Bank, the Fund and the UNDP plan to organize another regional Poverty Forum in Spring 2004. In-country courses on Poverty Analysis for policymakers, researchers and NGOs are also being offered and capacity building initiatives for stakeholders, including Roma, are also underway.

VI. RISKS TO THE STRATEGY

35. Successful implementation of the Serbia and Montenegro PRSP is subject to external and, especially, domestic risks. Although persistence of weak economic activity in key trading partners would dampen export growth and private capital inflows, more serious concerns center on the domestic front. More specifically, against the background of modest output and export growth and a fragile external position, failure to achieve high quality fiscal adjustment and deepen the structural reform process could leave SAM vulnerable to adverse shocks and undermine its ability to attain the PRSP objectives. Sustained fiscal adjustment will require challenging policy actions, including to control the public sector wage bill, subsidies, and transfers. Maintaining momentum on structural reforms will also entail difficult decisions, especially in restructuring the banking and enterprise sectors, as well as good progress in implementing the Action Plan on Harmonization and other measures to support integration with the European Union..

36. Following the December 28, 2003 parliamentary elections, Serbia is in the process of forming a governing coalition committed to reform and the PRSP priorities³. As soon as the coalition is formed, it will be critical that the new Serbian government take quick and decisive steps to initiate PRSP implementation and to ensure its sustainability through the budgetary and consultative processes. Montenegro also needs to move more decisively on its reform agenda. As evidenced in the December Serbian election, reform fatigue backlash continues to be a concern; however, the depth of the reforms makes a backward movement increasingly unlikely. At this crucial juncture, the governments need to sustain strong policy performance and to further strengthen popular support for the reforms by maintaining the dialogue and keeping the commitments established with the public during the PRSP development process. This would also facilitate continued support from the Bank, the IMF, and other donors.

37. Implementation capacity remains a major weakness and concern. Following adoption of the constitutional Charter in 2003, SAM is just initiating multi-year programs to build the necessary institutions. Implementation of the PRSP will thus in the short term present additional complexities and burdens for the governments. Strong government commitment is essential, but it alone is insufficient. Technical assistance and continued support from the donor community, particularly in costing, budgeting, monitoring and evaluation, will be vital

³ Discussions with key democratic block party leaders who are expected to form a governing coalition were held in Belgrade during January/February 2004. Party representatives reaffirmed commitment to the PRSP approach.

to the ultimate success of PRSP realization. The World Bank Group and the IMF intend to provide continued support for PRSP implementation.

VII. CONCLUSION

38. The staffs of the IMF and the World Bank consider that the Serbia and Montenegro PRSP provides a credible poverty reduction strategy and recommend that the Executive Directors of the IMF and World Bank reach the same conclusion. Bank staff further conclude that the PRSP represents an adequate basis for World Bank support and recommend that the Executive Directors of the World Bank reach the same conclusion.