POVERTY REDUCTION STRATEGY PAPER
FOR SERBIA

INTRODUCTION

Towards the end of 2002, the Government of the Republic of Serbia initiated the development of the Poverty Reduction Strategy Paper (PRSP) for Serbia. The initial platform, strategic options and the preparation process of this strategy and its implementation were all defined in the Interim PRSP, approved and adopted by the World Bank and the International Monetary Fund.

The PRSP, together with the Republic of Serbia Reform Programme, represents part of the overall development strategy of Serbia, within the wider framework of Serbia and Montenegro's accession to the European Union.

The PRSP is also part of the Government's Framework for International Support and Developmental Cooperation, as well as a plan of activities for the achievement of the United Nations Millennium Development Goals.

The importance given to poverty reduction by the new democratic Government of Serbia has already been clearly expressed in its first reform document "A Reform Agenda for Serbia (2001)" featuring three main objectives:

- The establishment of a modern state based on the rule of law, including the fight against corruption and organized crime;

- The revitalization of the economy through the introduction of market-oriented reforms;

- The fight against poverty and the improvement of the social protection system for the most vulnerable groups.

In line with the UN Millennium Development Goals, the PRSP defines poverty as a multi-dimensional phenomenon that in addition to representing insufficient income to cover basic needs, also includes a lack of employment opportunities, and inadequate accommodation and access to social protection, health, educational and communal services. These aspects are particularly important in the case of vulnerable and socially excluded groups. The other key elements characterizing poverty are lack of access to a healthy living environment and natural resources, above all clean water and air.

The PRSP represents a holistic plan of activities aimed at reducing key types of poverty by creating financial and other preconditions and by offering everyone the opportunity to secure an existence for themselves and their families. Serbia has sufficient human, financial and natural resources to eliminate - in a relatively short period of time and relying on its own strengths with the assistance of the international community - the most acute forms of poverty, particularly present in underdeveloped regions and concentrated among the most vulnerable groups.

Poverty in Serbia, apart from having similarities with other countries in transition and developing countries, also has many specific features:

First, widespread poverty is a relatively new phenomenon, caused by the dramatic drop in GDP and the living standards of citizens in the1990s, as a consequence of the former authoritarian regime, international isolation, severe economic sanctions, negative economic consequences evoked by the disintegration of the former Socialist Federal Republic of Yugoslavia, wars in the neighbouring countries, and NATO bombing.

Secondly, the latest research on the scope and causes of poverty clearly indicates that poverty in Serbia, besides being concentrated in the traditionally under-developed South and Southeast regions, due to dramatic economic and social changes in the 1990s, has spread to other regions as well. On the other hand, poverty mostly affects socially vulnerable groups (children, the elderly, persons with disabilities, refugees and internally displaced persons, Roma, the rural population and uneducated people). For that reason, the basic empirical findings that show that 10.6% of inhabitants or 800,000 individuals are poor, should serve only as a starting point for the development of the full PRSP, since only a small shift in the poverty line increases the percentage of the poor to 20% or 1,600,000 people.

Thirdly, under such highly unfavourable economic and social conditions, the new Government resolutely initiated a painful, but unavoidable process of transition towards a modern, market-oriented and open economy. The process of modernization, restructuring and privatisation of the economy as well as the rationalization of non-economic activities which is ongoing, has caused some additional social problems, through numerous redundancies and the creation of new "pockets" of poverty, which have been concealed up to now.

The characteristics and profile of poverty in Serbia point to the following three main directions in the formulation of the Poverty Reduction Strategy:

> **In the first place**, a strategy of dynamic economic growth and development, with an emphasis on job creation in the private sector. The increase in economic activities and greater international competitiveness of the domestic economy will lead to an increase in GDP, the creation of new jobs, better incomes and real sources for financing social and other public needs. This is a key development direction and the priority for Serbia, and is the only way to improve the lives of citizens and at the same time eradicate poverty permanently. This implies the continuation of the policy of macro-economic stability, the creation of an environment attractive to foreign investment and the mobilization of domestic investments; accelerated restructuring and privatisation which will revitalize those state/socially-owned enterprises capable of becoming market-oriented and competitive; the creation of a business environment for the development of entrepreneurship and faster development of small and medium enterprises; development of the control functions of the state which would legalize the so-called grey economy; a resolute battle against corruption and organized crime; and the efficient working of state institutions – legal, executive and judicial authorities.
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> **The second strategic direction** is the prevention of new poverty that will result from the modernization and restructuring of the economy and rationalization of the state and its basic functions. In line with the orientation towards market and other reforms, new employment opportunities need to be offered to these groups.

The state with its institutions (including the National Employment Agency, the republic and regional agencies for SMEE development, and the education system) in close cooperation with municipal authorities and local communities, through its own activities and the mobilization of non-governmental organizations, and with the expected assistance of the international community, should offer retraining incentives and opportunities. Significant economic and social efforts will be required, particularly in the regions with a traditional and non-profitable economic structure. Considerable financial resources represent a necessary, but not a sufficient condition.

The third strategic direction implies an efficient implementation of existing programmes, as well as defining new ones and measures and activities directly targeting the poorest and the most vulnerable groups (children, the elderly, persons with disabilities, refugees and internally displaced persons, Roma, the rural population and uneducated persons), particularly in the least developed regions. The goal of these activities is to initiate a long-term process of empowering vulnerable groups to move out of poverty, through the development of new market-oriented skills, and the provision of minimum standards of living. From the aspect of the most visible poverty, this will enable not only the survival of these groups, but also their equal access to employment, health care, education and utilities, as well as protection of their basic human rights. The permanent improvement in the overall economic and social status of the most vulnerable groups will, more importantly, prevent the recurrence of poverty within the same social groups.

The PRSP will be financed from fiscal resources, budgetary savings and additional resources with the financial assistance of the international community. This will enable the indicative costs presented in the PRSP to be reflected within the Medium-Term Expenditure Framework. In this way, the fight against poverty will find its place among Government efforts and in the preparation of annual budgets. This will enable the setting of realistic fiscal targets within financial and other constraints, and the commitment towards maintaining macro-economic stability in the country. At the same time, the "resource gap" (missing funds) will be identified, in order to define alternative scenarios for poverty reduction and the prevention of basic forms of poverty depending on the extent of support offered by the international community.

The PRSP consultative and participative process, and its adoption and implementation, are characterized by an integrated approach, aimed at:

- National ownership of the PRSP;
- Inclusion of all relevant stakeholders in the implementation of the PRSP;
- Efficient and transparent information dissemination;
- Efficient monitoring of the PRSP as a whole and in its individual aspects by means of adequate and internationally comparable indicators.

This multi-dimensional approach to the alleviation of poverty, apart from significant financial resources, requires great organizational efforts, coordination between the Republic and local levels, the definition of sectoral and other priorities, strong cooperation between state institutions, civil society and the international community, professional support, and above all, a sincere willingness and readiness of all participants to participate actively and responsibly in the entire process.

I SCOPE AND CAUSES OF POVERTY IN SERBIA

1. Main Causes of Poverty in Serbia

In the past decade (1990-2000), the fall in the living standards of the population and the increase of poverty in Serbia resulted in the first place from a great fall in economic activity. Gross Domestic Product (GDP) in 2000, both overall and per capita, was less than half the level achieved at the end of the 1980s. Such a fall in economic activity was a consequence of a ten-year general political and economic crisis.

The main non-economic factors in this crisis were the break-up of the former Yugoslavia, wars in the region, the international isolation of the country, and NATO bombing. The main internal crisis factors originated from the interruption of the process of social and economic transformation as a consequence of reviving traditional forms of social integration and the degradation of political culture with the crumbling of socialism. All this caused a lack of political will to carry out radical institutional reforms and, consequently, slowed down the development of market institutions and of a state based on the rule of law.

The secession of the former Yugoslav Republics led to the dissolution of the FRY single market and a drastic fall in the inter-republic and foreign trade of FRY (inter-republic trade between FRY and former Yugoslav republics accounted for 40% of GDP, while trade with other countries accounted for 20% of GDP[1]). In addition, a considerable proportion of the infrastructure and production capacities were destroyed by NATO bombing in 1999, which had an additional unfavourable impact in terms of a fall in production and employment. Poor economic results in this period were additionally aggravated by the inappropriate economic policy which caused high inflation rates in certain years of the previous decade and the so far unprecedented hyperinflation in 1993. The hyperinflation for its part led to great impoverishment of the population and the expansion of the grey economy which became the main means of survival for the majority of the population. The difficult economic and social situation was additionally aggravated by the great influx of refugees and internally displaced persons, whose number in some years reached 10% of Serbia's population. Apart from this, the living standards of part of the population were also affected by the (temporary) inability to dispose of their income and property in the former Yugoslav republics. The number of citizens with greater social needs grew, while the economic capacity of the state to meet these needs was in constant decline, so some of the most vulnerable groups had great difficulty coping with the consequences of the economic crisis.

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[1] This points to the great significance of the ending of the international blockade and the establishment of normal economic relations with the former Yugoslav republics

The most important factor in the growth of poverty was the fall in per capita income since inequality in income distribution was relatively stable during the previous decade. During this period, official unemployment increased. There was also hidden unemployment since the number of the employed decreased more slowly than the sharp fall in economic activity. At the end of the period, hidden unemployment reached the level of about one third of total employment. This situation in the labour market caused a fall in real incomes and arrears in their payment generating poverty for the majority of the population.

In the period 2000-2002, the establishment of macro-economic stability and the real increase of GDP (around 4-5% annually), as well as the increase in wages and other income in real terms, caused growth in consumption and living standards.[2] In spite of the elimination of price disparities in 2001 and 2002, prices remained relatively stable, living standards increased in real terms and poverty was reduced. Despite the falling trend, the level of poverty is still relatively high, with the percentage of the population near the poverty line being particularly critical.

The picture of poverty is additionally burdened with 480,000 refugees and internally displaced persons.[3]

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[2] These positive results were achieved owing to the adequate external assistance and realization of the succession and privatisation proceeds

[3] According to the latest data of UNHCR and the Refugees Commissariat of the Republic of Serbia, 280,000 refugees and 200,000 internally displaced persons were registered in the territory of Serbia and Montenegro.

Causes of Poverty

- Historical Outline -

Folk tradition very clearly distinguishes the causes of the emergence of poverty, and treats them differently. These causes can be classified into several main groups: 1. fateful, 2. inherited, 3. personal and 4. general.

Fateful poverty is the consequence of "force majeure" and it is very difficult or impossible to eliminate. Whatever one did, worked hard, created things, the result would always be negative. Something will always happen that will devalue one's efforts and leave the individual who had put his efforts into it without the rewards merited.

*"Force majeure" that prevents one from getting away from poverty is called **Misery**. In the Slavic folk tradition it is represented as a supernatural being who travels around the world, attacking and torturing people. It is possible to eliminate this kind of poverty, "to take misery off one's back", as the saying goes, only if one's own or one's ancestors' sins are tracked down and atoned for.*

Inherited poverty is frequent, and folk tradition is full of data and stories about poor families. This kind of poverty was very much present among the Serbs and one can freely say that it can be applied to the majority of poor people in Serbia. However, the fact is that this poor stratum has decreased over time. "Escape from this kind of poverty" has always met understanding both from individuals and from the broader community. The "escape" was fully divergent, i.e. it developed in different directions. One could change residence, find a job, become educated, save, work hard or move to a richer environment. According to folk stories collected and published by Vuk Karadžić, one could run away from inherited poverty by working, getting educated, and acquiring knowledge and awareness.

Personal causes of poverty are numerous and very clearly classified in folk tradition. Idleness, irresponsibility, laziness, prodigality, alcoholism, and gambling are the main causes of one's poverty. There is no understanding for such poverty and the common belief is that those individuals should not be given any material assistance because it is a futile effort. They are believed to be guilty for their own condition; therefore they have to find a way out by themselves. Miloš Obrenović had a similar opinion, and he did not consider poor "a good-for-nothing, a lazybones, a drunkard and the like, whom I never forgave and who are not to be forgiven for anything."

General reasons for poverty are consequences of natural disasters, economic crises or political events (wars, loss of privileges and position, state robbery). They are usually temporary and related to persons affected by some of these events. For those who become impoverished under such circumstances, if they have no personal guilt, there is great understanding among people, because they are "guilty without guiltiness" and the common opinion is that they should be given necessary assistance by the broader community and the state. They do not lose their reputation and the common belief is that they should be helped as soon as possible; also, that they will soon recover.

In the 19th century, and in some places even later, there was an institution called the "village basket" in which everyone allocated certain amounts of wheat after harvest, according to their ability and yield. That wheat would be given to the poor to feed themselves during winter and spring or when crops failedl. The village chieftain would decide with the most distinguished heads of households who would have the right to use the wheat.

In former times the state was usually not blamed for poverty, and it was not responsible for fighting poverty. The common belief was that it depended on the person himself whether he would be a poor or a rich man and that his success in life basically depended on his own efforts. Thus Čedomilj Mijatović advised the young that they would best succeed in life if they stuck to traditional virtues, such as honesty, diligence and thrift (1892).

2. Scope of Poverty in Serbia

2.1. Definition of Poverty and Basic Poverty Indicators

In this section, poverty in Serbia is analysed on the basis of the Survey on the Living Standard of the Population (SLSP) that was carried out in May – June 2002 on the territory of Serbia (without Kosovo and Metohija). The main sample comprised 6,386 households or 19,725 persons. This is the largest and the most comprehensive survey on living standards carried out up to now in Serbia.[4] In this section poverty is primarily observed as insufficient consumption, while other sections look at the multi-dimensional phenomenon of poverty relying on all available empirical and qualitative analyses.

In 2002, poverty in Serbia was for the first time defined by using household consumption as the main aggregate in poverty measurement.[5]

The poverty line was defined in two steps. In the first step the food poverty line was defined as the line of absolute poverty on the basis of a minimum consumer food basket and the minimum average daily calorie intake. This was based on the consumption structure from the Survey on the Living Standard of the Population (SLSP) and adjusted to the nutritional recommendations of the FAO (Food and Agriculture Organization), a daily average of 2,288 calories.[6] The minimum consumer basket for a four-member[7] household, defined according to regular standards, amounted to 7,605 dinars a month. The second step defined the complete poverty line that, as well as expenditures on food, included also expenditures on other things (clothes and shoes, hygiene and household goods, transportation, health, and education). It was defined as the total consumption of those households whose food consumption equals the minimum consumer basket. In that way the poverty line of 4,489 dinars by consumer unit was defined. Consumer unit allows for the differences in consumption of adults and children as well as for shared household costs.[8] Thus every individual whose monthly consumption by consumer unit is below 4,489 dinars is considered poor. About 10.6% of the population of Serbia or 800,000 individuals were below this poverty line in 2002, because their consumption by consumer unit was on average less than 4,489 dinars or 72 USD[9] a month, i.e. 2.4 USD a day (Table

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[4] The survey sample comprises population with permanent residence in Serbia, so that refugees and internally displaced persons are only partly included in this research.

[5] Just for the purposes of general comparison of the 2002 survey with previous research into poverty in Yugoslavia/Serbia, poverty was defined on the basis of household income so as to enable the use of the same aggregate for poverty measurement as used in previous research.

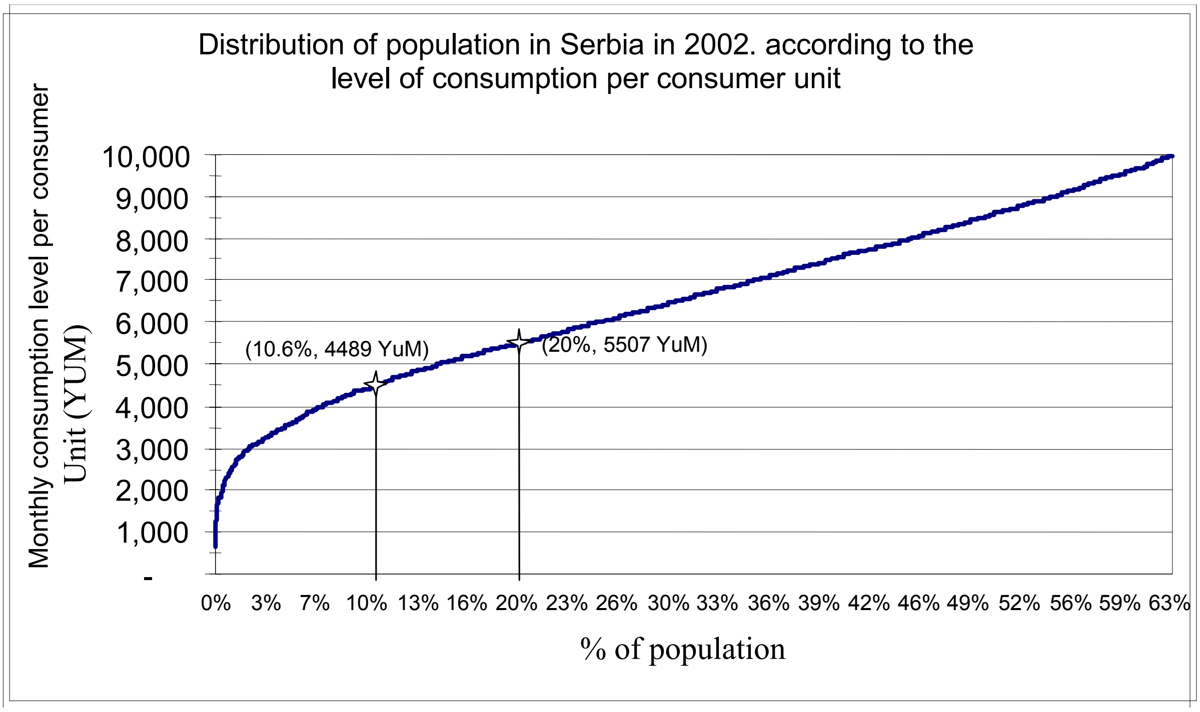
[6] This consumer basket reflects the current structure of consumption in Serbia. The consumer basket structure by each article equals or exceeds the consumption of the lowest decile.

[7] Four-member household includes two adults, one child younger than 7, and one child between 7 and 18 years of age.

[8] Consumer units in this study are determined empirically on the basis of SLSP data, using Engel's method. The equivalency scale used for expressing consumption of household in terms of consumption by consumer unit is as follows: Serbian scale = (1 + 0.81*(Adults-1) + 0.24*Children(0-6) + 0.75*Children (7-18).

[9] The official Dinar-US dollar exchange rate was used.

1). The SLSP analyses show that the depth and severity of poverty are not high and that is consistent with the fact that inequality in income distribution in Serbia is not high[10].



However, the concentration of population around the poverty line is high. Just a small shift of the poverty line upwards significantly increases the percentage of the poor. Consequently, the population group situated just above the poverty line is at risk of poverty, under the influence of external shocks, such as macroeconomic instability, job losses as a result of transitional economic reforms, etc. Because of that, the population situated just above the poverty line was also analysed since a small fall in real earnings and other revenues or the growth of real unemployment, could significantly increase the share of the poor in the coming period. For that reason, it is considered that the 20% of the population with consumption on average less than 5,507 dinars a month, is at risk of falling below the poverty line.[11]

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[10] The poverty depth (gap) equalled 2.2%, which indicates the amount of resources (as a percentage of the poverty line) that the state theoretically needed to mobilize to bring the whole population above the poverty line and eliminate poverty. The severity of poverty, an indicator that takes into account that some people slide deeper into poverty, i.e. further than others below the poverty line (which gives them greater weight), reached 0.8%. The severity of poverty indicates the degree of inequality among the poor and basically depends on a comparison between groups and with the overall population (e.g. Table 1, the rural population has considerably greater severity of poverty of 1.1% compared to 0.5% for urban poverty)

[11] If a subjective measure of poverty is used, based on the understanding of an individual about the level of income necessary for meeting his/her basic needs, more than half the population in Serbia were poor.

Table 1. Poverty Indicators in Serbia in 2002

	Population at risk of falling below the poverty line (poverty line = 5,507 din.)			The poor (poverty line = 4,489 din.)		
	Poverty Index	**Poverty gap (depth)**	**Poverty Severity**	**Poverty Index**	**Poverty Gap**	**Poverty Severity**
Urban	16.0%	3.3%	1.1%	7.8%	1.5%	0.5%
Rural	25.1%	6.1%	2.3%	14.2%	3.2%	1.1%
Total	20.0%	4.6%	1.6%	10.6%	2.2%	0.8%

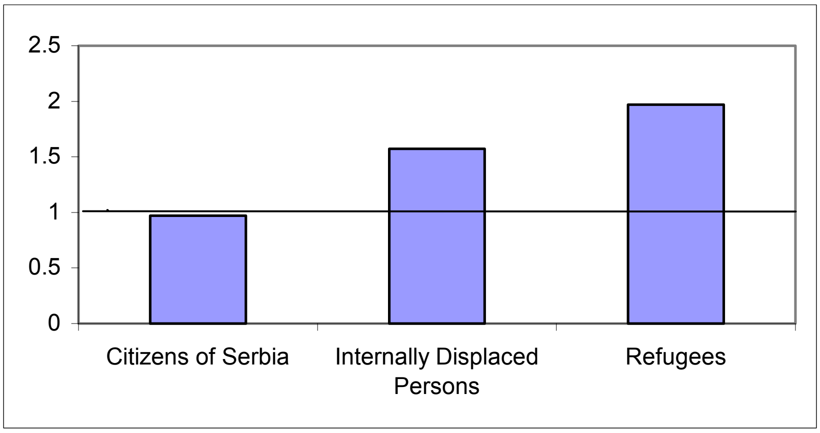
Source: SLSP 2002.

The SLSP shows that in 2002, about 800,000 people in Serbia were poor and about 1.6 million were at risk of falling below the poverty line. Observed by households, 10.3% or about 250,000 households in Serbia lived in poverty, and 19.5% or about 474,000 households were at risk of falling below the poverty line.

The picture of poverty in Serbia is even more sombre than this suggests, since the data discussed do not include all the refugees and internally displaced persons who are more affected and vulnerable than those with permanent residence in Serbia. Figure 1 illustrates this, showing clearly that refugees and internally displaced persons who are included in the SLSP are at much greater risk of poverty[12] than Serbian citizens. It is also necessary to mention that this survey does not include either Roma or the 25,000 people living in collective centres, who certainly belong to the most vulnerable group.

Arising from all these aspects, a rough estimate indicates that around a million people in Serbia are below the poverty line and more than two million are at risk.

Figure 1. - Relative Poverty Risk of Refugees and Internally Displaced Persons in Serbia in 2002.



Source: SLSP 2002.

[12] Relative poverty risk is calculated as the growth (fall), expressed as a percentage, of the poverty index of the reference group compared to the average poverty index.

Poverty in Serbia has become a rural phenomenon, as in the majority of other transition countries.[13] This can be explained by the fact that the growth of employees' earning and pensions in real terms, which represent a dominant source of income of the population in the urban areas, was relatively higher than the growth of other income sources. The other causal factor concerns difficulties in trying to encourage modern institutional practices in areas with a prevalence of traditional cultural patterns. The rural population was significantly poorer than the urban population since the poverty index of the rural population was almost twice as high as the poverty index of the urban population, while their relative poverty risk was about one third higher than the average of the total population. The depth (gap) and severity of poverty in rural areas was also higher than in urban areas. If the population at risk of falling below the poverty line is observed, it can be noted that the difference between the urban and rural population and the depth of their poverty are smaller.

2.2. Poverty Trends

Comparison of the level of poverty in 2002 with previous years. In order to form an adequate picture of the trend of poverty over a longer period, poverty in 2002 was measured in relation to income, since poverty surveys from 1995 to 2000 were also based on household income due to a lack of adequate information on consumption. For the sake of comparability, household income was defined in the same manner as previously. For the same reason the poverty line was established on the basis of the FBS consumer basket, as in former studies on poverty. The line was set at 3,560 dinars per consumer unit. HBS (Household Budget Survey) consumer units were applied to SLSP data. In this way, all three elements needed for the poverty trend analysis were made comparable. This did not, however, eliminate differences inherent in the data sources themselves (SLSP and HBS), namely, the differences in the sample and the questionnaire.[14] This is why a comparison of poverty in 2002 with previous years can only be used as an indication of possible tendencies.

Table 2. Changes in poverty levels in relation to income in the period 1995-2002

	1995	2000	2002
Poverty income in %	28.9	36.5	14.5
Poverty depth in % of GDP	4.1	3.1	3.5
Average income deficit in % of the poverty line	23.2	25.4	32.2

Note: The revenues of the population are defined in a comparable way for the observed period and expressed in terms of consumer units from the Household Budget Survey (HBS). The Consumer Basket defined by the Federal Bureau of Statistics was used as the poverty line for the whole period observed (1995-2002).

The data for 1995 refer to the Federal Republic of Yugoslavia according to: Posarac, S.: Human Development Report Yugoslavia (1997), while for the period 2000-2002, they refer to Serbia without Kosovo and Metohija.

[13] In the majority of transition countries, the reduction of urban poverty was much more successful than reduction of rural poverty.

[14] For further comparability of HBS and SLSP see in Krstic (2003), The Poverty Profile in Serbia, Poverty in Serbia in 2002, Ministry of Social Affairs

Source: HBS for the period 1995-2000, SLSP for 2002.

Despite these methodological limitations, there are certain indications that poverty in Serbia has been reduced, since 14.5% of the population was poor according to their incomes in 2002, compared to more than a third of the population in 2000 (Table 2). The real growth in GDP, wages, pensions and other income has stimulated the growth of household income (and consumption) and a decrease in poverty. However, although the share of the poor in the total population has fallen, they need much more income to reach the poverty line. That means that the poor were much poorer on average than two years previously, and poorer than in 1995.

Who is Poor?

- Historical Outline-

Classical poverty when one starves to death because one literally has nothing to eat or when an individual is not capable of providing for mere existence was very, very rare in the country of Serbia. Serbia was never a country in which people died from hunger; it has rather been a "paradise for a poor man" (Herbert Vivian, 1897).

There are many documents, starting from the Old Testament, that speak about poverty, the poor and their protection, but there are usually no concrete data on who is considered to be poor, where the line that divides the poor from others is and what it consists of. However, in the Byzantine document Prochiron (reference law), published in Constantinople in the 9th century, it is stated who is considered to be poor and thus not eligible to be a witness: "a poor man does not give testimony, and poor is the one who does not have property of fifty small coins." This is one of the first documents that define the poverty line by monetary value.

At a later date, it was again property that served as a line that reflected poverty status. Thus Prince Miloš Obrenović, asking in 1837 that taxes "should not be difficult for the poor", considered poor the one "who is really poor, who is honourable and diligent but has no land, the one who has children or is made poor in some other honourable way." He freed from direct taxes poor people with small children, who had no land but had to feed their families by working as day labourers. So, not having land was for Miloš the necessary but not sufficient condition to consider someone to be poor; the additional condition was that he/she had small children.

From the above examples it can be seen that the line dividing the poor and non-poor was defined by having or not having land or property.

2.3. Regional Component of Poverty

The region with the largest share of the poor is Southeast Serbia, particularly in its rural areas. Rural areas of Southeast Serbia are twice as vulnerable to the risk of poverty compared to the average of the entire population, while the population of urban areas is in a much better position since their poverty risk is almost at the average level. Not only is the rural population of Southeast Serbia the poorest, but also poverty in that region is the deepest and most severe. Western Serbia is the next region with an above average poverty risk, particularly the rural areas in which the poverty risk is higher than the population average by more than a third (+35.8%). The depth and severity of poverty in the rural parts of Western Serbia are also greater than the average. The data lead to the conclusion that the population of the rural areas of Southeast and Western Serbia are the most vulnerable. It represents 14% of the entire population and one quarter of the total number of the poor. One of the reasons for such an unfavourable picture in these two rural areas of Serbia should certainly be sought, among other things, in the much larger share of elderly, one-person and two-member households that were significantly poorer than other households. When the category of the vulnerable is considered, a very similar picture of regional distribution of poverty is obtained.

2.4. The Most Vulnerable Categories of the Population

Gender aspects of poverty. Poverty was approximately equally distributed between men and women since the percentage of poor men and women is almost identical (see Annex). Accordingly, the structure of the entire population by gender represents at the same time the gender structure of the poor population. The situation is the same among the vulnerable. This means that economic discrimination against women (see Anex, Table A1) was not manifested among the poorest population (the average consumption of women below the poverty line was the same as the average consumption of men). However, a number of other indicators (see Annex) point to the unfavourable economic and overall position of women.

Observed by age, the elderly (65+) were the poorest. Their poverty risk was 40% higher than the population average, and the depth of their poverty was also much greater than the average (Annex). They represented 17.7% of the total population and almost a quarter of the total number of the poor. Pensioners made up the largest share in the category of old persons (69%), particularly in urban areas, while other groups had smaller shares: supported persons (22%), agricultural workers (7%) and others (2%).

In considering poverty among pensioners, it is noteworthy that agricultural pensioners, particularly in rural areas, were much more affected than other pensioners, having a poverty risk twice as high as the general population average and facing significantly deeper and more severe poverty compared to other pensioners. Their situation worsens the overall picture of poverty among pensioners since their pensions are extremely low and were very much in arrears.

Children and poverty. The next category with an above average poverty risk is that of children. 12.7% of the population in this age group were poor, and their relative poverty risk was 20% higher than the population average. However, the share of children of this age group in the poor population is much lower than the share of the elderly, reaching 10.3%. Although children do not represent a significant proportion of the poor (because of their low share in the total population), their poverty was relatively deep in comparison to other age groups. The distribution of the share of the population at risk of falling below the poverty line in the total population according to age does not differ from the age distribution of the poverty index.

Poverty was more present in households without children than in households with children (Annex).[15] The poverty risk in households without children was above average (+8.5%), and they made up more than two thirds of the poor. The depth and severity of their poverty was close to the average. Observed according to the household size, the most affected were households of five and more members

[15] The Roma population was not included.

(poverty risk of +26.3%), while observed according to household composition, poverty was most present among single-person and two-member elderly households.

The most affected were elderly two-member households since their poverty risk was almost two thirds higher than the general population average.[16] They made up 12.2% of the total number of poor households, and the depth and severity of their poverty was much greater than the average.

Finally, it is necessary to point out that the categories of households that were most exposed to poverty correspond to those whose economic and material situation was the worst (population at risk of falling below the poverty line).

Link between educational level and poverty. It is easy to draw the conclusion that the share of the poor falls with the rise in educational level. People who are at greatest risk of poverty are primary school dropouts. The poverty risk in the case of these people was twice as high as the general population average and the depth and severity of poverty was significantly greater than in the case of people with higher educational levels.

Highly educated persons (college and university level) were not subject to the risk of poverty as their poverty risk was below average. Only 2.9% of college graduates and 2% of those with a university degree were poor. Such a distribution of poverty related to education level demonstrates that education pays off, since it is rewarded by the labour market. A very similar picture can be seen when the category of the vulnerable are observed by educational level.

Table A3 in the Annex shows poverty by social and economic status according to self-declaration. The poverty indicators differ significantly according to socio-economic status and the type of settlement.

Among participants appearing in the formal labour market, the unemployed were at greatest risk of poverty (59.4% higher than the population average), and also of the deepest and most severe poverty. Individuals employed in the formal labour market had a below-average risk of poverty. When observed according to type of settlement, the unemployed in the rural areas were the most vulnerable, since their poverty risk was twice as high as the general population average or 39.4% higher than the average of the rural population. In contrast, those formally employed in urban areas whose poverty index was more than two times lower than the population average and 38.6% lower than the average of the urban population were in the most favourable economic position.

[16] Elderly households are defined as households whose members are all 65 years of age and older

On the basis of these results, we can conclude that the categories of population in Serbia who are at greatest risk of poverty are:

1. The uneducated;
2. Unemployed and supported persons;
3. Elderly people (65+) and children;
4. Households with five and more members;
5. Elderly single-person and two-member households, particularly in rural areas;
6. Agricultural pensioners, particularly in rural areas;
7. The population of rural areas of Southeast and Western Serbia;
8. In addition, various research and other analyses show that Roma, internally displaced persons and refugees, as well as persons with disabilities, belong to the vulnerable groups exposed to the highest poverty risk.

2.5. Income/Consumption Inequality

2.5.1. Basic Income/Consumption Inequality Indicators in Serbia in 2002

Basic income and consumption inequality indicators are shown in Table 3. The Gini coefficient, based on per capita consumption and on the consumer unit, reached the value of 30, while it was somewhat higher when calculated for income.[17] The Decile Relationship shows that the consumption by consumer unit of the poorest person in the last decile was 6.7 times higher than that of the richest person in the first decile.

Table 3. Basic Inequality Indicators in Serbia in 2002.

	Gini Coefficient		Decile Relationship	
	Per capita	By Consumer Unit	Per capita	By Consumer Unit
Consumption	30.0	29.7	6.8	6.7
Income	33.3	32.2	9.8	8.1

Source: Branko Milanovic, Poverty in Serbia in 2002, Ministry of Social Affairs.

Table 4. Income Inequality in Serbia in the period 2000 - 2002.

	Gini Coefficient	
	Per capita	By Consumer Unit
2000	28.3	28.4
2002	34.4	33.9

Source: HBS 2000 and SLSP 2002.

[17] The Decile Relationship is defined as the relationship between the consumption (income) of the 90th percentage and 10th percentage. For this reason, the decile relationship is sensitive only to the changes at the ends of distribution, unlike the Gini coefficient which measures inequality over the whole consumption (income) distribution.

Income inequality in 2002, measured by the Gini coefficient, increased compared with the two previous years (Table 4) by about 6 Gini points (both per capita and by the consumer unit).[18]

Income inequality in Serbia corresponds approximately to the average value of the Gini coefficient for the group of selected transition countries (Table 5). In comparison twith the countries of the former Yugoslavia, income inequality in Serbia is between the levels in Bosnia and Herzegovina, Macedonia and Slovenia, on the one hand, and Croatia, on the other. The value of the Gini coefficient in Serbia, equalling 33, is situated within the value span of these countries which range between 26 and 36.

Table 5 Comparison between inequality of incomes in Serbia and selected East European countries (countries are ranked according to the Gini coefficient, on per capita basis)

Country (year)	Income or expenditures per capita (USD)	Gini coefficient
Hungary (income; 1999)	1800	26
Slovenia (income; 1998)	4900	26
Bosnia (income; 2001)	1300	27
Macedonia (1998)	1000	29
Byelorussia (expenditures; 1999)	630	30
Ukraine (income; 1999)	820	30
Bulgaria (income; 1999)	820	33
Lithuania (expenditures; 2000)	1200	33
Serbia (income; 2002)	**1480**	**33**
Croatia (expenditures; 1998)	3200	36
Estonia (income; 2001)	1600	38
Russia (income; 2000)	1000	40
Unweighted average	*1360*	*32*

Note: For Bosnia, Croatia and Byelorussia - incomes without imputed rent.
Source: Branko Milanović, Poverty in Serbia in 2002, Ministry of Social Affairs.

In comparison with other countries in transition, inequality in Serbia is somewhere between the values recorded in the Central European countries that have an inequality level below 30, and the Republics of the former Soviet Union (Estonia and Russia - close to 40).

2.5.2. Breakdown of Income/Consumption Inequalities

Labour earnings are the most important source of total income (45.5%) and represent the largest share in total income inequality (47% or 15 Gini points[19]). After labour

[18] Household income, for the purposes of this comparison, has been defined in the same way as in 2000, so income Gini coefficients in this and in the previous table differ. This means that household income does not include either income from durable consumables, or imputed rental value (for more details about other income components, see the discussion on inequality breakdown).

earnings, a smaller share in total income is attributable to pensions (16.3%), natural consumption (12.8%) and incomes originating from agricultural property (11.4%). Pensions and natural consumption are characterized by lower inequality than total income, and their share in total inequality amounts to 12.7% and 11% respectively or 5.3 and 3.5 Gini points. Income from agriculture has a relatively high concentration index (46.1), so that it accounts for 16.5% of total inequality. Other income sources contribute to a far lesser extent to total inequality.

2.6. Transfers necessary for raising the consumption level of the poor

Under the assumption of perfect targeting, and of the Government opting for the provision of (passive) social assistance to the poor as the only measure, it would have been necessary to provide 9.1 billion dinars (Table 6) or 1% of GDP[20] (not including administrative costs of payment of assistance) in order to eradicate poverty in Serbia in 2002. This is in addition to the amount of assistance already provided to the poor through material support to families (MOP). Since the assumption of perfect targeting is unrealistic, the actual funds necessary for the elimination of poverty might be several times higher than this minimum amount. If the targeting of social assistance to the poor were 70%-60%, it would be necessary to provide between 11.8 and 12.7 billion dinars for the elimination of basic poverty.[21]

Table 6. Passive transfers necessary for raising the consumption of the poor population to the poverty line level

	2002.
Average spending of the poor	3,539
Poverty line	4,489
Average resource gap	950
Average deficit (in % from poverty line)	21,2%
Budget necessary for eradication poverty	
Perfect targeting, in billion dinars	9.1
70% -60% targeting, in billion dinars	11.8-12.7

Source: SLSP 2002.

[19] The Gini coefficient corresponds to the sum of weighted average concentration indexes for each income source, whereby the weights represent the shares of corresponding income sources in the total income. The concentration index is calculated in the same way as the Gini coefficient, but the difference consists in the fact that it represents the distribution of a certain income source when the households (individuals) are ranged according to total income, and not according to the income source. (In the case of the Gini coefficient, the ranging criterion is a variable for which Gini – total income is being calculated.)

[20] GDP for the year 2002, which amounted to 948.3 billion dinars, was used for these calculations. The total population of Serbia was 7.45 million.

[21] In market economies, these resources are at least twice as high as the minimum amount necessary for the eradication of poverty in the case of perfect targeting. In transition countries, (Poland, Hungary, Bulgaria, Estonia and Russia) for 1 US dollar of assistance to the poor, between 1.5 and 8 US dollars were actually spent, not including the administrative expenditures related to the payment of these amounts (Braithwaite, J. Grootaert, C. and Milanovic, B. 1999, Poverty and Social Assistance in Transition Countries).

However, a permanent solution to the problem of poverty in Serbia, as defined by the PRSP, requires an active and multi-dimensional response to this challenge, not a passive one.

It follows that the calculation of the minimum financial resources necessary for the elimination of basic poverty must include a wider range of measures including health care and educational measures, incentives for raising income and the employment rate, the creation of a favourable environment for entrepreneurship and private sector development, and proactive social support and social inclusion of vulnerable groups.

3. The influence of economic growth on poverty reduction

The projections of the poverty trend until the year 2010 are based on the assumption that inequality between spending and GDP growth in real terms of 5% per year will remain unchanged.[22] During the period, personal consumption, which is directly linked to the dynamics of poverty, would rise on average 1.9% a year in real terms (see section 1.3.1 on macroeconomic projections). During the first sub-period (2003 – 2006) real growth of personal consumption would be somewhat slower (1.4%) compared to the second sub-period (2.3% from 2007 to 2010). Such growth of personal consumption by 2006, with no change in inequality, would reduce the poverty rate by 20%, while the percentage of the vulnerable would drop by 18% (Table 7). The fall in the poverty rate would be accompanied by an improvement in the depth of poverty. A rapid rise in personal consumption in the second sub-period would accelerate poverty reduction. Thus the percentage of the poor and the population at risk of falling below the poverty line in 2010 would be almost halved compared to 2002, under the assumption of unchanged inequality.

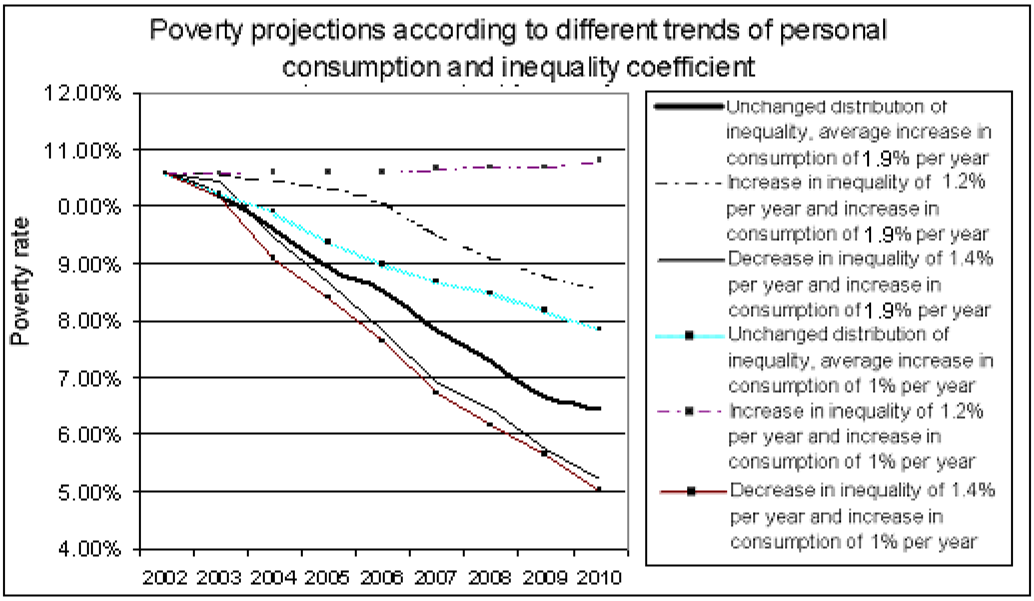
Table 7. Projections of poverty in Serbia 2003-2010

	Population at risk of falling below the poverty line		The poor	
	Poverty index	**Depth of Poverty**	**Poverty index**	**Depth of Poverty**
2002	20.0%	4.6%	10.6%	2.2%
Personal consumption rises on average 1.7% a year (2003 – 2006)				
2006	16.5%	3.8%	8.5%	1.8%
Personal consumption rises on average 2.3% a year (2007 – 2010)				
2010	12.6%	2.8%	6.5%	1.3%

Note: Consumption inequality remains unchanged.
Source: SLSP 2002

The graph below shows the possibility of a considerable decrease in poverty (from 10.6% in 2002 to 6.5% in 2010) with the assumption of an average annual growth in GDP of 4.5% and the growth of personal consumption of 1.9% a year, as well as the set of scenarios for the less ambitious growth of personal consumption of 1% a year.

[22] The poverty line remains unchanged.



The graph displays three basic scenarios of inequality of consumption and two scenarios of growth of personal consumption (1% and 1.9% a year). The first scenario of inequality exhibits no changes in the Gini coefficient of inequality (at the level of 0.31) in the period observed. The second predicts a moderate rise in the Gini coefficient to 0.34 in 2010; at 1.9% annual growth in personal consumption the level of poverty is 8.6%. The third predicts a drop in the coefficient to 0.28 in 2010; at 1.9% annual growth in personal consumption the level of poverty is 5.2%. The second set of scenarios predicts a less optimistic rise in personal consumption – at zero change in inequality the poverty rate in 2010 is 7.8%; at a rise in inequality of 1.2% a year, the rate is 10.8% and if inequality falls by 1.4% a year the poverty rate in 2010 will be 6.5%.

The assumption of unchanged inequality means that the poor benefit from economic growth in the same way as the average population. If the inequality in consumption dropped in the period observed, at the same rate of average growth of personal consumption of 1.9% a year, the alleviation of poverty would exceed that exhibited in Table 7. This means that the poor would benefit more from economic growth than the average population. On the other hand, a rise in inequality with the same rate of consumption growth would lead to a rise in poverty in Serbia.

II TRANSITION AND REFORM FRAMEWORK FOR POVERTY REDUCTION

1. Macroeconomic Framework and Factors of Sustainable Economic Growth

Although a multidimensional definition of poverty has been used, the level of consumption is still a critical factor for determining the poor and the vulnerable. Because of this, increased consumption by the poor will reduce poverty, but also positively influence economic growth.

Because total national consumption is an important element of total production (GDP), consumption by the poor will probably increase with the growth of production as long as inequality in society does not increase, and the foreign, domestic and debt balances remain the same. In other words, economic growth will, under these conditions, ensure economic opportunities for the poor, in the form of employment or increased income, which will enable them to overcome poverty.

Achieving internal and foreign economic balance (getting the fiscal and balance of payments deficit under control) is not only a condition for the poor to benefit from economic growth. It is also a precondition for achieving sustainable economic growth, while a loss of control would lead to macroeconomic instability and would have a negative effect on economic growth.

1.1. Macroeconomic Policy

During 2001-2002 **macroeconomic stability was established** and basic structural reforms were initiated. This is a firm base for the continuation of the reforms and establishing medium-term growth as a framework for poverty reduction. **Macroeconomic policy** was directed towards the removal of the basic misbalance and towards creating the basis for medium-term sustainable macroeconomic stability. Complete price liberalisation (except for infrastructure service prices) was introduced.

Monetary policy was directed towards controlling inflation which arose as a result of price liberalisation, and after that as a result of correcting price disparities and changes within the tax system. The money supply followed strong re-monetization and it was created mainly through foreign currency inflow. Only a small amount of currency emission was used to cover the fiscal deficit. The price liberalisation set foreign currency exchange rates at the market level, the flexible exchange rate was introduced, as well as convertibility on current transactions (Article VIII, IMF). By the NB policy, the nominal exchange rate was kept at a constant level during the last two and a half years, which led to considerable real appreciation of the Dinar.

One of the consequences of the real appreciation of the Dinar is that salaries have increased in Euros. On one hand, this lowered the competitiveness of the economy and on the other hand, it increased the purchasing power of the population in buying imported products. All this obviously had an averagely good influence on the rich, but at the same time just a small effect on improvement of the status of the poor.

With the price liberalisation policy, one of the main sources of the inherited **quasi-fiscal deficit** was corrected. The prices of infrastructural services were increased, so now they mainly cover direct costs of production**.** The electricity price was increased four times and has reached the sum of 4 cents per kWh, which covers operating expenses. The price which will enable the Serbian power generation economy to work normally is 4.5 cents per kWh. A significant correction of the utility service price was also achieved. The correction of price disparity is a significant condition for medium-term sustainable macroeconomic stability, because it decreases public expenditures on direct and hidden subsidies. Establishing price parity of infrastructure services is significant for rational resource usage and for achieving sustainable medium-term growth. On the one hand these measures had a negative effect on the poor, but on the other hand they released budgetary resources, which enabled the government to increase the level of direct support through better targeted programmes such as social protection and pensions.

Fiscal policy was interwoven with fiscal reform, and their goal was to enable necessary adjustments and public revenue and expenditure reform, and to create the necessary institutions. The basic measures in that direction were the introduction of a single sales tax rate (20%), and so called gross salaries as a tax base. The single sales tax rate contributed to the removal of arbitrariness. Its introduction represents a good base for the planned introduction of value added tax in 2004.

During 2002-2003, because of the negative effects of these measures on the poor, the Government annulled sales tax on some of the most important food articles and communal services.

Gross salaries now include the total income of employees (lunch, vacation bonus, etc.) as a base to determine taxation and incomes, so the actual labour costs were stated, and labour taxes according to sectors were balanced. In the medium term, this measure should lead to better labour allocation and to the restructuring of inefficient sectors, which should encourage sustainable growth. In the short term, it had a negative effect on employees in non-productive sectors (textile etc.), because most of their low salaries were gained through items which were not previously included in the tax base

The basic changes in public expenditures were directed towards better management of expenditures (introduction of the non-budget items into the budget, explicit budgeting of subsidies, defining fund deficits and providing budgetary transfers to cover them, etc.), providing regular payments (including pensions) and the reduction of payment arrears (social assistance), introducing the transition fund to support the people most affected by the reforms, larger increases in salaries in the education and health sectors compared to the public sector in general, etc. Most of these measures improved the status of vulnerable groups.

1.2. Basic Macroeconomic Indicators

The following macroeconomic indicators should determine the relative position of Serbia regarding development and poverty, its macroeconomic performance during the first two years of stabilization and finally its initial position for future medium-term growth.

There are two basic factors which determine the level of poverty in a country: the spending p.c. (per capita) level and inequality in distribution. The spending level is closely linked to the level of the gross domestic product (GDP) p.c. defined according to purchasing power, while inequality in distribution is measured by the Gini coefficient.

Since there are no estimates of GDP by purchasing power in Serbia, GDP according to the current exchange rate will be used. See Table 1.

Table 1

	Serbia		Bulgaria	Romania	Croatia	Hungary
	2001	**2002**	**2001**	**2001**	**2001**	**2001**
GDP pc in USD	1409.0	1945.7	1675.0	1743.0	4385.0	5228.0
Gross salaries USD	143.0	217.0	106.0	143.0	535.0	360.0
Net salaries USD	97.6	151.0				
Pensions USD	81.0	108.5				
Unemployment rate %*	28.6	30.5	16.3	10.8	16.1	6.5
Investments / GDP %	10.9	13.3	20.4	21.9	23.8	27.3

* The unemployment rate is determined according to data from the Employment Bureau.

The GDP p.c. is the same as in Romania and Bulgaria, but is less than half that in Croatia and Hungary. The next indicators of spending are average salaries and pensions: salaries are higher than in Bulgaria and Romania, probably pensions as well because they are connected to salaries.

In spite of macroeconomic stabilization and the commencement of the reforms, during the first two years of transition the Serbian economy recorded significant GDP growth (Table 2), even if the high growth of agriculture in 2001 is excluded. The transitional recession affected only industry, which after the period of inactivity in 2001, began to grow in 2002.

This suggests that transitional recession should not be expected in future reforms, and it seems that Serbia can follow the path of sustainable growth. It is obvious that the major production decrease in the 1990s and the accompanying low level of capacity usage caused the already very low level of production to fall to the minimum.

Table 2 in %

	Serbia	
	2001	**2002**
Growth rates :		
GDP	5.5	4.0
GDP without agriculture	2.0	5.0
Industrial production	0.0	1.8
Average salaries	16.5	29.9
Inflation:		
Average period	92.0	19.2
End of the period	39.0	14.8

A very high real increase of average salaries was also recorded. Part of the increase was caused by the increase in unemployment (see Table 1), which excludes people with very low salaries. In addition we must take into account the effects of the decrease in contributions on salaries of 10% which turned into a rise in net salaries. Finally, mistakes in registering salaries happen very often, taking into account that the system of salaries that did not include benefits (for public transport, lunch bonus etc) was supplanted by the system which does includes them. In the light of all this, previous official data certainly overestimate the real rise in salaries. But a real salary increase does exist, which means an improved status of employees. The above-mentioned average salary increase in foreign currency, should be also included.

After the price liberalisation at the beginning of the programme, and after correcting price disparity, inflation was brought under control, so its further medium-term decrease is possible.

In 2001 and 2002 there were relatively high growth rates together with a drop in employment, which, at first sight, seems paradoxical. This is mainly due to the fact that those who lost their jobs had hardly been working at all.

In the medium term, the sustainability of stabilization that has been achieved can be valued on the analysis of internal (basically fiscal) and economic trade imbalance. The review of basic indicators is given in Table 3.

Table 3

	Serbia	
	2001	**2002**
Export/GDP	25.3	19.3
Payment deficit/GDP	-10.3	-12.0
External debt/GDP		66.5
Public expend/GDP	39.5	46.1
Public income/GDP	38.0	42.5
Fiscal deficit/GDP	-1.5	-3.6
Primary deficit/GDP	-0.9	-2.6
Public debt/GDP	...	92.2

Public revenue and expenditure represent consolidated values in the Serbian territory; this includes the Republic, Federal, and local communities' budgets and funds. In 2001, there were already plans for significant fiscal adjustments with a deficit of approximately 3.5%. The actual deficit was less than half of that (1.5%), primarily due to the postponement of expenditures related to the servicing of foreign debt and the support of reforms. The result for Serbia was an unrealistically low level of public expenditures (39.5%). The total amount of public expenditures appeared in 2002, and it increased public spending to 46.1% of GDP, which represents a large sum for an economy in transition (see Table 7).

The fiscal deficit remained fairly moderate (3.6%) and by the standards of the EBRD represents a moderate risk. On the other hand, the existence of a relatively significant primary deficit (deficit that does not include interest payments for public debt servicing) presents a risk of unsustainable increases in public debt. Therefore, the primary deficit should basically be covered by non-credit resources (privatisation, donor funds and income from issued money), in order to prevent the explosion of debt. The public debt is very large (92.5 %), and for the most part it represents foreign currency debt: old foreign currency savings and foreign debt.

It follows that mid-term fiscal sustainability does not leave room for the increase of public spending in GDP, and requires that fiscal deficit be financed mainly from privatisation. This would enable a decrease in public debt to a sustainable level and, along with the expected moderate fiscal deficit, lead to medium-term internal sustainability, with low inflation.

Serbia's external economic position looks critical for the maintenance of medium-term macroeconomic stability. The current balance of payments deficit is high for both years (see Table 3). In 2002 the deficit equalled 12% of GDP, which in the medium term would be hard to maintain and falls into the critical zone according to the basic criteria of the EBRD. The main cause of the large deficit is the very low level of exports, which is now at half the level of Serbian exports in 1990; or between one third to one half of Bulgarian or Croatian exports relatively speaking (in terms of GDP) (see Table 8).

The foreign debt in comparison to GDP is fairly high, but not critically large (the borderline is 80%). However, with a high current balance of payments deficit and its coverage with new loans, the foreign debt could become unsustainable.

Therefore, a critical problem with medium-term macroeconomic sustainability is represented by the size of the current balance of payments deficit and its financing. This refers to the crucial role of export growth and foreign direct investment. The large real appreciation of the Dinar and the consequently high level of labour costs expressed in foreign currency certainly do not aid exports or foreign investment.

Finally, medium-term growth will crucially depend on the rates of investment. Serbia achieved very low levels of investment in 2001 and 2002, almost half that of the other economies compared to (see Table 1). Therefore, to achieve the desired growth, it is necessary to provide conditions for a significant increase in rates of investment within the Serbian economy.

1.3. Medium-term sustainable growth

The analysis of sustainable growth should provide a consistent macroeconomic framework for the medium term, and examine the sustainability and risk of the projected growth, and the determinants that define its size.

1.3.1. Macroeconomic projections and their sustainability

Rise in production, investments and savings

Keeping in mind the expected rate of growth of the real GDP of 4-5%, the medium-term macroeconomic implications are now considered.

The following Table projects the trends of the nominal GDP in Serbia and its possible structure.

Table 4. - GDP and its structure

	2002	2003	2004	2005	2006	2007	2008	2009	2010
GDP current prices, billion Dinars	931.0	1.118.2	1.263.0	1.402.4	1.535.9	1.677.2	1.831.5	2.000.0	2.184.0
GDP, million USD	14.592.5	19.280.0	20.441.2	21.634.3	22.909.1	24.301.9	25.779.5	27.346.9	29.009.6
GDP pc, USD	1.945.7	2.560.4	2.703.9	2.850.4	3.006.4	3.176.7	3.356.7	3.546.9	3.748.0
GDP real growth	4.0	3.1	4.1	4.5	4.5	5.0	5.0	5.0	5.0
Structure, in % GDP:									
Domestic demand	123.6	120.0	119.0	118.0	116.0	114.5	114.0	113.0	112.0
Spending	109.6	104.3	101.8	98.0	95.0	92.5	91.0	89.0	87.0
Personal spending	91.0	86.3	84.6	81.5	79.0	76.5	75.0	73.0	71.5
Public spending	18.6	18.0	17.2	16.5	16.0	16.0	16.0	16.0	15.5
Investment	14.0	15.7	17.2	20.0	21.0	22.0	23.0	24.0	25.0
Net export of goods and services	-23.6	-20.0	-19.0	-18.0	-16.0	-14.5	-14.0	-13.0	-12.0

Total spending (domestic demand): personal, public and investment, is larger than GDP for the sum of the export and import of goods and services deficit. This spending must be decreased over a period of time so as to provide foreign economic sustainability, i.e. to decrease the balance of the goods and services deficit. The basic structural change aimed at involves the relationship between personal spending and investment. The rate of investment should significantly increase in the medium term, from 14% to 25% of GDP, and in that way attain a level comparable to the countries in transition (see Table 1). This requires a relative decrease in personal spending (to 71%) and a decrease in material expenditures for public spending (to 15%) of three percent. Consequently, personal spending should realistically grow at an annual rate of 1.8 %, and public spending at the rate of 2.2%, which is considerably lower than GDP growth.

The relationship between the share of economic (private) and public investments in fixed capital can be appraised based on the well-known structure of investment in 2002: from a total of 14% investments in GDP, 12.1% make up fixed fund investments, and from that 10.1% are economic (private), and 2% public investments.

In view of the fact that investments are financed by domestic savings and foreign influxes, domestic savings can be estimated by taking away the current balance deficit (meaning the influx of foreign resources) from the investment.

Table 5. – Domestic savings %GDP

	2002	2003	2004	2005	2006	2007	2008	2009	2010
Investments	14.0	15.7	17.2	20.0	21.0	22.0	23.0	24.0	25.0
Current balance deficit	12.0	11.5	10.0	9.5	8.8	8.0	7.0	6.5	6.0
Domestic savings	2.0	4.2	7.2	10.5	12.2	14.0	16.0	17.5	19.0

It follows that for sustainable medium-term growth it is necessary for the Serbian economy to achieve a higher level of investment supported by a large increase in domestic savings. With regained confidence in the financial and banking sector, the transfer of domestic savings will be initiated as well as the transfer of money currently engaged in the grey economy into the formal economy. This is a precondition for achieving the projected rise in domestic savings.

Mid-term Internal Balance: Fiscal Projections

The medium-term internal balance is decisively determined by fiscal sustainability. Medium-term fiscal projections are given in Table 6.

Table 6. %GDP

	2002	2003	2004	2005	2006	2007	2008	2009	2010
Income, consolidated	42.53	42.4	42.0	41.8	41.7	41.7	41.6	41.4	41.2
Expenditures, consolidated	46.07	46.1	45.6	45.2	44.8	44.3	43.9	43.5	43.1
Total deficit	-3.5	-3.7	-3.6	-3.4	-3.1	-2.6	-2.3	-2.1	-1.9
Primary deficit	-2.6	-1.9	-1.5	-1.3	-1.0	-0.6	-0.3	-0.2	-0.1
Public debt	92.19	80.3	76.7	69.8	65.2	60.6	55.7	51.0	47.0

The projections take into account the above-mentioned imbalance. The share of consolidated public revenues in Serbia in GDP should decrease by 1.3 percentage points, to 41.2% in 2010. Public expenditures should drop by 3% down to 43.1% of GDP at the end of the period[23]. Consolidated revenue and expenditures in the medium term are acceptable in relative terms.

The fiscal deficit falls from 3.7% to 2% of GDP which is modest and acceptable. The primary deficit is eliminated in the medium term, although it is not negligible until 2006. The fiscal deficit is principally financed from the privatisation income projected at 2% to 3% of GDP. Since the incomes exceed the primary deficit, the share of public debt in GDP is considerably reduced to the level of 47% at the end of the period.

[23] There have been announcements from government representatives that public expenditures and fiscal deficits will decrease faster than was stipulated in the previous table. However, these announcements have not yet appeared in the Budget Memorandum, nor in any other government documents.

A comparative survey of public revenues, expenditures and deficits, displayed in Table 7, shows that the medium-term fiscal projections discussed above are reasonable.

Table 7. %GDP

	Bulgaria 2001	Romania 2001	Croatia 2001	Hungary 1999
Income	37.7	31.4	38.7	42.3
Expenditures, consolidated	40.0	36.0	49.3	45.8
Total Deficit	-2.3	-4.6	-10.6	-3.5

The risks involved in medium-term fiscal sustainability are primarily tied to the projected income from privatisation and its use for the coverage of the deficit. That is, in the event that the primary deficit is covered by a new debt, this would lead to a non-sustainable growth of public debt. Preliminary research indicates that projected income from privatisation is achievable.

Another risk originates from the question whether or not it is possible to maintain the scope of public spending within the projected framework. Aggregate comparisons between the initial state in 2002 and the confirmed budget for 2003 on the one side, and international comparisons on the other, suggest that that is possible. However, this should be confirmed by a more detailed analysis of public expenditures in Chapter II. The projected level of public income is achievable.

Medium-term external balance of payments equilibrium

It has already been pointed out that the basic macroeconomic imbalance in Serbia's economy represents a large deficit in the current foreign balance of payments, caused by the disproportionally low level of exports. The projections of the current deficit have previously been used for calculating the amount of domestic savings. The sustainability of the projections is now discussed.

Table 8. %BDP

	2002	2003	2004	2005	2006	2007	2008	2009	2010
Current deficit	12	11.5	10	9.5	8.8	8	7	6.5	6
Financing:									
Foreign direct investments	6.0	7.5	7.0	6.0	5.5	5.9	6.2	5.4	5.0
Donations	2.0	1.5	1.0	0.5	0.5	0.2	0.2	0.2	0.2
Indebtedness	4.5	2.5	2.0	3.0	2.8	1.9	0.6	0.9	0.8
Foreign debt/GDP	66.5	58.8	60.6	62.6	61.1	58.4	56.0	53.5	51.1
Rate of debt servicing (servicing/export)	5.5	13.1	15.0	15.9	18.0	20.9	20.1	18.7	17.6
Export of goods and services (%GDP)	19.3	19.5	22.5	25.5	27.8	30.0	31.7	33.4	35.0

A very high current deficit remains until 2006, and 10% of GDP (EBRD) can be taken as a critical limit of medium-term sustainability. Apart from the extent of the deficit, the length of its sustained existence also poses a risk.

Financing the projected current deficit should show whether it is sustainable to continuously produce a high deficit in the medium term. Sustainability demands that foreign direct investment should play a key role in financing the deficit. The share of such investment in GDP should range between 5% and 7%. In absolute amounts, these investments should range between 1.3 billion to 1.6 billion USD a year.

A high share of foreign direct investment is necessary to maintain the flow of loans for financing the deficit at an acceptable level in relation to the sustainability of the foreign debt. The projected debt for financing the current deficit thus drops from 4% to 1% of GDP.

All this makes the foreign debt sustainable. That is, the share of foreign debt in GDP falls from 66% to 51% (the critical level is 80%), while the debt servicing rate amounts to 20% at most (the critical value being 25%). This, of course, is possible since two thirds of the debt was written off by the Paris Club. It is also expected that debts to the London Club, and to Russia, China and others will be successfully reprogrammed, and this was taken into account in the above assessment.

1.4. Sustainability of projected economic growth: sources of growth

The previously outlined medium-term macroeconomic projections are based on the assumption of 5% real growth. A significantly lower rate would bring high risks because some basic factors, like the servicing of foreign debt and public spending, are almost independent of the scope of production. Therefore, slower growth of production would mean proportionally larger public expenditures and a higher fiscal deficit on the one hand, and a larger rate of foreign debt servicing on the other.

The latest projections of the IMF (July, 2003) basically assume the same rate of growth as does this analysis. A growth rate of 4% in 2004 and 4.5% in 2005 is predicted. Although our projections are given for a growth rate of 5%, they would in fact be sustainable for every rate between 4% and 5%. Two other important elements of the macroeconomic framework, external sector and fiscal, are also basically consistent with these two analyses.

In the following part of the document, we shall discuss how realistic the projected growth is in the wider context of the impact of the reforms on growth, based on the accumulated experience of transitional economies, as well as the question of whether the projected macroeconomic framework can serve as a basis for the projected level of growth.

The growth survey in 13 European countries over the transition period (1989 to 2001) brings out three basic points relevant to the assessment of the medium-term growth rate in Serbia. In the first place, all the countries have gone through a sharp transitional recession with a significant fall in production. Secondly, after passing through the transitional recession, a certain number of countries were able to achieve continuous growth in production (Hungary, Poland, Slovakia, etc) while others (Bulgaria, Romania, Czech Republic, etc) have entered into yet another recession. Finally, the highest level of medium-term growth achieved is approximately 5%.

The Serbian economy recorded a larger fall in production during the 1990s than took place in the transitional countries being considered.. With the start of stabilization and reforms Serbia achieved growth in production, while the recession was felt partly in industry (see Table 2). It follows that the economy has gone through transitional recession and that it can ascend onto the path of medium-term growth. A decisive element for the achievement of high medium-term growth is that the growth is continuous, that is to prevent either a balance of payments or an exchange rate crisis, i.e. a fiscal crisis that would tip the economy into recession.

Comprehensive econometric research of transition economies shows that basic determinants of their growth were: a low inflation rate, a decrease in public spending, and reforms. A decrease in the inflation rate, i.e. establishment of macroeconomic stability, led to the increase in the growth rate. The influence of public spending on growth is shown in the relative (in terms of GDP) size of the fiscal deficit, i.e. moderate public spending. It was confirmed that a larger fiscal deficit, i.e. relatively higher public spending, causes a decrease in the rate of growth. Finally, structural reforms led to the acceleration of growth. The degree of liberalization, the index of small and medium enterprise privatisation, private sector share in GDP etc. were used as reform indicators. Empirical research also explained the phenomenon of transitional recession: reforms at first lead to a decrease in the growth rate, and later to its increase.

Based on the correlations for the sample set of transition economies, it is possible roughly to project the potential growth rate of Serbia's economy, bearing in mind the previously stated presuppositions on macroeconomic stabilization and public spending (Table 6), as well as on the corresponding dynamics of reforms. Since the largest part of the fiscal deficit will be financed from privatisation income, while only a small part will be covered by loans, i.e. non-inflationary sources, it follows that the inflation rate can be significantly reduced from 19% in 2002 (Table 2) to 5% after 2005. The reform dynamics are planned in such a way as to achieve the level of "weaker" EU membership candidates in 2006. Such dynamics of fiscal and macroeconomic adjustment on the one hand and of structural reforms on the other show, on the basis of the experience of other transitional economies, that medium-term average growth in Serbia of 5% a year is ambitious but feasible.

Public investments in infrastructure

A part of the total investments, which are to support medium-term growth, are public investments. They are only a small part of overall investment, but apart from their direct impact on growth in production, they also have an indirect effect through creating a favourable environment for investment and growth in production. The share of capital expenditure in the public expenditure of Serbia is low. Therefore, above-average growth is planned for the medium-term period. There should be a relative increase from 2% to 4% in the share of GDP, thus achieving a level comparable to international standards.

It is estimated that around one third of the overall investment[24] in Serbia in the period 2004-2006 will be directed to infrastructure (transport, energy, telecommunications, postal service, utility infrastructure). These investments will be financed from:

- Resources of the enterprises in the above-mentioned sectors (their own resources and commercial loans),
- Budgetary resources (republic and local budgets), and
- Expected donor funds and soft loans.

It is estimated that the entire necessary resources for investing in telecommunications and the postal service will be provided from commercial sources (national and borrowed). Modernization and construction in other infrastructure activities will to a great extent depend on budgetary resources, donor funds and soft loans.

According to the assessments, the allocations from budgetary resources (republic and local budgets) for infrastructure (transport, energy and utilities) and housing in the next three years will amount to 2% of GDP on average, which equals around two thirds of the overall budgetary investments. Apart from infrastructure, some 1% of GDP will be allocated from budgetary resources for health care, education, public administration, and security.

The resources of enterprises from these sectors, as well as budgetary resources, are not sufficient investments, and the financial performance of enterprises and of the state do not allow for borrowing under commercial terms. The decrease in donor funding and soft loans would considerably slow down the investments, which would in turn hinder the modernization of these sectors. Besides infrastructure, housing also requires soft loans. Such loans would have multiple positive impacts on economic activity and employment. The share of donor funding and soft loans amounts to some 20% of the overall infrastructure investments.

[24] Infrastructure share in GDP is relatively high due to its deteriorated state and the fact that these are actually capital intensive sectors.

Foreign direct investments

Foreign direct investments are the crucial element for sustainable medium-term growth. They directly contribute to the growth of production, and they make it possible to establish external and partly internal balances in the medium term. Thus, in the previous projections foreign direct investments are the main source for covering the current balance of payments deficit. They also generate large growth in exports, as shown in the experience of transitional economies. A significant growth in exports and financing of the current balance are the main planks of the medium-term foreign economic sustainability of Serbia. Foreign direct investments, through tender privatisation, will represent a significant source of fiscal deficit coverage, which will contribute to the establishment of the internal balance in the medium term.

Table 9. - Cumulative foreign direct investment (FDI) per capita (USD)

		FDI p.c. (USD) 1989-2002.
1.	Czech Republic	3413
2.	Slovakia	1784
3.	Slovenia	1722
***4.**	**Serbia and Montenegro**	**1610**
5.	Hungary	1336
6.	Poland	997

*Cumulative FDI p.c. for Serbia and Montenegro pertains to the period 1997-2010.

		FDI p.c. (USD) 1989-2002
1.	Croatia	1568
***2.**	**Serbia and Montenegro**	**903**
3.	Bulgaria	547
4.	Romania	405

* Cumulative FDI p.c. for Serbia and Montenegro pertains to the period 1997-2006.

The projected level of foreign direct investment, as already mentioned, is approximately 1.3 – 1.6 billion USD, that is, around 5-6% of GDP. In order to assess the amount of foreign investment, we compare cumulative values per capita for the preceding period (1989 – 2002) in advanced transitional states with the projections for Serbia and Montenegro (1997 – 2010). We also compare investment planned for Serbia and Montenegro until 2006 with total realized investment in less advanced transitional economies.

Table 10. %GDP

	Bulgaria	Romania	Croatia	Hungary
Exports/GDP in 2001	55.7	33.5	46.7	60.5

There is scope for many improvements in this area, taking into account the extremely low levels of Serbian exports. The projected considerable rise in exports from 19% of GDP to 35% in 2010 means, for example, that Serbian exports in 2006 should reach over 6 billion dollars, which roughly corresponds to the amount of exports achieved in 1990. Comparison with the neighbouring economies (Table 10) also shows that the planned rise in exports can be achieved and this, together with foreign direct investment, presents the main strategic option for Serbian economic development.

2. Fiscal Limitations in Poverty Reduction Strategy Implementation

Introduction

An effective public fiscal management process is critical for ensuring the success of PRSP implementation. In particular, the budget and fiscal management system should be the main tool through which public expenditure implications of PRSP policies are translated into budget activities.

2.1. Recent Trends in Fiscal Policy

Substantial fiscal adjustment has taken place in the last two years within the context of the stabilisation programme begun by the government in 2001. Fiscal adjustment involves redefining the role of government (away from being the direct producer of goods and services towards providing social security, investing in and maintaining economic infrastructure, and establishing a legislative and regulatory framework for private sector activity), incorporating all public sector expenditure into the budgetary process, reducing budgetary arrears and fiscal gaps in social insurance funds, as well as increasing revenue mobilisation.

The purpose of this fiscal adjustment has been to constrain the fiscal deficit. Subsidies to enterprises and capital investment have been reduced, whilst transfers to the population, in the form of social benefits, have increased in importance. Nonetheless, implicit subsidies to enterprises remain.

2.2. Recent Trends in Public Revenues

Consolidated public revenues in Serbia in 2002 reached the level of 42.7% of GDP which is somewhat higher than other countries in the region[25]. The share of consolidated public revenue in GDP in Serbia is probably somewhat over-stated due to the under-stating of GDP because of the incomplete inclusion of the private sector and the greater extent of the grey economy in relation to the comparison countries. Based on the share of the consolidated public revenues in GDP, one can conclude that the tax burden in Serbia, compared with other European transition countries, is moderate.[26] With the exception of the contribution on salaries, one can make the same conclusion by comparing tax rates of other transition countries. The uniform sales tax rate is 20% (considering exemptions, the average weighted rate amounts to 16%-17%), the rate of the tax on salaries is 14%, and contributions on employee and employer's salaries are 33.6%.

Within the structure of public revenue in Serbia, taxes and contributions on salaries dominate (approximately 15.5% of GDP) and consumption taxes (close to 15% of GDP).

[25] Less successful transition countries exhibit a lower level of public revenues in terms of GDP than more successful countries. This is due to the fact that, either these countries are less developed, or that the basic governmental functions, including the ability to collect public revenue, are at a very low level.
[26] As compared to the countries of Asia, Africa and Central America that are at the same development level, the tax burden in Serbia is high.

The share of corporate income taxes is substantially smaller than in other countries in transition.

In 2002 the share of public revenue in Serbia's GDP increased by five percentage points compared to the 2001 level. The main generator of this growth in the share of public revenue is the increase in payments made, which is especially evident with sales tax and excise duties. In addition to the increase in the number of payments made, the abolition of discretional exemptions and reductions in the tax base for particular sectors and companies also contributed to the growth of public revenue share in GDP. The increase in the share of customs revenues, despite the significant decrease in customs rates, is a consequence of the increase in the value of import share in GDP as well as the increase in the share of consumer goods in the imports.

The planned fall in the share of public revenue in GDP in 2003 is a consequence of fiscal relief of the economy that was implemented in the second part of 2002, and above all else includes:

- Significant decrease in tax rates on financial transactions and the exemption of loan transactions from payment of this tax;
- Decrease in tax rates on gain from 20% to 14% and the introduction of significant incentives for investment and employment;
- Expansion of exemptions from sales tax.

Furthermore in 2003 growth in the level of payment collection is expected, especially on retail sales tax, due to the introduction of the obligation to issue and receive bills as well as the introduction of fiscal cash registers.

Table 1. Consolidated public revenues % GDP

	2001	2002	2003
	Realization	**Realization**	**Plan**
Revenue	38.0	42.7	42.4
I Current revenue (1. +2.)	38.0	42.7	42.4
1.Tax revenue (1.1+…+1.10)	36.2	40.6	40.2
1.1. Customs	2.0	2.6	2.3
1.2. Personal income tax	4.5	5.1	5.2
1.3. Corporate income tax	0.5	0.5	0.5
1.4. Retail sales tax	9.9	11.1	11.6
1.5. Excises	3.6	4.7	4.9
1.6. Property tax	0.3	0.4	0.4
1.7. Financial transaction tax	1.4	1.1	0.3
1.8. Extra profit tax	0.2	0.3	0.0
1.9. Other taxes	3.4	4.3	4.2
1.10. Social insurance contributions	10.4	10.5	10.7
2. Non-taxable revenue	1.8	2.0	2.1
II Capital revenue	0.0	0.0	0.0

Recent Trends in Public Expenditures

The share of public expenditures in GDP in 2002 in Serbia closely corresponds to the level that successful countries in transition (Hungary, Czech Republic, Poland, Slovenia and Slovakia) had in the mid-nineties. Within the structure of public expenditure[27] by economic classification the most significant share was that of pension expenditures and social programmes, as well as expenditure for salaries. In comparison to successful countries in transition Serbia had an above average share in expenditure related to earnings and pensions, while the share of expenditures related to interest rates and capital investment was below average.

The share of consolidated public expenditures in GDP in 2002 increased by 6.4 percentage points compared to the previous year. Observed from the point of view of economic classification, the main generators of growth of public spending are the increase in pensions, salaries, reconstruction costs and servicing of debts.[28] In the case of pensions, the growth in share is the consequence of what is referred to as transferred growth[29], while for salaries a significant factor is the slower growth of prices than projected (it was agreed with trade unions to increase salaries in accordance with the projected growth of prices).

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[27] The introduction of a system for evidence and classification of public revenues and expenditures in accordance with international standards started during 2002. Because there are still adjustments being made to the system, and at the level of local communities it is just being introduced , data regarding the structure of expenditures are still unreliable. For example, according to data from local communities expenditures for subsidies grew constantly from 2000-2002, despite significant elimination of the disparity of prices for utility services. It is assumed that in the case of local communities there is a significant part of capital investment that is shown as subsidies.

[28] The data on the public expenditure structure in 2001 and 2002, by economic and functional classification, have changed compared to the first version based on final data on execution of budget and funds for 2001 and corrected budget and funds reports for 2002. With the revision of the Serbian budget for 2003, which includes also expenditures of the whole SAM financed from public revenues in Serbia and Montenegro, the planned structure of public expenditure for 2003 was changed.

[29] The scope of implementation of the so-called Swiss formula for pension indexation was to provide slower pension growth than GDP growth. However, the average salary in 2002 grew twice as fast as GDP, resulting in faster growth of average pensions than that of the GDP.

Table 2. Consolidated public expenditures – economic classification % GDP

	2001	2002	2003
Total	39.3	45.9	45.9
1. Salaries	8.7	10.1	10.3
2. Purchase of goods and services	6.7	7.0	7.0
3. Pensions	9.4	11.7	11.7
4. Social protection	3.2	4.1	4.0
5. Subsidies and restructuring	5.7	6.3	6.2
6. Capital investment	1.3	2.0	2.1
7. Public debt servicing	1.7	2.1	2.5
7.1. Interest	0.8	0.9	1.3
7.2. Paying of debt	0.9	1.2	1.2
8. Other expenditures	2.6	2.6	2.1

In comparison to other countries in transition, in 2002 Serbia had an above average share in expenditure for defence, while the education expenditure was below average[30]. Expenditures for health and social care are at the level of the average for the region.

Table 3. Consolidated public expenditures - functional classification

% GDP

	2001	2002	2003
I Total expenditures (1. +…+10.)	39.3	45.9	45.9
1. General public services	4.4	5	5
2. Defence	3.6	3.4	3.3
3. Public order and safety	2.6	2.7	2.8
4. Economic affairs	3.8	4.3	3.5
5. Environment protection	0.0	0.1	0.1
6. Housing construction and utilities	2.6	3.6	3.4
7. Health[31]	4.6	5.2	5.3
8. Recreation, culture and religion	0.5	0.6	0.7
9. Education	2.7	3.4	3.8
10. Social protection and pensions	14.5	17.6	18

In the first two years of transition Serbia achieved a relatively low level of fiscal deficit in comparison to other countries at the beginning of transition. The low level of fiscal deficit in 2001 is a consequence mainly of the better collection of public revenue than planned and the absence of foreign debt servicing, while in 2002 the main cause of the

[30] By adding the expenditures for education that are financed from the budget of local communities this deficit would decrease, but probably would not be eliminated.

[31] According to the estimate of World Bank experts, the health care expenditure share in GDP exceeds 6%, if the additional forms (such as health care expenditures at the local level and within the defence system) were included. This is above the average for Central and East European countries set at the level of 4.7% of GDP. Precise estimates of out-of-pocket health expenditures are still missing, though some surveys conducted on a small sample indicate that these expenditures range between 2 and 4% of GDP.

low level of deficit is the commitment to solid fiscal policy, which creates a favourable base for macroeconomic stability and growth.

A slight increase in the deficit since 2001 has been facilitated by the increase in availability of external resources and receipts from the privatisation process. Nonetheless, government policy is to keep the deficit at or below 3% of GDP.

Table 4.Total and primary fiscal deficit % GDP

	2001	2002	2003
Total deficit	-1.3	-3.3	-3.5
Primary deficit	-0.5	-2.4	-2.2

The total estimated domestic and foreign public debt at the end of 2002 was approximately 14.2 billion USD, which is 92.2 % of GDP. This total includes the sum of the unregulated debts (London club, debts to other countries that are not a part of the Paris club as well as the total sum of foreign debt from the region of Kosovo and Metohija). It is estimated that, upon reprogramming, these debts will be partly written off whereupon the relation between the public debt and GDP will be 70-75%, depending on the reprogramming conditions. Furthermore economically consistent[32] servicing of the obligations of debtors from the region of Kosovo and Metohija would additionally decrease the ratio between the public debt and GDP.

2.1.1 Impact of Recent fiscal Trends on Poverty

Total expenditures for the protection of the poor in Serbia equal approximately 4% of GDP, which is close to the average value for countries in transition. The most significant item of social protection, not including pensions, is the expenditures for child protection. Following that are the expenditures for taking care of those who lost their jobs during the process of restructuring (transition fund), and the expenditures for assistance to the unemployed and families living in poverty.

[32] This assumes that the servicing of debts from the region of Kosovo and Metohija for the most part is carried out from GDP realised in the region of Kosovo and Metohija.

Table 5. Expenditure for protection of the poor in Serbia

% GDP

	2001	2002	2003 (plan)
Social protection total (1+2)	3.2	4.1	4.0
1. Social protection from Serbian budget	2.3	2.9	3.1
One off aid	0.1	0.0	0.0
Social protection for the poor	0.3	0.3	0.5
Child care	1.4	1.4	1.4
Protection for the disabled and war veterans	0.2	0.2	0.2
Pupils	0.0	0.0	0.1
Students	0.1	0.1	0.2
Refugees	0.1	0.1	0.1
Social protection of employees within the public sector	0.0	0.0	0.0
Benefit fund for protection from natural disasters	0.0	0.0	
Transition fund	0.1	0.6	0.7
2. Social protection at other government levels (1)	0.9	1.2	0.9
From that for the unemployed	0.5	0.5	0.5

1) This includes social expenditures at the federal level, at the level of local communities and the unemployment fund.

Changes in sales tax and income taxes during 2001 have had a direct impact on living standards and poverty.

The introduction of a uniform sales tax rate at the beginning of 2001 caused a one time increase in prices of basic vital products that were previously taxable at lower rates, which temporarily worsened the living standard of poorer classes. At the time that the uniform sales tax rate was introduced the only exemptions were for the purchase of bread and public utilities. The initial list of products that are free of sales tax was later expanded so that at the beginning of 2003 this tax exemption list included basic food products, utilities, basic medicine, etc.

At the introduction of Value Added Tax (VAT) in the first half of 2004, a decision will be made on the number of VAT rates (one or several rates, a uniform rate with exemptions for a certain number of products etc).

Decreases in taxes and contributions on salaries by ten percentage points had directly allowed an increase in average salaries by approximately 10% along with unchanged expenditures on work units. The growth of average salaries due to the decrease in fiscal burdens on salaries on average had more than compensated for the increase of expenditures because of the transfer to a uniform sales tax rate.

The beginning of state debt servicing toward the population (old foreign currency savings, large debt to pensioners) contributes to the alleviation of poverty. The relevance of government debt servicing toward the population is noticeable through the fact that in 2003 the total payments for this purpose will be approximately 1.7% of GDP. The social implications of public debt servicing are especially important due to the fact that a significant part of these debts are paid off to the poorer and older part of the population.

In the period 2004-2005 the third tax reform phase should be carried out, with the purpose of harmonizing the tax system of Serbia with tax systems of EU member countries.

2.3 Medium-Term Expenditure Framework

The Government's medium-term fiscal policy is to maintain fiscal stability through further fiscal tightening, ensuring better use of existing resources, increasing revenue mobilisation, and providing tax incentives and other reform measures designed to stimulate business activity.

The medium-term fiscal parameters are intended to be based on the Ministry of Finance's medium-term budgetary framework, set out in the Budget Memorandum which was approved in June 2003. These included, for the first time, sectoral expenditure ceilings for the 2004-2006 period, consistent with a realistic overall resource framework, within which sector ministries are expected to contain their budget requests.

The main objectives for the setting of the basic MTEF fiscal parameters for the medium term include:

- Lower recurrent spending to make more room for greater investment provision.
- Ensure no arrears and settle any existing arrears.
- Tax relief (expanding the list of vital products and services exempted from the sales tax).
- Tax relief to stimulate investment.
- Decrease subventions.
- Faster real increases in wages for priority sectors.

It is necessary for the level of public expenditure within the medium-term period to be defined in a way that supports[33] the implementation of the most significant macroeconomic goals - fast growth and economic stability. This implies lower tax rates to encourage domestic and foreign investors. Low taxes and a sustainable deficit imply a level of consolidated fiscal expenditures that could in the medium term, at best, reach the level of the regional average. More precisely, the medium-term framework should provide for the realisation of long-term sustainable fiscal policy and state solvency. State solvency is usually expressed through the condition that the discount value of future primary surpluses be larger or equal to current values of the public debt. Fulfilling this condition practically means that gradual decreases in the primary deficit and its transfer

[33] It is mandatory that the projections of the scope and structure of public spending displayed in this document be treated as unofficial and preliminary. The Republic Ministry of Finance and Economy, in collaboration with other ministries, is developing a medium-term plan of optimisation of public spending in Serbia. It is expected that a draft version will be proposed by the end of April, and that the final version will be developed by the middle of 2003. Only after the adoption of the medium-term plan will it be possible to treat a specific level and structure of public spending as a goal from the aspect of state policy.

into the zone of positive values (primary surplus) must necessary be planned within the framework of medium-term projections[34].

The decrease in the share of the public debt to less than 60% of GDP represents an indication that long-term fiscal sustainability is secured. With the assumption that the existing debt toward the London Club and government creditors is written off to a significant extent and that the question of debt for the region of Kosovo and Metohija be solved in an appropriate manner, the public debt in the second part of this decade would fall below 60% of GDP. The realization of revenue from privatisation of 2-3% of GDP, would allow for the larger part of the fiscal deficit to be covered by non-credit resources in the next couple of years, primarily from privatisation revenue. Considering that foreign and domestic debts will be rapidly paid off within that time period, this would allow for the decrease in the absolute level of public debt.

The medium term fiscal framework includes the expected and planned changes in the structure of public spending. Changes in the structure of public spending are partly exogenously given. For example, adopting a Law on Domestic Public Debt Servicing (old foreign currency savings, Jugoskandik, Dafiment) as well as signing the agreement on reprogramming with foreign creditors as a whole defines the expenditures on the basis of current public debt servicing. Other changes reflect the priority changes (decrease in military share and increase in the share of education and capital investment in GDP), increase in productivity in the public non-profit sector (decrease in the share of labour costs in GDP), coordination of rights with economic possibilities and population (pensions), and progress in privatisation and economic restructuring (subsidy and restructuring expenditures). In some cases the contribution of specific sectors in GDP will remain fairly steady but within the future period there will be intensive changes within the sector itself. This is, for example, the case with health care whose total expenditures, financed by the state will increase by the same rate as GDP, but there will be significant changes within the sector that will result in better quality service and higher productivity (rationalization of institutional network, reducing number of employees, better equipment).

Basic changes within the structure of public expenditures considered from the point of view of economic classification are relative decreases in the share of salaries, pensions, subsidies, restructuring expenditures and social protection, and the increase in the share of capital investments and the expenditures related to public debt servicing.

[34] According to the standard definition, primary deficit is equal to total deficit reduced by interest rate expenditures. When used as a measurement of long-term sustainability it is necessary to reduce the primary deficit by non-credit sources used for government financing - income from privatisation and donations.

Table 6. Consolidated public expenditures - economic classification % GDP

	2003	2004	2005	2006	2007	2008	2009	2010
Total	45.9	45.6	45.2	44.8	44.3	43.9	43.5	43.1
1. Salaries	10.3	10.0	9.8	9.7	9.6	9.5	9.3	9.3
2. Purchase of goods and services	7.0	7.0	7.1	7.1	7.1	7.1	7.1	7.1
3. Pensions	11.7	11.8	11.5	11.2	10.9	10.6	10.4	10.1
4. Social protection	4.0	3.8	3.7	3.6	3.5	3.4	3.1	3.1
5.Subsidies and restructuring	6.2	5.0	4.5	4.0	3.5	3.0	2.8	2.8
6. Capital expenditures	2.1	2.5	3.0	3.2	3.3	3.6	3.8	4.0
7. Public debt servicing	2.5	3.5	3.6	4.0	4.4	4.7	4.9	4.5
7.1. Interest payments	1.3	1.6	1.6	1.9	2.0	1.9	1.9	1.8
7.2. Paying off debt	1.2	1.9	2.0	2.1	2.4	2.7	3.0	2.7
8. Other expenditures	2.1	2.0	2.0	2.0	2.0	2.1	2.1	2.2

With reference to the points outlined above it seems that the implementation of sustainable fiscal policy (low tax rates, low fiscal deficit, decrease of the ratio between GDP and public debt, larger expenditures for education, etc.) requires a gradual reduction of public expenditure intended for the social protection of the poor.

The reduction of social protection expenditure share in GDP in 2006 compared to 2003 would amount to 0.4 percentage points. Considering the estimated growth of GDP by 4-5% in the period 2003-2006, the above-mentioned reduction of expenditure for social protection implies its real growth at the rate of 1.4% annually. Given that the most important rights within social protection are index-linked to the cost of living, the expenditure for social protection per beneficiary would remain unchanged in real terms. The increasing of the expenditure amount along with a constant level of expenditure per beneficiary (other conditions remaining unchanged) enable the growth in the number of beneficiaries (vulnerable groups identified in the Poverty Reduction Strategy), that is, the introduction of new types of social protection. The expected gradual reduction of transitional forms of social protection (transition fund, severance payments) makes additional room for new beneficiaries, that is, new types of social welfare. Regarding economic purposes of expenditures for Poverty Reduction Strategy implementation, the dynamics of pension expenditures are relevant. The plan is to cut the share of pension expenditures in GDP by 0.5 percentage points by 2006. The basic assumption that this plan is based on is that the average pensions will grow in real terms by 2.5% annually, while GDP will grow by 5%. To achieve this it is necessary to provide the appropriate pension indexation rule.

Changes in the structure of public spending according to functional classification include the decrease in the share of expenditures for defence, social expenditures and the growth of the share of expenditures for economic issues, education, health care and public services.

Concerning the implementation of the Poverty Reduction Strategy, changes in health care and education expenditure are relevant. According to the plan, by 2006 the share of health care expenditure in GDP will increase by 0.2 percentage points, while education expenditure will increase by 0.4 percentage points. Taking into account the projected growth of GDP of 5% annually, health care expenditure growth in real terms would amount to an average of 6.3% annually, while growth in education expenditure would amount to 8.6%. However, in terms of optimization of public expenditure and the reform of these sectors, the change of expenditure structure within them is decisive. The expenditure structure change means in the first place that average salaries grow in real terms as fast as GDP (that is 4-5% annually), and, on the other side, that total labour costs grow more slowly than GDP because of the necessary reduction in the workforce.[35] In addition to the control of the real increase in salaries, it is necessary to make significant rationalizations of the network of health care and educational institutions. Fast real growth of the level of public expenditure for education and the school system, along with strict control of labour costs and rationalization of the network of health care and educational institutions would enable significant growth in expenditure intended for implementation of reforms and improvement of equipment in institutions in health care and education. All of the above-mentioned changes would result in improved quality of and better access to services in education and the school system.

Table 7. Consolidated public expenditures -functional classification % GDP

	2003	2004	2005	2006	2007	2008	2009	2010
I Total expenditures (1. +…+10.)	45.9	45.6	45.2	44.8	44.3	43.9	43.5	43.1
1. General public services	4.2	4.5	5.0	5.4	5.7	5.8	5.9	5.9
2. Defence	3.8	3.3	2.9	2.5	2.3	2.2	2.2	2.2
3. Public order and safety	2.8	2.7	2.5	2.3	2.2	2.2	2.1	2.1
4. Economic affairs	3.5	3.4	3.2	3.0	2.9	2.8	2.7	2.6
5. Environment protection	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2
6. Housing construction and utilities	4.1	4.1	4.1	4.1	4.1	4.1	4.1	4.1
7. Health care	5.3	5.3	5.4	5.5	5.5	5.6	5.6	5.6
8. Recreation, culture and religion	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
9. Education	3.6	3.8	3.8	4.0	4.2	4.3	4.5	4.5
10. Social protection and pensions	18.0	17.8	17.6	17.3	16.7	16.2	15.7	15.4

Table 8. Revenues, expenditures and deficit % GDP

	2003	2004	2005	2006	2007	2008	2009	2010
Consolidated revenues	42.4	42.0	41.8	41.7	41.7	41.6	41.4	41.2
Consolidated expenditures	46.1	45.6	45.2	44.8	44.3	43.9	43.5	43.1
Total deficit	-3.7	-3.6	-3.4	-3.1	-2.6	-2.3	-2.1	-1.9
Primary deficit	-1.9	-1.4	-1.3	-1.0	-0.6	-0.3	-0.3	-0.1

The implementation of the outlined scope and structure of public spending involves a number of risks and uncertainties. The uncertainties are related to the non-existence of the officially adopted reform programmes for some of the main spenders of budget

[35] Employees in health care and education make up over 60% of the total number of employees in the public non-profit sector. Therefore, a significant reduction of employees in the public non-profit sector is not posible without a reduction of employees in these activities. According to the research carried out by the World Bank on the sample of single hospitals and schools, there is a significant surplus of labour, especially unskilled labour.

resources: health, education, defence, and internal security. There is also a significant portion of existing foreign debts (London club, debts toward Russia, China, Kuwait, Libya, etc.), that is not regulated and as a result the conditions of their servicing are still not known.

The basic risks in the implementation of a sustainable level of public spending are related to the following:

- Slower average GDP growth rate than projected,

- Significant one-off devaluation of the currency exchange rate,

- Significantly smaller influx of foreign investments than projected and lower income from the privatisation process,

- Expansion of potential government obligations based on the loans for reconstruction and restoration of the infrastructure,

- Impositions for war damages.

Some of these risks are interconnected so that with their appearance together a large number of negative scenarios could develop. For example, the low level of foreign investments combined with small amount of revenue from privatisation could generate economic stagnation with preserved stability or alternating periods of growth and recession.

2.4. Fiscal reforms

Sustained fiscal stability will be made possible only by the continuation of the process of fiscal reforms. The Government initiated the process of fiscal reform in order to improve the use of scarce public resources and ensure that Serbia's public finance system is suited to a modern and efficient public service within a market economy. Measures undertaken have included:

- Adoption of a modern Law on the Budget System based on international best practice, covering: (i) budget comprehensiveness; (ii) the introduction of a strategic budget phase in the overall process (prior to the start of the annual budget process); (iii) requirement for budgetary parameters to be medium-term in nature; (iv) strengthening of the functional/programme-related classification to facilitate the link between policies and budgets;

- Specification of a longer budget calendar which allows more time for analysis and scrutiny by Parliament;

- Adoption of Law on Public Procurement and formation of Public Procurement Agency;

- Implementation of wide-ranging tax reforms, including rationalisation of tax structure and improvements in tax administration;

- Improved budget format, based on an international standard classification structure;

- Reform of the payments system, including introduction of Treasury system;

- Better budget reporting required to Parliament and introduction of external audit of the budget;

- Stricter Parliamentary review of the financial plans for the extra-budgetary social Funds.

Thus, the budget system is introducing more rigorous professional and political verification of demands made by the budget users, as well as better correlation between the plans for spending and accepted social and macroeconomic goals. In the phase of budget implementation and plans for social insurance funds, the application of regulations decreases the possibility of abuse and waste of resources. The application of the law on public procurement introduces competition into the buying of goods and services, which, with the given expenditures, secures better supply and quality of services. The application of this law is especially important from the point of view of social protection because it secures better quality services in health and education within the given level of expenditures.

The Government is committed to undertaking further fiscal reforms in order to ensure sustained fiscal and macro stability and to facilitate implementation of the PRSP.

- Further payment reforms, including expansion of Treasury operations;

- Strengthen tax administration, including establishing regional Large Tax Payers office and preparing for the introduction of VAT, improved tax audits and introduction of self-assessment;

- Continuation of tax reform measures including: (i) abolishing a large number of taxes that are unfavourable in terms of allocation, lack transparency, and impose high administrative requirements whilst at the same time failing to generate significant fiscal yields, e.g. financial operations tax; (ii) simplifying direct taxes, such as the income tax; (iii) increasing receipt of periodic property taxes and abolishing taxes on securities; and (iv) abolishing significant numbers of compensations and replacing them by appropriate taxes.

- Improve budget formulation, including: (i) introducing/strengthening a Medium-Term Expenditure Framework (MTEF) based on a comprehensive resource framework and three-year sectoral ceilings; and (ii) undertaking resource allocation reviews

- Other public expenditure reforms, including: adopting a new Pension Law to introduce more appropriate indexation of benefits and increasing the retirement age

As is discussed below, the budget should be the main mechanism through which the priorities of the PRSP are translated into funded activities. This will require development of the explicit link between budgets and policies/activities at the sector level. In particular, sector ministries will need to restructure their budgets by: (i) undertaking a strategic policy review/analysis for each sector and sub-sector, setting out the key policy objectives and priority policies for the sector/sub-sector; (ii) carrying out a detailed review of key expenditure programmes within sectors/sub-sectors, including a comprehensive analysis of the activities currently supported by budgetary resources; (iii) identifying measures to improve efficiency of resource use; and (iv) strengthening capacities for budget analysis and planning.

3. Transition to a market economy

3.1. Establishing conditions for private sector development

3.1.1. Reform and Economic Growth

Theoretical and empirical research has shown that there is a significant link between reform and economic growth. The nature of the link between these two phenomena is such, that radical and all-inclusive reform aimed at the creation of an integral market (creating a real market economy) is a precondition for rapid economic growth. The key to this is that all-inclusive reform creates a business environment which is attractive for private capital investment, especially for foreign direct investment.

There are two important types of reforms:

- The first includes economic policy reforms which will facilitate the development of the market economy, encourage efficiency in resource allocation and attract new private investment, both domestic and foreign.

- The second is institutional reform, which should create new and stable rules of the game and lead to their consistent and unbiased enforcement.

In short, this institutional reform should lead to the creation of market and democratic institutions and should also establish the rule of law. All this leads to the reduction of transaction costs, especially in capital transactions. If this takes place in Serbia, more new private direct investments (especially foreign) may be expected.

The link between reform and economic growth, and thus the link between reform and poverty is of key importance for overcoming poverty. That is why it is important to answer the question of the sources of political incentives for the initiation, formulation and implementation of reforms. The political economy of reform considers different configurations of political forces (for and against reforms) as well as their political and reform outcomes.

The existence of different political forces is natural and expected. Reform measures are not neutral, there are both winners and losers, and individual welfare is also influenced. Along with the changes of phases within reform, the roles of winners and losers also change – those who profited from the first phase of the reform may become losers in the second phase. There are at least two types of losers. The first type are influential losers and the second are the ones who are not (usually the poor). From this point of view, one should be aware of the fact that powerful resources are available to the influential losers, which can be used to stop the reform at a level far from a fully-fledged market economy.

The experience of East European transition has shown that the biggest winners and advocates of reform are private entrepreneurs and the middle class and that maintaining the course of reform depends on the ability to create coalitions of interest within these two groups. However, this would not have been possible if social consensus and a new form of social solidarity had not been established – different from the statist and protectionist solidarity that existed under socialism. An important element of this new awareness, i.e. cohesion, was the resistance of East European countries to Soviet domination, which had not existed in FRY.

From the perspective of the political economy of the reform, compared to the situation in most East European countries, there are particular circumstances in Serbia. The problem is that some of the reforms were conducted during the 1990s, before democracy was established. Influenced by the impending collapse of the old (socialist) regime, they lacked a clear concept and a wish to create a fully-developed market economy. The real reform started with the democratic changes in October 2000. The most significant reform policies were based on the well processed experiences of East European countries in transition. The first phase of this reform, based on the reform of economic policies, has been carried out over the last two years.

The reform started by forming a large reform coalition, which in time began to crumble. However, regardless of all the pragmatism needed for the implementation of reforms within the limited resource framework, stable democracy is necessary for building mechanisms and institutions that will additionally advance and maintain the basic social consensus.

The recent events (since 12 March 2003) constitute a new political turning point for the reform in Serbia. The assassination of the Prime Minister and the government reaction that followed created new political incentives, removing the limitations on conducting a complete institutional reform and enabling the reform of the justice system, the introduction of the rule of law and a resolute fight against organised crime.

3.1.2. Privatisation and restructuring of the real sector

Privatisation of the Real Sector

The privatisation of the real sector in Serbia is being conducted by applying a model based on sales conducive to good corporate governance, with increased efficiency, attracting new investment. The model itself is relatively complex and requires a long period of preparation, not only for conducting the whole process but for every single transaction as well. Besides this model, privatisation of the real sector should include the completion of the privatisation of enterprises partially carried out under previous privatisation models.

Full privatisation, effected by creating concentrated private ownership, leads to the increase of enterprise efficiency, but very often at the cost of a lot of people losing their jobs. This consequence of privatisation has made government make quite strict demands on the "social programme" when applying the model for tenders, namely that investors provide for the surplus manpower. It is clear that such a demanding policy has shown negative results in attracting foreign investors, though it represented a good transitional model in terms of reaching a social consensus, so important for Serbia. Therefore the new policy (starting with the recent change of the Law on Privatisation), will not be so demanding.

Concerning the acceleration of the privatisation process in Serbia, with the fixed institutional costs being already borne (creation of legislation and constitution of institutions), an acceleration of the process may be expected, especially the acceleration in auctions. Over the next two years privatisation of the state-owned enterprises can be expected.

Restructuring of the Real Sector

According to the current privatisation programme, a number of large enterprises in Serbia (especially socially-owned holding companies), which have a long track record of financial losses , should be restructured prior to privatisation. It is estimated that restructuring is a precondition for successful privatisation through sales.

This type of restructuring means the fragmentation of such enterprises, in order to form a number of smaller enterprises. The basic idea is to create smaller enterprises with some business opportunities, which can be privatised, while the rest would be liquidated. Studies on the restructuring of large enterprises are being carried out, and it can be expected that, following the recommendations of these studies, pre-privatisation restructuring will be conducted in 2004. Since the restructuring is often linked to considerable political problems (risks) and manipulations, good programmes and persistent collective negotiations are needed to carry out this process successfully.

Short-term considerations show that restructuring will slow down the increase in production and cause decreases in employment. A large part of the unemployment which will be created is just hidden unemployment as shown by research on the informal economy and a number of employees of those enterprises are actually employed within the informal sector. The important thing is that, by the restructuring process, a healthy economic core is preserved and the reform dynamic accelerated. The long-term considerations show that liquidation of some of the existing enterprises, which are being restructured, will release resources (real capital in the first place) that can be used for new enterprises, especially small and medium, which will favourably influence economic growth and employment. In this way, the sections of the restructured enterprises with business opportunities will be able to make faster progress.

The new law on bankruptcy (to be adopted in the end of 2003) will significantly further the restructuring process by enabling the liquidation of enterprises which cannot be privatised due to the lack of business opportunities and accumulated debts.

3.1.3. Infrastructure and private sector growth

Infrastructure is a precondition for economic growth. Inadequate supply of infrastructure services discourages investment, thus lowering economic growth rates and, in turn, fostering poverty. The phenomenon can be observed both at the national level (national infrastructure systems such as telecommunications, the electrical power industry and highways) and at the local level, whether it is local branches of national infrastructure systems (such as local telecommunications networks) or public utility systems (such as water supply or heating).

Apart from an overall increase in the supply of infrastructure services, the problem can also be addressed by making the process itself more flexible, that is, by allowing for investor participation in the construction of the infrastructure network in keeping with his own needs. In addition, urban planning control of the realization of the investment needs to be more flexible in order to encourage investment.

The reform of infrastructure services, investment in them and the increase in their supply has, as has already been argued, a favourable direct and indirect impact on poverty alleviation. Moreover, construction work stemming from investment in infrastructure services increases the demand for unskilled (unemployed) labour, and the proportion of the poor in this group is above average.

The reform of infrastructure services in Serbia has just begun, so investment work so far has been mainly carried out on the renovation of existing infrastructure, financed from public resources. The reform requires a completely new legislature, new regulatory regime and specialized institutions to carry it out. So far these issues have not been given priority in the reform process in Serbia.

Reform in the area of infrastructure services allows for private investment, thereby raising their supply. Taking into account the low amount and poor quality of infrastructure services in Serbia together with the neglect they sustained during the 1990s, investment of private capital (probably mostly foreign) is the necessary precondition for their further development.

Pricing policy in the field of infrastructure services (electrical power and gas supply, water supply) is an important issue for the poor. In the case of electrical power, which is a key problem for them, it is suggested that all the prices should be increased through the reform of the tariff system to reflect the real (market) costs, while the poorest households should be granted subsidies, provided that they rationalize their consumption. At the same time, financial support for switching over to cheaper means of heating is envisaged[36].

3.1.4. Reform and Development of the Financial and Capital Market

Financial Sector

Contemporary empirical research has shown that the development of the modern financial sector provides incentives for economic growth and enables a decrease in inequality in income distribution. This means that the development of the modern financial sector has a beneficial effect on poverty.

The inherited state of the banking sector in Serbia caused development to take place in two directions. One was bankruptcy and liquidation of the largest domestic insolvent banks. This was successfully accomplished and none of the predicted major problems occurred. The other was attracting foreign banks to establish new banks in our country. The entry of the foreign banks and the formation of completely new banks proceeded slowly. To some extent, this was because of the National Bank policy that insisted on the privatisation and possible take-over of the incumbent domestic banks.

Regardless of the results achieved, the supply of loans (under favourable conditions) for small and medium enterprises, i.e. small private entrepreneurs, is still modest. One of the causes is insufficiently developed mortgage legislation, which prevents the financial sector from obtaining solid security. This solid security would diminish investment risk, which would cause interest rates (risk dividend) to decrease. Adoption of the Law on

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[36] See Annex for the Matrix of detailed objectives and activities for the reduction of energy poverty.

Mortgage on Immovables entered into Registry, the Law on the Guarantee Fund, the Law on Financial Leasing, Law on Concession and their efficient application is very important for the further development of the financial sector and economic growth.

Capital Market

One of the basic preconditions for a fully operational market economy in Serbia is the creation of an efficient capital market. This means accelerated economic growth and a decrease in poverty. Creating an efficient institution of this kind enables efficient trade in stocks (securities), and efficient trade of property rights on capital. For the efficient allocation of capital as a factor of production, the protection of private property rights of a capital owner is crucial. This is also important for economic efficiency and dynamic economic growth. These two are the base for overcoming poverty.

It is also crucial that, as soon as possible, laws on investment funds and other laws regulating financial markets, as well as the new company law, should be enacted. These laws will enable better protection of capital owners (especially minority shareholders), and will improve corporate governance and capital investment.

3.1.5. Reform of the business environment

Establishing a conducive business environment

With the aim of improving and stabilising the business environment, the Government of Serbia initiated an ambitious legal and administrative reform (see Annex – The Report on Legislative Activities of the Government of the Republic of Serbia). The main principle of the present reform is to bring Serbian legislation in line with European legislation, creating at the same time an environment conducive for economic growth within the private sector. The key elements of these reforms are securing and attracting foreign investment, increasing local investment by removing legal and administrative obstacles to the establishment, registration and successful operation of businesses, including the simplification of the tax regime and inspection services. Full implementation of the Law on Public Procurement and adoption of the proposed set of anti-corruption and anti-trust laws are also important elements of this reform.

Foreign trade liberalization

Theoretical works and voluminous empirical research have shown that liberalisation of foreign trade leads to real income increases and the acceleration of economic growth, and it has a neutral effect on income distribution. That makes foreign trade liberalisation an important element of the strategy for overcoming poverty.

Foreign trade liberalisation in Serbia has stopped somewhere in the middle. After the initial reforms in 2000 and 2001, which led to the cancellation of non-tariff import barriers, lowering of the tariff rate, and simplification of the foreign trade transaction procedure, everything has come to a halt, so the rate of duties is still quite high. One of the causes was political pressure by certain domestic producers, whose low efficiency made it impossible for them to face import competition successfully. Further liberalisation may be expected during the process of foreign trade harmonisation between Serbia and Montenegro, i.e. the implementation of the harmonized Action Plan in the next two years, as well as in the process of joining the World Trade Organization which has been initiated. The effective liberalisation has also been achieved through numerous bilateral agreements on free trade zones with neighbouring countries as well as with other trading partners (such as the European Union, Russia, etc).

Foreign trade liberalization, i.e. the removal of export and import barriers, represents the key precondition for the establishment and strengthening of regional economic cooperation. This process commenced with the signing of bilateral free trade agreements, and it would be further strengthened by the creation of a regional customs union (probably by accession to the EU), which would make this region increasingly attractive for foreign direct investment and thus increase the rate of economic growth in Serbia.

Product Market

The most important reform of the Serbian product market is the introduction of new competition (antitrust) laws and the establishment of institutions to enforce these laws. This will enable the elimination of non-competitive market structures and behaviours (such as cartels), which will lower prices and increase the real income of all consumers, including the poor.

Labour Market

Institutional reforms of the labour market in Serbia should enable more efficient interaction of supply and demand for this factor. The first among the planned reforms is the reform of the Labour Market Office and the establishment of a network of employment agencies, which should improve information exchange. In the field of labour demand the timely circulation of information is very important, as well as the creation of incentives for employers to hire more people. In the field of labour supply, labour mobility and adjustment are crucial, that is, the unemployed should be encouraged to adjust to market needs.

The legal basis of this reform is a new Law on Employment (2003). After that comes the hard work of building institutions, especially creating the network of employment agencies.

Strengthening the rule of law in the economic sector

The rule of law is an important precondition for the protection of private property rights and the supervision of the execution of contracts. Only in this way will conditions be created for private capital investment and the acceleration of economic growth.. It is crucial that the rights of investors and creditors should be protected and not the rights of debtors. The present sluggish, inefficient, and even biased judiciary gives privileges to debtors rather than to creditors.

3.1.6. Reform of Public Finances and Poverty

Reform of the public finance system affects poverty in two ways. Direct effects are: the increase in the efficiency of income redistribution efficiency, so transfers to the poor are also more efficient, which reduces poverty. Indirect effects are the successfully reformed system of public finances and the policy of relatively low tax rates, i.e. low burdening of economic subjects, which are a significant part of an environment suitable for private capital investment. This increases economic growth as a basic precondition for overcoming poverty.

During the last two years in Serbia, some important moves have been made in the area of public finance reform, which were directed towards increased efficiency of revenue collection, controlled money flows and efficient management of public expenditures. In the field of revenues, sales tax rates were unified. In the field of expenditures, control of subsidies to large enterprises was established, and quasi fiscal deficits were eliminated.

All-inclusive institutional reform is still to be conducted, together with capacity building of the tax administration and the implementation of the radical tax reform, based primarily on the introduction of value added tax, as the basic form of indirect tax, which should generate significant fiscal revenue and reduce the scope of the grey (informal) economy. The acceleration of this reform will create an environment conducive to private investment, so that increases in the economic growth rate can be expected. This will certainly have positive effects on poverty reduction.

During 2003 the formulation of a radical tax reform that should introduce significant changes into public finances has been taking place in Serbia. The basic element of the reform is the introduction of the Value Added Tax that should substitute for the sales tax as of 1st January 2004. In addition, this tax reform is expected to abolish a great number of taxes that are unfavourable in terms of allocation, lack transparency, and impose high administrative requirements while at the same time failing to generate significant fiscal yields, as is the case with the financial operations tax. Direct taxes, such as income tax, will be simplified and become easily collectable. The new policies in the field of property tax will result in the increase of the receipt of periodic property taxes and the abolition of taxes on securities. Finally, a great number of compensations (typical fiscal mechanisms inherited from socialism) should be abolished and replaced by appropriate taxes. The aforesaid changes, together with other elements of tax reform in Serbia that have not been specifically mentioned here, will enable the creation of a modern tax system to stimulate economic growth and create conditions for poverty reduction in Serbia.

3.2. Building Strong Public Institutions

3.2.1. Public Administration

Present Status and challenges

The previous regime left Serbia with a legacy of politicised and fragmented administration, ill-suited to performing the framework-setting role that public administrations are expected to play in modern democracies.

With Serbia's transition to a market economy, the role of the government sector has fundamentally changed from one of providing all economic and social services to that of:

- ensuring an appropriate legislative and regulatory framework for economic activity, particularly by the private sector;
- providing an enabling environment (e.g. through reducing unnecessary bureaucratic impediments) to facilitate the development of a vibrant private sector; and

- either contracting or being the direct service provider in areas in which the market fails to produce the right level of services at a socially acceptable price (e.g. public health services).

The new role of the public sector should be focused on the delivery of key services as well as ensuring that the necessary framework is in place for the market to function in a satisfactory manner. This implies a close partnership between all stakeholders in society including all levels of government, the private and civil sector including the media, labour unions, employer associations, NGOs, etc. Such a government needs to be results-oriented, transparent and accountable with respect to both the delivery of services and the effective use of public resources. This implies the need to set clear standards within each area of public activities and establish continuous monitoring of the implementation of activities and projects.

The main goal of activities in the public sector is to meet citizens' needs. This implies active participation by citizens in the process of design, implementation and monitoring of services. Therefore, there is a need to affirm the approach based on citizens' needs.

Successful functioning of the system as a whole requires partnership and collaboration at all government levels (central and local), as well as teamwork. These relations imply strong decentralization of competences and finances, strengthening the rule of law by the state, the market model of the economy, and market principles.

A number of challenges face the public sector "central and line ministries and local administrations" in adapting to the needs of the market economy. These include:

- Frequent changes at the top (ministry level) often lead to changes in the senior managerial ranks (e.g. assistant ministers / heads of sections and to a lesser extent department heads). It is difficult for senior management to propose and implement institutional reform if they (and their staff) do not know how long they will be in post.

- High turnover of staff, which results in ministries and agencies being unable to hold on to key skills, particularly in new skill areas. Highly skilled staff, particularly senior policy and managerial staff, tend to be tempted away by the private sector, aid agencies or technical assistance projects to work as consultants.

- There is a lack of appropriate technical skills to match the new roles required by market reforms. This shortage of skills is exacerbated by the high turnover of staff, where those with appropriate skills have tended to leave the public sector faster than other staff.

- Demoralisation of staff, caused by low salaries, lack of resources to carry out the task at hand; no delegation of clear responsibility; lack of professional development and career opportunities, and frequent changes of senior staff. This is exacerbated by the lack of a functioning and neutral staff recruitment and promotion process.

- Weak management in ministries and agencies, which tends to be dominated by a hierarchical and command-and-control approach and lack of transparency and coherence in decision-making processes. Poorly targeted staff training.

- Ministry structures ill-suited to the needs of the public sector in a market economy. Over-emphasis on technical work and relatively limited attention paid to the development of policy and strategy.

- Weak co-ordination of initiatives, projects and information flow within and across sectors, and between government agencies and ministries working within the same or related fields.

- Weak central government co-ordination mechanisms, and limited capacity within the General Secretariat to support the leadership functions of the Prime Ministers and the Government in their collective efforts as a united body. This makes it demanding to co-ordinate, oversee and to ensure accountability.

- Since it has been important to launch reforms quickly in many individual areas of the administration, adequate attention may not always have been given to how various measures would affect each other and their total effect. As a result, a large number of new bodies and agencies have been established in addition to the existing administrative structure, and it has not been restructured and adapted. Consequently, in some cases, this has resulted in more complex administrative structures.

- Ensure an efficient and rapid implementation of new and revised legislation and thereby ensure a sufficient and clear institutionalisation of the reforms.

Goals and strategic directions

An efficient public administration reform is a key condition for the successful and rapid transition of Serbia to a modern society with a viable economy.

A well-organized and competent public administration is a key factor for a successful integration into the European Union. The SAp and the EIp are the single most vital catalyst for reform during the coming period due both to their importance and to the massive task of making all legislative and administrative procedures compatible with EU standards and the "*acquis communautaire*".

In response to these challenges, the Government has begun a number of initiatives in recent years. In particular, a number of new laws have either been put in place or are being prepared in order to modernise the public administration, including, the Law on General Administrative Procedures, the Law on Administrative Disputes, the Law on Administrative Courts, the Law on Public Administration and the Law on Civil Servants. However, implementation of these laws is weak due to fragmentation of responsibilities and unclear leadership. As a result, a single strategy for the overall public administration reform in Serbia has not been adopted. Thus, there is a risk that some of aspects of the above-mentioned laws will have to be revised if they are to be adopted before a strategy.

At the same time, a number of specific reform projects are taking place within some ministries, including the introduction of human resource management systems, the development of project management skills, the establishment of a change agent, and limited capacity building in ministries. However, these initiatives are not well co-ordinated and are not supported by the strengthening of central co-ordination mechanisms.

It is necessary to ensure the provision of a dynamic, efficient and transparent public administration which is well suited to the appropriate role of Government in a market economy and which will support the development of an active private sector through the provision of a transparent and accountable legislative and regulatory framework.

The strategy on public administration reform is being prepared, and includes the following elements:

- Strengthening the central co-ordination mechanisms of the Government including the support function of the PM and the Government with the objective of facilitating the effective and efficient performance of the Government's collective duties.

- Improving the pay and grading system. This will involve changing the pay structure, rationalising and/or introducing the grading system and reducing the overall public sector wage bill.

- Improving human resource management. This will include introducing transparent and merit-based systems of recruitment and promotion, review and appraisal. It will also include modern management structures and the development of staff training programmes. Strengthening public sector institutions is an integral part of the EU's Stabilisation and Accession Process (SAP).

- Improving the efficiency and relevance of ministries and agencies through restructuring and improvements in human capital development. These will follow functional reviews of institutions to identify the main aims and activities of each remaining ministry/agency, set out the appropriate structure which best meets these functions and the most suitable level of staffing and skill requirements, and identify efficiency measures.

- Strengthening anti-corruption measures to improve the delivery of basic public services. This will involve regularising out-of-pocket payments for services through setting, monitoring and enforcing the list of such fees and charges. It will also involve gradual increases in the salary levels of key public sector workers, within the context of the overall reform of the public sector salary structure.

- Improving communications within and across ministries and agencies through appropriate use of information technology.

- Strengthening public procurement. Following the adoption of the Law on Public Procurement, there is the need to adopt supporting procurement systems and procedures.

- Identifying a public administration reform champion. The establishment of a State Administration Reform Council within Government to act as a political/strategic decision-making is in progress.

- Establishing the function of an ombudsperson to act on behalf of the public in relation to state institutions and public services.

3.2.2. Corruption and Poverty

The direct influence of corruption on poverty lies in the fact that public services, which should be a public good, become a paid service. The purchasing power of the poor is small so they are especially sensitive to the existence of corruption. They cannot afford expensive public services that should be free. In other words, corruption discriminates against the poor and has direct negative effects on poverty.

Corruption prevents the proper functioning of legally prescribed procedures for exercising rights, by enabling those who are well-off to exercise even rights they are not entitled to, while the poor, regardless of entitlement, are prevented from exercising their rights. Additionally, this weakens public trust in the impartiality and independence of government bodies, and blocks the operation of institutions.

The indirect effects of corruption on poverty are far more significant. In the first place,, corruption does not only involve redistribution in favour of the person carrying it out, it also incurs its own costs since a corrupt deal calls for real resources. This inevitably leads to economic inefficacy (lowering the effectiveness of resource allocation), since it incurs considerable transaction costs. These are, in turn, transferred to end users which leads to rises in prices and falls in the purchasing power of all consumers, especially the poor.

Theoretical and empirical research has shown that corruption decelerates economic growth by lowering its rate, and dynamic economic growth is the precondition for overcoming poverty. The basic cause of this effect is in the fact that a higher level of corruption discourages foreign investors, and has a significant influence on the total amount of investment and the growth rate; this is especially true for developing countries and states in transition. Discouraging investment reduces the economic growth rate with considerable unfavourable effects on poverty.

Finally, a special kind of corruption is political corruption which leads to state capture. In such cases individuals misuse executive and legislative powers in a corrupt manner in order to influence policies and laws in keeping with their own private interests rather than the interests of society as a whole. Policies and laws adopted in this way actually hamper economic development and drastically increase poverty.

Although comparisons of the intensity and the extent of corruption across different states are methodologically questionable, it is certain that Serbia has inherited a high level of corruption from the period preceding the political change in October 2000. Among the main causes of corruption in Serbia can be listed strong and far-reaching state intervention as well as inadequate state administration, that is, under-qualified and underpaid state officials having broad discretionary powers in the application of regulations.

At the very beginning of its term of office (January 2001) the first democratic Serbian Government announced the fight against corruption to be one of its priorities, though over time the declared and the actual course of politics moved in different directions. This especially holds true for the operation of the Anticorruption Council as the principal body in the suppression of corruption as well as for the preparation of anticorruption laws. However, the state of emergency declared after the president's assassination and energetic measures undertaken by the Government broke the main levers of organized crime and intensified the fight against corruption.

The non-governmental sector plays an important role in the suppression of corruption. As an example of this we can quote an action plan offered to the authorities by a non-governmental organization.

Action Plan

A successful anti-corruption struggle demands a comprehensive approach, consistent and sustained effort and energetic execution resting on predetermined responsibilities and regulations. The main elements of the anti-corruption programme are:

1. Commitment: the main precondition of the anti-corruption effort is the commitment of the political elite in the state and all its bodies together with the firm resolve to undertake the necessary steps, resting on a full understanding of the negative influence that corruption has on the effective and just operation of the state administration and thus on economic, political and social life;
2. Accountability of the Serbian Assembly: The Serbian Assembly, as the representative of the will and sovereignty of the people, should be a bulwark against corruption and a guarantee of good rule; it has two main functions: as a legislative body and as a supervisory body for the work of executive authority;
3. Accountability of the Government: The Government of the Republic of Serbia is responsible for the operative work on suppression of corruption: it is obliged to give precedence to the fight against corruption, to carry it out continuously both through state institutions and through proposals for institutional reform;
4. Break with the past: the Government of Serbia should enquire into all major, known and unknown corrupt affairs from the previous period, so that perpetrators can be punished and made an example of, to all potential perpetrators;
5. Transparency: the operation of all state bodies and officials should be made transparent and public through the presence of the media at sessions, publication of reports made by state and other bodies, and similar actions;
6. Accountability: make everyone within the state administration accountable, from the government and other state bodies, through political parties and their leaders to each state official;
7. Reducing discretionary powers: carry out maximal deregulation of regulations wherever possible in order to reduce the discretionary powers of the state administration and limit the scope for possible corruption.
8. Laws: adopt anti-corruption laws and amend the penal code in order to define precise sanctions for corrupt behaviour and attempted corruption;
9. Public procurement: adopt the law on public procurement based on competitive methods (tenders, auctions etc), applying to all institutions financed from budget and state funds as well as for state enterprises;
10. Independent central control body: establish Main Control, an independent body exclusively linked to the Serbian Assembly which would supervise and inspect financial transactions from all budgets and all public enterprises as well as other similar tasks; investigation and sanctioning would be independent from the Government and subject to public scrutiny;
11. Anti-corruption Agency: establish a special anti-corruption body within the Serbian Assembly to coordinate anti-corruption efforts;
12. Other anti-corruption bodies: establish separate anti-corruption bodies within certain branches of the state administration such as the police force, the customs, taxation office, health service and others;

13. Administrative reform: reform the state administration in accordance with new laws on state administration and on administrative procedure;
14. Change in personnel: replace a certain proportion of state officials, especially in sensitive services (the customs, the police, judiciary, administration);
15. Judiciary reform: reform the judicial system so as to extend its independence from executive authority and political parties and their leaders;
16. Police force reform: strengthen internal control, special training, code of ethics;
17. International law: join the OECD Convention for the Suppression of Bribery from 1997;
18. International cooperation: secure the cooperation of all state and other institutions and organizations of civil society with partners from abroad in a struggle against corruption;
19. Education: long-term and short-term training activities for specialized services, state officials and the public on the causes, consequences and methods of fighting corruption; introducing certain relevant matters into school programmes;
20. Ethical standards: develop ethical standards of proper conduct and include them in regulations;
21. Free media: free media play an important role in exerting anti-corruption pressure on state officials and fostering awareness of the manifestations, depth and consequences of corruption; media campaigns can be organized, as well as various panels, documentaries about corruption in society, reports by relevant bodies on their activities, findings of research and similar.
22. Advertising and field campaigns: for the promotion of the fight against corruption (posters in relevant institutions, badges with appropriate messages, fliers and other promotion material "a week of fighting against corruption" and similar.
23. Research: promotion of continuous research and professional work on the issues posed by corruption, symposiums, seminars, publishing; the special role of empirical research on determining progress in the struggle against corruption through occasional opinion polls.

Source: CLDS: Corruption in Serbia, 2001

3.2.3. Judicial System and Justice

The state of emergency, established upon the assassination of the Prime Minister Zoran Đinđić, provided certain political incentives and removed some obstacles to the reform process. However, it is important for reform not to relate only to the criminal judiciary, i.e. the fight against organized crime, which has naturally been given priority, but also to the civil procedure, i.e. those parts that are crucial for regular and unhindered performance of business activities.

The importance of the state being based on the rule of law entails the creation of a system of norms that would enable the establishment of modern state institutions, implementation of decentralization, protection of basic human rights and liberties, building of democratic relations and strengthening of the independence of judicial authority whose reform should be oriented towards higher professionalism, depoliticisation, strengthening of ethical codes and modernization.

Accessibility to justice is one of the key dimensions of social welfare and poverty reduction, and it has a strong impact on citizens' satisfaction and their identification with the legal, political and social system. This area represents a big reservoir to draw on for the humanization of society and its democratisation, but is also an area of strong conflicts of interests and power. Many obstacles and much resistance can therefore be expected regarding reforms in this area.

The authoritarian regime which ruled by abusing rights has left as its legacy long-lasting disorder and the absence of the rule of law, it disrupted the principle of the hierarchy and subordination of legal acts, and promoted a proliferation of legal regulations and imprecise and conflicting legal norms and loopholes in the law, which created a wide area for arbitrary decision-making, for great discretion in evaluations and thus also for abuse.

Many holders of judicial functions and activities agreed to political intervention and influence , departing from the rules of the profession, and thus reducing the law to the position of servant to daily politics and the political interests of the authorities.

Such a state of affairs has provoked a deep crisis in the law and the principles of justice. Long-standing negative experiences of citizens related to corruption in this sphere, to different abuses of the law and numerous injustices, resulted in a loss of confidence that values of freedom, equality and justice are attainable. Such a state of injustice has led to the decline of citizens' legal awareness. Citizens today have a poor knowledge of legal principles and procedures, they hardly know their rights and the methods and mechanisms they can use for exercising these rights.

The strategy of judicial system reform as a universal guarantor of constitutional values implies the adoption of the Constitution and positive laws in harmony with international standards by means of which the legal system is established and basic rights and liberties of citizens are protected, which indirectly means strengthening the principle of the rule of law. The reform includes separation of the judicial branch of authority from the legislative and executive branch, as well as strengthening the independence of judicial authority, raising the quality and effectiveness of the work of courts and other judicial bodies and the emancipation of the judicial professions. This would enable the exercise of rights guaranteed by international instruments that are linked to judicial procedure.

An important part of this reform is the protection of citizens by the Constitution and laws, modernization of the courts and simplification of the procedure, depoliticising of the work of the courts, professionalisation, and strengthening of the system of continuous professional training. Intensive training of judiciary representatives on the application of international norms would lead to the efficient implementation of these norms and improve public awareness of the significance of human rights.

Citizens become the focus of the judicial system and reform has to bring them improved access to courts, a rise in the quality and effectiveness of court proceedings, greater accessibility to justice, and sufficient scope for the evaluation of the performance of judicial bodies..

3.2.3.1. Range of judicial reforms

In early 2002 a set of five laws relating to the judiciary came into force, designed with the active participation of experts and with respect for professional knowledge, principles and standards, as well as European standards. These Laws are the following: the Law on the Court System, the Law on the Judiciary, the Law on the Judiciary High Council, the Law on Public Prosecution, and the Law on Headquarters and Areas of Courts and Public Prosecutors. These Laws have regulated all-important issues in a new way, providing the basis for demarcation between judicial and other spheres of authority, and thereby reinforcing the independence of the judiciary.

The Law on Courts determines the network of courts, their competences, organization, and modernization. Together with the Law on Ministries, this Law draws a line between judicial authority and executive and legislative authority. The Law on Courts increases the competence of first level courts in order to reduce the excessive work load of second level courts; it introduces the Court of Appeals and Administrative Tribunal, which represents a specific rationalization and modernization of the system.

These Laws adequately regulate the status of magistrates' courts, which were abused for years as semi-court, semi-administrative bodies for restricting and threatening basic human liberties (including draconian punishment and persecution of the independent media, with arbitrary assessments by the magistrate judge on what "the truth" was, etc.).

In July 2002 the Law on Changes and Amendments to the Law on Judges was adopted. The Constitutional Court of the Republic of Serbia brought in a decision on the annulment of certain provisions of the Law; in March 2003 a new Law on Changes and Amendments to the Law on Judges was adopted, introducing partial changes to some of the questionable provisions (in accordance with the decision of Constitutional Court), while some provisions remained the same. Since in the field of legislation dealing with the organization and functioning of the judiciary some issues are not regulated, there is room for arbitrariness in the interpretation of norms and the assigning of excessive discretionary rights to the executive authorities compared to the judicial authorities.

Status, election, dismissal and establishment of judges' accountability

- The status of judges has been considerably strengthened and brought closer (although not made equal) to the status of parliamentarians or representatives of the executive authorities. The judges are guaranteed independence (real and material), job security (re-election is abolished and they are nominated for steady positions) . The new Laws have highlighted the principle of the political neutrality of judges and emphasized the ban on their party membership and involvement.

- The procedure for nominating presidents of courts and their deputies, judges, prosecutors and deputy prosecutors was set out, as well as the criteria and necessary qualities for their selection (expertise and worthiness), and it was put under the crucial influence of the legal profession. As in all developed states based on the rule of law, the right of candidacy was given to the High Judiciary Council as a body whose decisions guarantee the principles and criteria of expertise, since it consists of the most prominent judges, prosecutors, lawyers, experts and other representatives of the legal profession.

- The control of their work, disciplinary measures and dismissal of judges are specified by new Laws and put under the dominant influence of the legal profession, to prevent abuses of this extraordinarily important Law by everyday politics, which often happened previously (with imprecisely regulated conditions for dismissal, great discretion and arbitrariness in appraisal, dismissal without legal basis or explanation, and application of shortened procedures for the dismissal of judges, etc.). The new Law introduced the Big Personal Council as an independent expert body consisting of 9 prominent judges from the Supreme Court; it is the main disciplinary body responsible for establishing the accountability of judges in respect of possible failings in performance and expertise, and to recommend adequate disciplinary measures.

- Partial restructuring has been carried out in a large number of courts; a great number of judges have been dismissed or resigned, as well as a number of prosecutors, with a public debate on procedures and methods of implementation and concerns about possible abuses.

Working Conditions of Juridical Bodies

It is necessary to increase the independence of judicial authority in this sphere. The question arises regarding the conceptual place of the Prosecution and the Public Attorney's Office in the system, their attitude towards the Courts, the Executive authority and the Police, as well as their role in legal proceedings (increased efficiency, quality and independence in work). Many analyses pointed to the Prosecutor's Office as an operational bottleneck, which is exceptionally exposed to corruption.

The issue of greater material independence for the judiciary was also tackled making the judicial budget part of the state budget, with the active participation and greater influence of juridical bodies (High Judiciary Council) in determining its size in cooperation with the Ministry of Finance and the Government. Independent disposal of resources by juridical bodies will reduce the dependence of the judiciary on executive bodies that still have large competences in court financing, outlays, allotment of apartments, housing loans etc.

3.2.3.2. Further steps

- Adopting the new Constitution, and the forms of decentralization and regionalization, will require organizational and actual adjustment of judicial authority, but it will at the same time provide the best basis for full reform. Some of the most important issues are: the protection of basic human rights and independence of the judiciary, guaranteed also by the signed international agreements and declarations, as well as ensuring constitutionality and the rule of law with elaboration of the place of the constitutional judiciary in the system.

- Further strengthening of the independence of the judicial authority branch, raising the status of judges to that of parliamentarians and representatives of executive authority, introducting a judicial budget as a guarantor of greater material independence of the judicial authority, promoting a continuous process of education and training, as well as improving sensitivity about social issues and problems. In this context, the issue of the relationship between the Ministry of Justice and the judicial system (place, role and competences) should be dealt with consistently with standards appropriate for a state governed by the rule of law and with an independent judiciary.

- Improving the quality, professionalism and working efficiency, strengthening openness of work, improving material and technical working conditions of juridical bodies, creating anticorruption programmes. Introducing information technology (e-government) for increased transparency and higher accessibility to justice: automatic movement of documents, creation of functional databases accessible to citizens through websites for all areas (so far only the registry of companies has been organized as a functional database) etc.

- Reforms should encompass the entirety of process laws that would enable modernization and rationalization of work in this area (civil procedure, penal code, bankruptcy act, company act etc.) and simplify and accelerate these processes, along with strengthening the principle of parties' equality, banning discrimination in terms of the right to use one's native tongue in the court procedure, respecting the right to legal remedy etc. In these areas the interests of different groups often collide and therefore strong resistance is expected.

- The reform should introduce new professions, such as: notary public, magistrate, judiciary police, court crier, bankruptcy commissioner, and ombudsman. Their introduction requires the existence of schools for these professions, as well as permanent education and training.

- The codification of professional ethics is an exceptionally important part of this reform. It implies professionalisation, strengthening of ethical codes, and different attitudes towards citizens and parties as service users. Measuring the quality of work of juridical bodies, the satisfaction of citizens regarding "accessibility to justice", and continuous improvements to the quality and effectiveness of the work are important parts of this whole reform.

- Relations between the judiciary and citizens imply a restored public confidence in this branch of the authority. Cheap and easy access to the judiciary, the reduction and eradication of corruption, the control of the level of court fees (setting up the system of free-of-charge legal assistance) and exemption of socially vulnerable categories from payment of court fees (instituting rights for the poor) are some of the important principles of this reform. An important part of these processes is the continuous improvement in the public legal awareness along with disseminating knowledge about their rights and methods of exercising and protecting those rights.

3.2.4. Decentralization of Local Self-Government

The new Constitution of the Republic of Serbia is currently being prepared. It is expected that this process will result in the new distribution of competences between different levels of government (Republic of Serbia, potential regions, local government).

The Poverty Reduction Strategy project in Serbia cannot not be successfully implemented if the relationship of cooperation and partnership between the State and the local governments has not been established. The problems of poverty can be identified most easily in the local communities, while the poverty reduction programmes could be created in the best possible way on the basis of suggestions from citizens, local organizations and NGOs, including the most efficient way of implementing such projects. At the same time, it is very important for central government to be responsible for the promotion and development of mechanisms and activities oriented towards the poor at the national level, including sharing experience with local self-governments.

Local government authorities can establish more direct relations with the citizens, they can more easily move them and motivate them for the creation of private and public arrangements and partnerships, they can create an environment attractive for capital investment and for initiating different development projects These competences and functions of the local authorities are among their most important competences and give them the opportunity to be entrepreneurial.

3.2.4.1. Current status

There is a general impression that adequate attention is not being paid to issues of social policy and poverty reduction in society, and concretely in municipalities, and also that there is no consistent strategy in this area.

The key legal framework meant to govern the operation of local government bodies is the Law on Local Self-Government enacted in February 2002, and the municipal charters in compliance with the above Law have been passed. This Law has just initiated decentralization, while the forthcoming constitutional reform is to create the normative basis for a further decentralization and a functional reform of all the governmental levels. The process of modernization, and strengthening the status and functional capacities of local government imply a new distribution of competences, and a new type of partnership among the various levels of government, new forms of coordination and the establishment of new financial arrangements, together with the strengthening of local government financial autonomy (fiscal federalism). Regulations on municipalities and other types of territorial organization, public administration, property, local finances etc. are a precondition of reform in this area.

Local Government Competences

The set of local government competences comprises all the key dimensions necessary to ensure the conditions for a better life for citizens. The new Law on Local Self-Government has expanded the scope of the original competences of local government, and it has precisely defined both the original competences and those newly entrusted to it. The significant original competences of municipalities include the provision of utility services such as the supply of water and gas, sewage, sanitation, collection and disposal of garbage, the traffic infrastructure and the road network, in addition to the areas of elementary education and primary health care, cultural institutions and activities, social services, sports, recreation, ecology and environmental protection and finally, stimulating economic development.

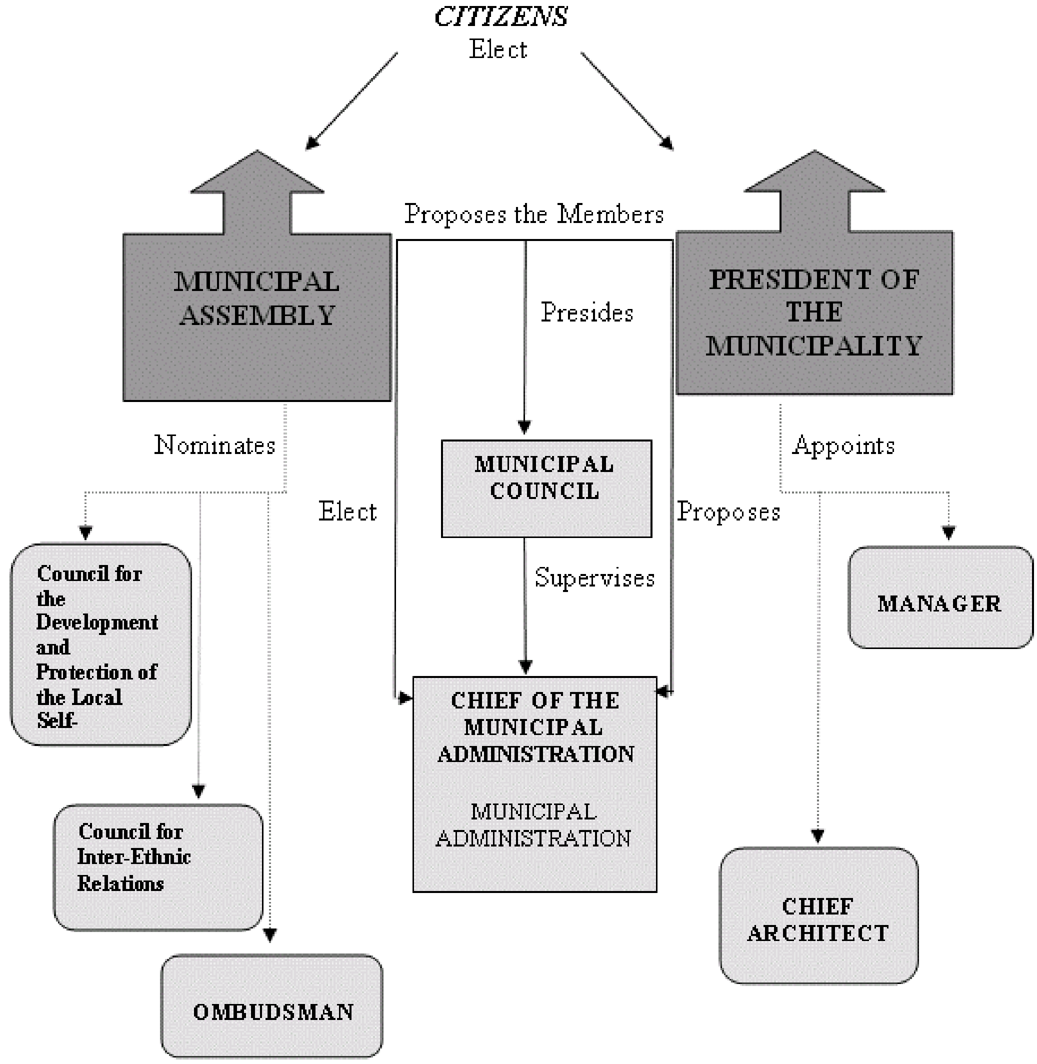
In the area of social care, to which the reduction and prevention of poverty belong, the municipal competencies have been transferred from the State to the municipal level, and such jobs are carried out under the supervision of State bodies. Moreover, the original competencies of a municipality include the provision of the expanded entitlements of citizens, and also the development of specific forms of social care and protection. Substantial economic problems reduce the opportunities for major activities in that area.

The above range of competencies makes the local level an important starting point in the implementation of the Poverty Reduction project. The process of decentralization and transfer of competences to the local community level has an additional impact in terms of raising the responsibility of municipal authorities in the realization of human rights.

Organizational Structure and Functions of a Municipality

The present organization of municipal authorities is a classical European assembly-mayor model, with strong elements of a system of unity of authority. The new Law on Local Self-Government, which will come into force on the occasion of the next local elections in 2004, provides for two new optional models of organization: the mayor-assembly model, and the assembly-manager model.

The following diagram illustrates the new organizational structure and relations among the most important bodies of a municipality.



The Law on Local Self-Government introduces the city manager, civic defender (ombudsman) and chief architect (urban planner) as new institutions. The city manager proposes projects that stimulate economic development, increase chances for entrepreneurship at micro level to become reality, with constant empowerment of entrepreneurial initiative and creation of private-public arrangements and partnerships. His job would also be to encourage and coordinate investments and to secure the attraction of capital, as well as to initiate amendments of regulations which make the realization of business initiatives difficult. The Civic Defender (Ombudsman) protects collective and individual rights and interests of citizens and represents an additional institution for strengthening citizens' confidence in justice and the rule of law. Thereby necessary preconditions for the creation of an efficient control and monitoring mechanism are established. The job of the Chief Architect involves creation and control of construction standards and preserving urban spaces and their environment. These three institutes are optional and each municipality decides on a certain arrangement of authority, in conformity with its particular circumstances, assembly decision, statute and other acts.

In this way a certain organizational flexibility of the local government model is introduced, and the functioning of the entire institutional framework has been strengthened.

In many cases, municipal administration is still inefficient, with an inadequate qualification structure for public servants, poor equipment and outdated working methods. The new Law on Public Administration introduces its modernization.

Local Finances

Traditionally, the Serbian municipalities used to have their own property, but it was taken away from them and transferred to the state following the Property Law of 1995. This act has seriously jeopardized the position of the municipality as a legal and economic entity.

Legal regulation of municipal property is linked to the passing of a set of laws that should solve some open questions (restoration of dispossessed property to private persons and pubic entities, registration into cadastral registries, and so on), but any further postponement would leave municipalities dependent on the central government and would interfere with the very essence of reforms. Nevertheless, the new laws have helped the course of reform in several ways. The municipalities have been given several new taxes, a portion of tax funds has been redistributed in favour of the local governments, and the municipalities have been given an opportunity to raise loans, which has resulted in an almost doubling of local self-government revenues in the period 2001-2002.

Some 35% of the total municipal revenues originate from resources partly or totally controlled by local government, which represents a considerable share, compared to other countries in the region. However, in order to create a more efficient system of local government financing, existing local government revenues need further strengthening.

One of the major problems is that the system of local government financing is to a large extent based on part of the sales tax (30% comes from this source), because Serbia is obliged soon to substitute this tax with the Value Added Tax (VAT), in accordance with EU standards. Upon the introduction of this tax, the system of local government financing will have to undergo radical changes, because VAT cannot be allocated according to the place of collection (as was the case with sales tax).

Further steps towards reform would imply the restoration and protection of local government property, and a greater financial autonomy of local government with the right to establish tax rates. That would secure an opportunity to the local governments, by creating an attractive tax environment and providing services of a better quality, to attract capital and investment to their territories, and thus to encourage economic growth as one of the ways of resolving the problem of poverty. Another part of the reforms would mean the establishment and strengthening of the partnership between the central and local governments in the distribution of goods and financial resources, which is indirectly a part of efforts to establish a developmental model of decentralized market re-distribution.

Direct Democracy and Participation of Citizens

Regarding the immediate democratic institutions, the Law provides for a civic initiative, a citizens' open meeting and a referendum. However, in reality, the level of citizens' participation is very low: they have no information about most important municipal affairs, local authorities do not see citizens' participation as a prerequisite for successful work, there is no transparency, and the scope for citizens' influence is too limited, which leads to great apathy and passivity.

3.2.4.2 Problems and Constraints

Due to the lack of a strategic approach at the macro level, a consistent strategy for poverty reduction does not exist at the municipal level either. The majority of municipalities have so far performed such jobs just mechanically as assignments transferred by the State, and without a greater involvement in developing strategic plans, or towards creating and implementing new projects and programmes. In practice, the municipalities have reacted only from time to time and temporarily in assisting the most urgent and difficult cases. Such a state of affairs has primarily resulted from poor economic capacities which do not allow effective and efficient resolution of the problem, but also from insufficient democratic awareness, institutional weaknesses etc.

The Role of the Self-Government in priority sectors of the PRSP

The municipal assembly is only to take over the role of leader and to initiate strategic, developmental, intersectoral work with other actors in the municipality, in several sectors: education, health care, the private sector, employers, labour unions, social welfare centres, labour market, Refugee Commissariat, NGOs etc. For the purpose of institutionalising sustainable strategic and intersectoral work more and more municipalities will establish socio-economic councils.

Social welfare and social assistance. The most significant implementers of social protection activities in municipalities are local governmental bodies, Social Welfare Centres, a certain number of social institutions, and the numerous humanitarian and non-governmental organisations.

A Social Welfare Centre is a municipal authority specifically established for the purpose of carrying out such assignments, and it is the main carrier and implementing agent of social policy at the municipal level. In the municipality, there is a number of typical humanitarian organizations (the Red Cross and others) and NGOs, which perform that type of activities. The Commissariat for Refugees and the Employment Bureau also collect some data, and carry out analyses that may be relevant in dealing with problems of poverty.

Education. Primary education falls within the new competences of local governments (provision of infrastructure and buildings, as well as foundation rights), for which local governments must prepare themselves. The new Law on Primary Education will specify the distribution of the competences and financing between the state and the local governments.

The most important stakeholders in the sphere of education are the municipal authorities (Assembly, executives bodies and the Secretariat for Education), as well as schools, professional educational organizations and NGOs dealing with educational issues. Users of services (students and parents) have an important place in the reform of the education system. It is thought that the introduction of a per capita financing system for schools would raise the quality of their work.

The new laws create the possibility for alternative school programmes.

Health Care. Primary health care is included in the new competences of local governments (provision of infrastructure and buildings), which entails allocation of funds for carrying out such activities. The current status is slightly improved, but only *the new laws* in this area will provide for a more specific distribution of competences among various levels of government, as well as the manner of financing (see chapter “Health Care Towards Poverty Reduction”).

Housing and Urban Development Planning. A substantial part of the municipalities in Serbia suffer from chaos in both urban and architectural planning, with non-registered buildings and a lack of planning. There is no accurate data on subtenants and a substantial number of citizens live in inadequate flats (in respect of both conditions and size). See chapter “Regional, Rural, Urban and Housing Aspects of Poverty”.

Local governments have certain operational advantages in identifying both problems and realistic objectives, and creating adequate housing programmes together with citizens. In the area of urban planning, the city urban planner could play a useful role in preventing illegal construction and introducing standards in developing the urban areas.

Functional Relationships

The relationship between the municipal and Republic authorities is satisfactory, but the information exchange from the Republic level to the local one is insufficiently effective and is inefficient. The practice of delivering information through political parties’ channels has not ended and the problem of symbiosis of the state and party (through their bureaucracies) should be raised as one of the obstacles to the implementation of reform processes and modernization.

The relationships between municipal authorities, services and organizations in this area are correct, but there is an evident problem of poor functional links among the actual and potential stakeholders. Furthermore, these relationships are burdened with all the weaknesses of the neglected local governments, such as offices poorly equipped for information technology,, a discrepancy between the municipal by-laws and legislation, inadequate skills among the staff, outdated knowledge, a primary focus on political and party issues, too large an influence of individuals and informal lobbies on the decision-making process, poor monitoring of the implementation of projects and activities, as well as the slow implementation of decisions, levelling of remuneration and generally low salaries of staff, poor transparency of work, and a culture of exclusiveness and quite a low participation of citizens. The practice of measuring the efficiency of the work of municipal authorities has not been established at all, so introducing qualitative and quantitative indicators would contribute to improving the quality of work in that area.

The Resources, Human Resources and Equipment

The salaries, various services, equipment, and capital investments in buildings are financed out of the municipal budget, but the lack of financial resources needed for major projects is obvious.

The municipalities lack key experts, those who would deal with the strategy and the development, planning, decision making, organisation, coordinating and controlling of activities. Knowledge and skills are required in order to secure the municipality's own income (private public partnerships), to create an environment attractive for investments (entrepreneurship, marketing and information sharing), and to include in the development all potentials of the citizens. The training of new personnel (city managers) is of exceptional importance. The existing personnel also require a comprehensive and continuing education in order to understand the nature of social phenomena and the interconnection of the problems to be resolved. Through this training they would be able to develop a greater creativity in their work.

In most cases, municipalities have at their disposal very modest technological equipment, the purchase of which is provided for out of the municipal budget, and all of them lack the means to create a network for a single information system.

The Participation of Citizens and the Local Community

Despite the recent changes and the fact that the current law foresees citizens' participation in governance and decision-making processes, this is rarely implemented in practice. In the course of the previous 15 years, the autocratic regime caused all the democratic mechanisms of government to deteriorate substantially. Municipal officials and municipal administrations have not yet developed ways of increasing and improving the quality of citizens' participation. Members of local assemblies and municipal authorities need to be educated on the ways to improve the dissemination of information and achieve higher transparency in their work. At the local elections votes are still predominantly given to political parties and less in response to the effects of the work of officials and their successes.

On the other hand, citizens rarely consider the municipality as a place and a mechanism whereby they could resolve their (in fact, general) problems. Consequently, citizens and municipal authorities remain distant and opposing parties, with separate needs and interests.

It is encouraging that in the majority of municipalities, the authorities have established good cooperation with non-governmental organizations by assisting them both financially and logistically in the implementation of various projects for poverty reduction or prevention, recognising in such projects both common and general interest.

3.3. Global and Regional Integration

3.3.1. European Integration

In addition to a greater degree of democratization, the European integration process represents a key factor for securing stablization in Serbia. Stability is a precondition for the increase in foreign investment and domestic savings, which are also the preconditions for economic development. The inclusion of Serbia in European institutions in the next decades will be a crucial step for further social, economic and political development.

3.3.1.1. The Stabilization and Association Process

The European Commission for the so-called countries of the western Balkans (Albania, Bosnia and Herzegovina, FYR Macedonia, Croatia and Serbia and Montenegro) which are not in the first or the second group of countries to become full members of the EU, has created a stabilization and association process (SAP). This process should gradually prepare these countries for membership of the EU, and should give their governments political encouragement to cooperate with the Commission/Union. In other words, for

Serbia and Montenegro (and others as well) the Stabilization and Association process is a first step towards full membership of the EU.

In Serbia and Montenegro, this process has begun with the establishment of a Consultative Task Force FRY-EU which, through a series of meetings in 2001 and 2002 and other activities on preparing the Stabilization and Association Agreement, enabled information exchange, adjustments of local policies and reform of local institutions. One of the results is the establishment of the Office for European Integration at the federal level, i.e. at the level of the state union, in 2001. Now a feasibility study is to be prepared. This study will provide an evaluation of the readiness of the country to begin negotiations in 2004 on the policies that will be part of the Stabilization and Association Agreement. The parts of the agreement on foreign trade liberalization and on opening EU market for the domestic products export are of greatest importance for economic growth and overcoming poverty.

The commencement of work on the Feasibility Study is conditional upon the adoption of the Action Plan for the harmonization of economic systems, i.e. foreign trade policies and regimes between Serbia and Montenegro, which practically boils down to the defining of an Action plan for the creation of a customs union.

The CARDS programme, led by the European Agency for Reconstruction, which encourages reform and transition, is also a part of the process of integration into the EU. Generally speaking, such help creates preconditions for economic growth, and improves it as a tool for overcoming poverty. The CARDS programme itself does not deal directly with poverty or its eradication, i.e. with some specific vulnerable groups, but as the reconstruction requirements decrease, the CARDS funds are progressively used for sustainable economic development.

The focus of the CARDS programme is on building institutions, strengthening administrative capacities, the judiciary and internal affairs, which will basically help create a credible business environment and thus encourage further investment and so have an indirect favourable effect on the suppression of poverty, either through the stimulation of economic growth and job creation or through increasing real revenue of the country and real budgetary funds for the fight against poverty. The European Commission and the member states also provide macro-financial assistance (MFA) in grants and loans for direct budgetary support. This help has the same effects on poverty as World Bank budgetary support by loans for structural adjustment. The first MFA instalment included and amount for payment of arrears to the European Investment Bank.

European integration plays an important role in the successful implementation of the Poverty Reduction Strategy. In the first place, the Stability Pact for South-East Europe will significantly help the process of the return of refugees, which will have a direct positive impact in one difficult area of the poverty issue in Serbia.

Secondly, the European Union in Copenhagen in 2002 and in Brussels in 2003 affirmed “the European perspective” of the West Balkan States, which opened the way for Serbia and Montenegro to take part in the programmes of the Community, especially in the areas of education, professional training and the so-called “twinning” programmes for the transfer of administrative capacities into the European Community. This would directly contribute to the achievement of Strategy objectives, partly through direct financial support for the education system and partly through creating a recognizable European business environment playing a key role both in attracting strategically important investors and in improving the level of security for small enterprises – two cornerstones on which the economic growth of newly accepted members of the European Community rests. To that end, it would be advisable for the creators of the economic policy of Serbia and Montenegro to adopt the principles of the European Charter on small business enterprises, to which we are obliged as signatories of the Solun Declaration.

Thirdly, through direct asymmetric preferential trade arrangements, the European Union directly supports Serbia's accession to EU market, and thus, indirectly supports employment; it carries out non-inflationary expansionary measures of economic policy towards the Serbian economy.

Fourth, it has been agreed, within the SAA, that cooperation with the West Balkan countries will follow the "step-by-step" principle which means that Serbia and Montenegro have a strong incentive to approach the European Union at the rate at which they are able to bring their regulations into line with the relevant principles and regulations of the EU, in order to further economic growth and indirectly aid the success of the Poverty Reduction Strategy.

Fifth, it should be borne in mind that in the Amsterdam Treaty ratified in Lisbon in March 2000, the Council of Europe came to the conclusion that the level of poverty and social exclusion in the EU itself is too high and that a determined effort must be made towards its eradication by the year 2010. The measures proposed for the implementation of the European Strategy are completely compatible with the measures adopted in the Poverty Reduction Strategy in Serbia.

3.3.1.2. Harmonisation of Economic Policies with Montenegro in the light of the Stabilization and Association Process

Future development of the international integration of Serbia and Montenegro crucially depends on harmonisation of their economic systems and economic policies. After the changes in October 2000, the international economic integration of FR Yugoslavia was not significantly disturbed by the existence of two economic systems, two monetary areas and two customs (foreign trade) areas. But since the new state union of Serbia and Montenegro has been formed, under the patronage of the European Commission, i.e. European Union, it is expected that there should be harmonisation of economic policies. This means that there should be a customs union and the adjustment of certain indirect taxes, especially excise tax. Two main directions of international integration: membership in the World Trade Organization (WTO) and the Stabilization and Association Agreement (SAA), depend on how fast the customs union, i.e. the common market of Serbia and Montenegro, materialises.

At the beginning of June 2003 the Action Plan for the harmonization of the economic policies of member states was adopted to eliminate obstacles to the free flow of people, goods, services and capital. According to the Action Plan, the republics reached a compromise by which Serbia would lower its customs rates, not at once but over the next 18 to 24 months and Montenegro would go on using non-tariff barriers; the foreign trade systems will be brought into line in the following 18 to 24 months. Meanwhile there will be two customs areas and two customs administrations. In addition, duty rates in Serbia will be reduced from 9.4% to 7.1%; the foreign trade system rests exclusively on tariff protection; there are virtually no non-tariff barriers and tariff rates are relatively high. On the other hand, Montenegro has substantial non-tariff protection; relatively low duty rates, but numerous non-tariff barriers (quotas and licences) which are not transparent and which will not be abolished by the Action Plan. The tariffisation of these barriers has not yet taken place, but according to some preliminary estimates, effective protection was lowered from over 20% to below 10%. As for the foreign trade regime, the member states will submit proposals on the Law on Foreign Trade by December 31 at the latest. As they are to be based on the regulations and practices of WTO, harmonization of these documents should not, in principle, pose a problem. The effects of harmonization on poverty should be viewed from the perspective of further liberalization of foreign trade, joining the World Trade Organization and the process of stabilization and greater integration with the EU.

3.3.2. International Financial Institutions

After the political changes of October 2000, Serbia and Montenegro restored its membership in international financial institutions (the International Monetary Fund, the World Bank, the European Bank for Reconstruction and Development, while membership of the European Investment Bank is related to European Union membership).

The International Monetary Fund (IMF)

The membership of Serbia and Montenegro in the IMF was restored in December 2000, while the first Stand-by agreement was concluded in June 2001. At the moment an EFF (Extended Fund Facility) agreement is being conducted. Though the basic IMF role is to give support to the national currency by giving loans as a way of supporting the balance of payments of a country, the significance of the agreement with the IMF is far greater. These agreements are the preconditions for the macroeconomic stability of a country, and what is more important, they are the guarantee that this stability will be maintained. Because of the positive effects that macroeconomic stability has on poverty reduction, membership in the IMF, i.e. an efficient implementation of an appropriate IMF agreement, is a precondition for the reduction.

One of the preconditions for concluding any of the agreements with the IMF is a balanced budget, that is, the curbing of the fiscal deficit, which may limit the possibilities for income redistribution towards the poor. Since the basic strategy for overcoming poverty is the acceleration of economic growth and macroeconomic stability and not income redistribution, the agreement with the IMF is crucial, as it accelerates economic growth.

In the field of relations with the IMF nothing new is expected except the continuation of the implementation of the EFF agreement which will last until March 2005.

The World Bank

Serbia's membership of the World Bank was restored in May 2001. At the same time, a three-year Transition Support Strategy (TSS) was harmonized and Serbia was admitted to the IDA (International Development Agency). This means that the credits provided by the World Bank will be under concession conditions (with respect to interest, grace period of the credit and terms of payment), which are better than market ones. It was anticipated that Serbia will receive 540 million USD, under TSS, 80% of which will be in the form of structural adjustment credits (SAC). This programme represents direct budgetary support linked to the implementation of planned reforms.

By means of this budgetary support, the budget balance will be maintained and macroeconomic preconditions for accelerated economic growth and consequently, poverty reduction, will be created. This creates preconditions for an increase in the available resources and for increasing the transfer to the poorest, which directly decreases poverty.

TSS expires in the first half of 2004 and will be substituted by the Country Assistance Strategy (CAS). There is a question whether Serbia will be allowed to keep IDA status or whether this status will be changed to IBRD (International Bank of Reconstruction and Development) status under the new CAS. Since IDA credits are granted under more favourable conditions than IBRD loans, it is important to try to keep the present status. The status will be negotiated with the World Bank taking account of the social, economic and political situation.

The European Bank for Reconstruction and Development (EBRD)

Serbia has been a member of the EBRD since January 2001. Recent EBRD activities in Serbia were directed towards creating a business environment suitable for development of the private sector, i.e. creating economic growth. These activities therefore had only indirect effects on poverty. Some direct effects came from investments in infrastructure, especially in utilities, which provided improvements in the basic infrastructure services for the poor.

The European Investment Bank (EIB)

The commencement of cooperation between the European Investment Bank (EIB) and Serbia and Montenegro, has been marked with loans for the rehabilitation of large infrastructure facilities, which have improved the general business environment and provided opportunities for future job creation, but without any direct effect on poverty reduction.

3.3.3 Membership of the World Trade Organization

Membership of the WTO should be considered in the framework of further foreign trade liberalisation and its beneficial effects on poverty, either through the growth of real incomes of all consumers in one country, through encouraging economic growth without any changes in income distribution, or through decreases in the prices of certain products.

Apart from that, membership of the WTO brings most favoured nation status (MFN). This will increase export demands and beneficially affect economic growth. The most important benefit is that the WTO provides the most favourable transition framework.

Finally, membership in the WTO will lead to the conclusion and implementation of agreements on free trade zones, which are important for effective foreign trade liberalisation. These agreements have to be conducted according to WTO regulations.

Though the obligation related to these agreements originated from the Stability Pact and not from membership of the WTO, members are obliged to remove any hidden barriers in such agreements.

III STRATEGIC DIRECTIONS OF THE REDUCTION OF POVERTY IN SERBIA

The reduction of poverty in Serbia depends on the capability of achieving sufficiently high levels of sustainable economic growth, together with an effort to prevent inequalities in the distribution of the national revenue from deepening. Achieving social and economic stability is a precondition for the attainment of this objective. In such a context, the continuation of the process of democratisation as well as the process of European integration, along with maintaining the level of macroeconomic stability which has been achieved are key elements for increasing economic activity and employment, the growth of salaries and the reduction of poverty.

1. Improved Employment Opportunities

The unemployed faced not only the greatest risk of poverty but also the most severe and deepest levels of poverty compared to other actors in the labour market. The proportion of unemployed individuals in a household considerably reduces consumption and increases the risk of poverty.[37]

1.1 Creation of new employment opportunities

The main objective of the economic reforms in Serbia is the creation of a modern, export-oriented market economy dependent on the private sector and capable of achieving dynamic economic growth and job creation. In such an economy, new employment opportunities as well as opportunities for economic growth will result from increased internal and external demand with the improved competitiveness of Serbian companies and more efficient use of available resources.

To be successful in this task the economy needs a clear ownership structure, strong corporate governance, and better management. In this context the ongoing comprehensive reform of economic legislation and the efficient privatisation process are critical (see Annex for more information on the comprehensive legislative reform currently being undertaken in Serbia).

Through FDI, private investments, the development of an entrepreneurial spirit and the SME sector, it is the objective of the government to increase the share of private ownership in the economy from 42.5 percent in 2002 to 75 percent in 2005.This will result in a dramatic increase in the overall share of workers employed in the private sector where the average salary is higher.

Increased domestic and foreign demand is a mechanism for increasing economic activity and creating new employment opportunities.

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[37] For more on this methodology see in Krstic, G: The Determinants of the Consumption of the Poor, Poverty in Serbia in 2002, The Ministry of Social Affairs, 2003

Increased internal demand

Increased internal demand will result from a combination of the following factors:

- increased employment and investment rates through an FDI driven privatisation process;
- increased employment and investments as a result of foreign direct Greenfield investments;
- increased purchasing power and domestic savings;
- increased public investments.

So far the privatisation process has resulted in **increased investments in privatised companies** at the pledged amount of EUR 567 million. The objective of the privatisation process is to sell up to 70 percent of state and socially owned companies via transparent auctions and tenders. By September 2003, out of 1074 companies offered for privatisation, 843 had been sold. In addition to the above-mentioned investments, this has resulted in a million euros of total privatisation revenue and 253 million EUR for social programmes (severance payment and retraining). A large proportion of the privatisation revenue has come in the form of FDI.

There is also an increase in Greenfield investment. Serbia is rapidly establishing a liberal investment regime. Although structural barriers still persist, the Government endeavours to remove impediments, reform business activity and open the economy to foreign participation.

FDI investments through privatisation and Greenfield investments have a **multiplier effect**. Demand for local goods and services will increase due to the actual investments and the need for inputs to the production process. In addition the employment of staff will result in increased personal consumption and investments.

The **increase in purchasing power** is linked to a real increase in salaries. The Serbian average monthly net salary increased to USD 151 in 2002 from USD 90 in 2001 and USD 45 in 2000. As of May 2003, the monthly net salary has further increased to EUR 170.[38]

As the average salary is higher in the private sector than in public and state owned companies, this trend is expected to continue with the continuation of the reforms towards a market economy based on private capital. The increase in purchasing power is expected to result in an increase in domestic savings.

Public investment is expected to rise in the forthcoming period. This will be accomplished through the improvement of the management of public expenditures with the aim of redirecting budgetary funds which are now used for public spending into investment.

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[38] The Republican Statistics Bureau and NBS

Increased external demand

Increased external demand will mainly be driven by the following elements:

- liberalization of foreign trade
- increase in exports
- strategic position
- free trade agreements
- WTO and European Integration

Liberalization of Trade and Free Trade Agreements

Although liberalization of foreign trade in the short term will have a negative effect on existing employment it will have a positive effect on employment in the medium to long term. Liberalization stimulates restructuring, so that companies that are not in a position to withstand the pressures of competition must either adjust or close down. This opens up the economy for the development of new and profitable enterprises which will create new employment opportunities and higher wages.

Increase in exports

Serbia's integration into the international economic processes and the improvement in exports represents a prerequisite of its development, since it is a small country and therefore bound to have large-scale economic trade with the surrounding countries. Hence the increase in exports will be one of the main generators of economic growth.

Strategic position

It is the objective of Serbia to become the major trading and market centre in South East Europe. It is strategically located within Central East Europe and borders new member states. Serbia is the natural gateway between South East, Western, and Central Europe, positioned at the intersection of Pan European corridors no. 10 and no. 7, on the banks of the Danube, one of the biggest and most important river routes. Together with a well-developed transportation network, this makes Serbia easily accessible.

Free Trade Agreements

Serbia is in the middle of the South East Europe Free Trade Area that enables duty-free access to a market of 60 million people in Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Former Yugoslav Republic of Macedonia, Moldova and Romania. The diversity of the eight countries in the area, in terms of their position, legal environment, growth potential, resources and prices, offers a great opportunity for companies and investors to improve their business performance through regional cooperation. A draft free trade agreement was signed in 2001.

The main points of the agreement are as follows:

- Liberalization of at least 90% of mutual trade by the end of 2008;

- An appropriate common set of preferential rules;

- WTO-consistent provisions for the application of anti-dumping, countervailing, safeguard measures and intellectual property protection;

- Transparent and non-discriminatory measures concerning public procurement, state aid and state monopolies;

- Harmonization of trade legislation with that of the EU (especially customs procedures, competition law, company law, company accounts and taxes and banking law).

Serbia and Montenegro is also the only country outside the Commonwealth of Independent States (CIS) that has a Free Trade Agreement with the Russian Federation allowing it access to the market of 150 million people.

In the preceding chapter we discussed European integration and joining the WTO.

Increased Competitiveness as a mechanism for creating new employment opportunities

The National Competitiveness Strategy, the preparation of which is drawing to a close, sets the following priorities:

- improving the productivity of the private sector, emphasising improvements in quality and added value rather than price-based competition;

- integration into the international business community so that Serbian companies can develop their business markets and strategic partnerships;

- building industry clusters in high priority sectors to improve the productivity of the sector and the enterprises, including research and development, human resources and capital markets;

- improving companies' access to and productive deployment of financing;

- attracting strategic foreign investors whose financial and intellectual capital can rapidly accelerate the restructuring of individual firms or provide the foundation for the development of new exporting clusters;

- actively searching for investors willing to make substantial, long-term investments in plant improvement, worker retraining, and research and development;

- increasing the capabilities for using existing technologies and innovations to create new competitive advantages;

- improving market and business skills.

"The comparative advantage of Serbia is reflected in its educated workforce, low wages, functioning infrastructure, cheap overheads, strategic position in the centre of the

Balkans, as well as the potential for expanding to other Balkan countries through Serbia." (The National Competitiveness Strategy).

Increased investments as a mechanism for creating new employment opportunities

A significant determinant of the speed of medium-term growth and thereby the creation of new employment is the share of investment in GDP. From a very low level of 14% a significant increase is expected to a level of 25% as in comparable transition economies. The increase in investment share should mainly be achieved through increasing domestic savings from the current minimal level of 2% of GDP to 17% of GDP.

Improved utilisation of capacities together with a relatively low capital coefficient during the first years of the medium-term period should provide the projected growth rate and the increase in employment opportunities with lower investment rates.

In the 1990s production in Serbia was more than halved, which brought about a proportional fall in the use of capacity. Naturally, some of the capacity meanwhile became obsolete, but the infrastructure remained. Therefore only moderate investment is necessary to boost economic activity.

The aim of introducing tax incentives is to create a highly favourable tax system, encouraging investment, accelerating the development of underdeveloped regions and facilitating employment opportunities. Corporate profit tax is the lowest in the region at 14 percent. Incentives include ten-year tax holidays for investments in fixed assets over 100 million EUR and creating more than 100 work places. Investment in regions of special interest to Serbia is encouraged through a five-year tax holiday. There will be special tax benefits for investments of over 100 000EUR and the permanent employment of at least five workers. Moreover, VAT will replace sales tax in 2004.

Domestic savings and the banking sector

The increase in domestic savings mentioned above will contribute to the development of a healthy banking sector. The first step in the restructuring of the banking sector was a necessary but difficult pruning of insolvent domestic banks. This resulted in the closure of 23 banks out of 98, including the largest four. During the same period a certain number of foreign banks have established themselves and foreign interest is still high. The next step is for the state to privatise nine banks in which it is a majority shareholder, as well as to sell minor holdings in seven other banks. The plan is that most of these banks should be sold to strategic foreign investors, leaving at least two strong domestic banks. This should all contribute to the creation of a healthy and competitive banking system.

Along with the privatisation of banks, it is envisaged that the supervision of the banking system will be strengthened through the adoption of the supervision development plan as well as through the establishment of a supervisory council. As for legal regulations, a law has been adopted requiring the use of international accounting and auditing standards. It is intended to provide necessary preconditions for a reliable banking system which would attract domestic savings and secure their rational use.

The development of the existing institutions (insurance and similar) and the establishment of new ones (voluntary pension funds etc) will open up new opportunities for collecting and augmenting domestic savings. This, together with the banking system, should mobilise the existing and future savings of the population, the sector which is traditionally a net saver.

Total saving deposits within the Serbian banking sector have increased several times from a very low level in 2001 to over 1 000 million USD at the beginning of 2003. For the most part domestic savings will be invested in small and medium-sized enterprises which should be, together with foreign direct investment, the main generators of growth.

Public investments

Even though only a small part of overall investments, public investments are important for medium-term growth. In addition to their direct impact on growth, they also have an indirect effect through the creation of a favourable environment for investment and growth. The share of capital expenditure within the budget of Serbia is low. Therefore, above average growth is planned for in the medium term. There should be a relative increase from 2% to 4% of GDP to reach a level meeting international standards.

It is estimated that around one third of the overall investment[39] in Serbia in the period 2004-2006 will be directed into infrastructure (transport, energy, telecommunications, the postal service, utility infrastructure). These investments will be financed from:

- Resources of the enterprises in the above mentioned sectors (their own resources and commercial loans),
- Budgetary resources (republican and local budgets), and
- Expected donations and soft loans.

So far more than 1 billion EUR in concessionary loans have been directed into infrastructure: 449 million EUR to transport including 220 million EUR to the road, 127 million EUR to the railway and 127 million EUR to the aviation sectors; 346 million EUR to the energy sector and; 217 million EUR to local level infrastructure (water, central heating and local transport). In addition, around 95 million EUR in concessionary loans have been agreed for investments in the health and education sectors

Investments will support the creation of a revitalised and reliable power sector which aims to become an important electricity exporter in a region with an overall deficit of energy. Currently a new energy law is being drafted which will provide for harmonisation with the EU and fast liberalisation. The creation of joint venture and concession enterprises is encouraged. Potential areas are the development of pipelines, gas storage facilities, and the modernisation of thermal and hydro electro power plants.

As regulatory and market reforms gather speed with the aim of building a modern telecommunications system that will meet the growing needs of a customer-based market economy, the level of investment is expected to increase. By 2005 it is expected that a fully digital network will be established.

[39] The share of infrastructure in GDP is relatively high due to its deteriorated state and the fact that these are actually capital intensive sectors.

It is estimated that the entire necessary resources for investing in telecommunications and the postal service will be provided from commercial sources (domestic and borrowed). Modernization and construction in other infrastructure activities will to a great extent depend on budgetary resources, donor funding and soft loans.

Investments by the state, domestic enterprises, and foreign investors in infrastructure will have direct and indirect impacts on the level of economic activity, employment and poverty reduction. Direct impacts will include GDP growth and higher employment. Multiple effects of infrastructure investment on economic activity result from the fact that in the building of infrastructure mainly domestic raw materials are used. Also, investments in housing and certain infrastructure investments are labour-intensive, which stimulates employment, particularly of the semi-skilled (poorer) labour force. An additional significant contribution to poverty reduction is increased accessibility and quality of services in infrastructure activities.

Construction of infrastructure contributes to reductions in costs and increased efficiency of economic activities in a particular location. Modern infrastructure stimulates commercial investments into the industry and service sectors. Implementation of these investments leads to the improvement of the overall level of development of certain areas which, in turn immediately alleviates poverty. In this context it can be said that investments in infrastructure represent one of the generators of economic activity and employment and therefore of poverty reduction as well.

All these investments will not only contribute to employment during the transitional period but also to laying the foundation for the future.

Foreign direct investments

It is clear that there are still significant obstacles to the entry of new enterprises. These obstacles concern high political and regulatory risks. While significant improvements have been made, substantial legislative and institutional reform is still required. The most important part of this reform is linked to the reform of the legislative and justice system, since uncertainty in this area, including slow enforcement of court decisions, is one of the most important sources of risk for investors.

Serbia has enacted specific legislation outlining guarantees and safeguards for foreign investors. The former Federal Law on Foreign Investment (January 2002) has been formally incorporated into Serbian law (2003) and establishes the legal framework for investment in the Republic. The law eliminates previous investment restrictions; extends national treatment to foreign investors; allows for the transfer/repatriation of profits and dividends; provides guarantees against expropriation; and allows for customs duty waivers for equipment imported as capital-in-kind. In late 2002, the Government of Serbia promulgated new tax incentives for foreign investors.

Since foreign capital is vital to the restructuring of the real sector it is of vital importance to remove barriers and stimulate investor interest. Thus, reform efforts have not been limited to the promulgation of the two foreign investment laws. Rather, the government has understood the need to make reforms to a wide body of laws that will improve the overall business regulatory environment and enable private sector companies to grow and to compete.

Sustainable mid-term macroeconomic stability is another factor that should attract foreign direct investment. It has already been stated that inflation has been brought down to a very low level together with extensive liberalization of prices, that the Dinar was made convertible, foreign trade liberalized, and so on.

Although total FDI levels are still negligible compared to elsewhere in the region, Serbia could easily overtake other countries in Southeast Europe.

Total level of Level of FDI (million USD)

2000	2001	2002	2003	2004	2005
60	160	550	1.000	1.300	1.600

FDI numbers for 2003, 2004 and 2005 are rough projections

A stimulating investment environment is based on implementation of the so called «12 commandments»: a stable and predictable macroeconomic policy; an effective and honest (incorrupt) government; a large and growing market; freedom of activities in the market; minimum government control; reliable infrastructure; availability of high-quality factors of production; a strong currency; possibility to pay up profits, dividends and interest rates; a stimulating taxation climate; freedom to do business between the markets

Privatisation and investments

The direct effect of privatisation is an initial drop in employment in newly privatised enterprises. However, privatisation also creates preconditions for new, sound private investments. Such investments will lead to the creation of new jobs, though this will take some time. Over time it is to be expected that privatised enterprises will create significant new employment opportunities.

The Law on Privatisation, adopted in 2001, met with general approval as the best law on privatisation in all the former socialist states and has already won a considerable amount of trust concerning the privatisation process.

The sale of large socially owned enterprises is expected to be completed by the end of 2006. The privatisation of large public companies is expected to begin in 2005 depending on the completion of reconstruction, the adoption of relevant regulations and the establishment of regulatory institutions. The work on the draft legislation and setting up the institutions is under way.

Privatisation of small and medium-sized socially-owned enterprises through auction is a precondition for accelerated growth within the SME sector. It is expected that around 800 enterprises will be privatised in this way in 2003 and that in 2004 privatisation of almost all small and medium-sized enterprises will be completed.

During the coming period the state will sell its minority shares in companies that started the process of privatisation under the old regulations and thereby complete the privatisation of these enterprises.

The Ministry of Economy and Privatisation together with the Agency for Privatisation mostly carry out the comprehensive government plan concerning privatisation as well as working on strengthening capacities for this complex task.

Greenfield investments

The experience with transition in Eastern Europe has shown that foreign direct "green field" investments and new direct private investments by domestic investors are the basic vehicle for accelerated economic growth and the creation of new employment.

New enterprises are not under the pressure of the past. They do not have inherited debts, and are organised to maximise profits and economic efficiency. Without these new investments, even the privatisation of existing enterprises cannot provide the projected economic growth and creation of new jobs.

The largest Greenfield investment so far is Ball Packaging which has made a commitment to invest 75 million EUR . Merkator, with an investment of 38 million EUR and plans for further investments in other cities than Belgrade are the largest investor in the retail sector. So far, it has created more than 400 new jobs. Tetra Pack with the investment of 30 million EUR is among the most successful Greenfield investments. The workforce efficiency in this enterprise is high in a European context and they export to Bosnia and Herzegovina, Macedonia, Greece and Germany.

So far the number of newly created enterprises has been smaller than expected. The Ministry of International Economic Relations endeavours to provide the necessary conditions for improvement in the area through an accelerated effort for the development of the investment environment as well as the development of the strategy for the promotion of investment which will be better targeted, based on active measures and simultaneously continuing the effort to enhance the competitiveness of Serbian economy. This will be done in close cooperation with the Ministry of Economy and Privatisation which undertook the task of drawing up the Industrial Strategy for the Republic of Serbia, which, as its essential component, should result in action plans for industrial growth in various sectors, including:

- The development of smaller industrial units.
- The sustainability of medium and large industrial units.
- Promotion of certain industrial sectors.
- The recovery of industrial enterprises with poor business performance.
- The development of entrepreneurship.
- Protecting the environment (promotion of environmentally friendly production).
- Equal employment opportunities.
- Promotion of exports.

The SME sector as a mechanism for creating new employment opportunities

SME Strategy

At the beginning of 2003, the Government of the Republic of Serbia adopted the document entitled "The Strategy of Development of Small and Medium-Sized Enterprises and Entrepreneurship in the Republic of Serbia for 2003 – 2008". The primary objective of this strategy is to create a framework for the creation of a sustainable, internationally competitive and export-oriented sector of small and medium-sized enterprises and entrepreneurship (hereafter referred to as SME sector) in the forthcoming five-year period.

In this respect, the Government of the Republic of Serbia defined the development of SME sector till the end of 2007 as its main strategic goal with an increase in the overall number of SMEs from around 270,000 (in 2002) to around 400,000. This involves:

- Giving precedence to the sectors capable of significantly increasing employment and stimulating economic development: processing of agricultural products, industrial production, tourism, and electronic business (e-business).
- Strengthening the organized system of support to the SME sector by way of development of the capacities of the institutions of this system at all levels.
- Elimination of legal obstacles for the operation of enterprises and private entrepreneurs by creating a new legal environment that will facilitate and not hamper the development of the SME sector.
- Implementation of the reforms of public services in order to ensure more efficient provision of services and significantly reduce the administrative and bureaucratic obstacles encountered by the SME sector.
- Increasing the competitiveness of the SME sector through programmes for the development of enterprise management and the adoption of systems of quality and innovation.
- Strengthening links between the education system and the scientific and research system and the SME sector.
- Stimulating the sale of products and services of the SME sector in the local market through better links between large enterprises and SME activities, such as subcontracting, by creating conditions for greater participation of the SMEs in public procurement and greater sale of consumer goods from the SME sector.
- Channelling of the grey economy into legal flows.
- Promotion of activities related to assistance in the development of the SME sector by a continuous media campaign.

SME Financing

The lack of financial resources is one of the most serious problems of small and medium-sized enterprises and entrepreneurs in the Republic of Serbia. Establishing an SME Guarantee Fund, with the aim of providing security to creditors for a part of the loans granted to SMEs which have growth potential but are not bankable will mitigate some of this problem. Therefore, it is important to capitalise this Fund as soon as possible, including with funds provided as international assistance.

The private sector remains a dominant source of financial resources for the development of the SME sector. Therefore as mentioned earlier it is critical that the banking reform is completed as soon as possible.

The creation of a legal framework for the establishment and operation of microfinance institutions would secure greater accessibility of financial resources for poorer citizens and entrepreneurs, by way of microcrediting which allows for more favourable conditions and simpler procedures than bank credits, though the conditions are still strict. In most neighbouring countries, as well as in Montenegro, donors' willingness to provide resources for microfinancing, through NGOs and other institutions besides banks, has led to the creation of legal conditions for these activities. Microfinancing has also been supported through the "Strategy of Development of Small and Medium Enterprises and Entrepreneurship in the Republic of Serbia for 2003-2008".

During 2003, access to capital for micro-enterprises and self-employment has significantly improved in certain regions in Serbia. There are now three big financial institutions offering micro loans: ProCredit Bank, Opportunity International and Nacionalna Stedionica.

Implementation of SME strategy

In addition to the Ministry of Privatisation and Economy, the Republican Agency for Development of Small and Medium-Sized Enterprises and Entrepreneurship has national responsibility for the implementation of the strategy.

The regional SME agencies and centres will be providers and catalysts of concrete support to owners and managers of small and medium-sized enterprises and to entrepreneurs. It is therefore a priority to extend and strengthen this network as well as the quality and the variety of services provided. By the end of 2002, ten regional agencies and centres were opened in: Belgrade, Kragujevac, Kruševac, Niš, Novi Pazar, Novi Sad, Subotica, Užice, Zaječar, and Zrenjanin.

At the regional and local level, local authorities will have an important role in the stimulation of SME development, assisted by a network of regional agencies, centres, and offices for the development of SMEs providing information and advisory services and training programmes (either directly or indirectly through qualified business consultants) for the SME sector.

Legalisation of the grey economy and employment

The share of the grey economy in Serbia is still very large. The government objective is gradually to integrate the grey economy into the formal sector. This will not be possible unless conditions are created which will discourage the public, enterprises and workers from operating in the informal market. An optimal strategy for the inclusion of the grey economy combines both incentives and penalties.

Wages in the grey economy are considerably higher than in the formal labour market, to some extent owing to tax evasion. The focus should be on the elimination of barriers to business, which have a destimulating effect and which contribute to the spread of the grey economy. Deregulation of economic activities and more transparent institutions will also have a positive effect on the level of corruption. Therefore the fight against the grey economy in many ways starts with the creation of conditions for a more dynamic development of the overall private sector. The introduction of VAT, the lowering of taxes and contributions together with the widening of the tax base and the improvement of public revenue collection and control (and stricter penalties) will reduce the attractiveness of the grey economy and raise operational expenses within this sector.

The development of small and medium-sized enterprises and entrepreneurship, as well as the increase in the economic efficiency of the enterprises, will bring about an increase in wages and the creation of new workplaces in the formal economy. This will also reduce the attractiveness of the grey economy.

In other words, the dynamics of reducing the grey economy will be closely linked to the dynamics of the completion of the transition policies.

Agriculture as a source of new employment opportunities

Agriculture is of the utmost importance for Serbia since it makes up a quarter of GDP (25.1 per cent in 2001). The sustainable growth of the private agricultural sector will play an essential role in the alleviation of rural poverty. The vision of the future status of agriculture is clearly set out in the Law on Agriculture which provides guidelines for the adoption of programmes and policies, sets benchmarks for monitoring progress, and makes it possible for all within the agricultural sector to make long-term plans with a higher level of security. It also provides a framework for the policy of agricultural support.

Some of the relevant objectives are:

Improving the profitability of the agricultural and food processing industry will be achieved through applied research and the application of results; through improving the skills of present and future farmers; providing technical and business advice; promoting the exchange of market information.

Health and environmental protection and achieving the status of a country which provides healthy food for the needs of the Republic of Serbia in international trade will be achieved through the control of contagious animal diseases as well as diseases transmitted through food consumption; the control of agricultural pests and diseases; and reducing the side effects of pesticide use, veterinary medications and food additives. Full harmonisation with the EU is set as a long-term goal.

Improving effectiveness and investment in production and processing will be achieved through the completion of the privatisation of agricultural complexes and processing plants.

Encouraging optimal and effective use of production resources yielding best economic effects through the development of market-oriented agriculture and the membership of Serbia in the WTO and the European Union. This demands customs reform as well as various forms of support for agriculture.

Promoting the optimal use of land through the rent and sale system, encouraging the establishment of profitable farms. **The rational use of water resources** will be ensured through the creation of appropriate agencies and mechanisms ensuring effective management of main river systems, flood protection, maintenance of primary and secondary irrigation systems together with the allocation of rights for the use, management and distribution of water to agricultural producers.

Creating competitive and effective markets for agricultural basic materials and produce, setting prices in line with quality, establishing producers' marketing organisations, independent product quality assessments, and monitoring monopolistic behaviour in the farm produce markets.

Protection of arable land, habitats, wildlife reserves and support for the production and sale of organic food. Protection will be an integral part of agricultural and rural policies. The support for the production of organic food will be capitalised owing to the low level of use of artificial fertilizers in the preceding period. It will also include adequate standards and certification systems.

Creating conditions for credit support for agricultural producers. Assistance through reformed agricultural counselling services will be provided through help in drawing up business plans as well as creating conditions for the development of organisations and of microfinancing.

The attainment of these objectives will stimulate employment and economic growth, thus improving social well-being in rural areas (with special emphasise on border and mountainous regions which suffer from emigration).

Local development strategies as a mechanism for creating new employment opportunities

The regional differences in the type and structure of unemployment and in competitive advantages suggest the need to find different approaches and policies. Therefore, the overall changes in the economic system aimed at stimulating growth and new jobs should be supplemented by incentives at the local level.

Through local initiatives and measures municipalities can support the development of a conducive environment for the establishment and growth of economic activities, thus increasing the attractiveness of a municipality or a region for domestic and foreign investors.

Hence the Government of Serbia encourages individual municipalities or groups of municipalities to draw up a strategic plan for social, economic, and land development to facilitate business decision-making by potential investors. As of now, the majority of local governments have not developed strategies for the stimulation of employment. It is therefore necessary to draw up development plans on both a municipal and/or an inter-municipal basis that would build upon concepts and policies presented in national strategies and adapt these to local conditions. These planning tools should highlight concrete activities, needs and development goals. Such plans should take into consideration:

- direct investment into infrastructure with the aim of making the region more attractive for potential investors;
- self-promotion (activities whose purpose is not only to inform but also to attract interested investors);

- direct support of economic activities (renting land and facilities along with certain concessions to local and foreign institutions, banks, or insurance companies, setting up of industrial zones, incubator business centres, concessions, exemption from city and municipal taxes, etc.);

- incentives for the development of small and medium-sized enterprises and entrepreneurship.

Without these local level actions plans, the national PRSP employment strategy will most likely fail when it comes to the creation of new employment opportunities. Initiatives for concrete employment programmes should come from the regional and local level. Decentralization supports the identification of innovative and effective policies for a problem where there are no global recipes.

Local governments should also increase their co-operation with the aim of highlighting and building support for reforms and significant projects.

1.2. The Development of a More Effective Labour Market

1.2.1. Current status and problems

Formal Labour Market and Unemployment

The labour market is the main channel through which economic growth influences poverty, because income from work represents the main determinant of living standards.

The formal labour market in Serbia is has the following characteristics: a relatively low level of employment of the population; a high unemployment rate and its trend of continued growth; high hidden unemployment; a low share of employment in the private sector; low wages; and low mobility of the labour force.

Table 1 shows the participation rates and unemployment rates that are defined in two ways: according to the standards of the International Labour Organization (ILO) and according to self declaration of the respondents. The participation rate calculated as the proportion of the active in the total working-age population (men from 15-59 and women from 15-54 years old), according to the definition of ILO, amounts to 62.2% while, according to self declaration, it is somewhat higher and amounts to 65.2%. However, what is particularly important to emphasise is that the unemployment rate, as defined by the ILO, is considerably lower than the unemployment rate according to the statements.

Table 1. - Participation and Unemployment Rates in Serbia in 2002

	ILO	Self-declared
Participation rate	62.2%	65.2%
Unemployment rate	8.4%	23.3%

Note: ILO – International Labour Organization; the unemployment rate was calculated for men from 15 to 59 years of age and for women from 15 to 54 years of age.

Source: Survey on the Living Standard of the Population (SLSP) 2002

Where is the difference? The difference is in that that the ILO definition, which provides for international comparability, starts from the assumption that unemployed persons are those who did not work in the reference period, that they actively searched for a job, and were readily available to start working if someone offered them a job. There were 256 thousand such persons, while those who declared themselves as unemployed, a part of whom worked, were 745 thousand[40]. This means that only a third of the declared number of the unemployed represents the actually unemployed persons. Hence the unemployment rate, according to the ILO definition, which provides for the international comparability and more realistically mirrors the actual state in the labour market, amounted to 8.4%. It is important to mention that this unemployment rate is somewhat lower than the unemployment rate (defined in the same way) calculated using the data from the Survey on the Labour Force (SLF) dated 2002, which amounted to some 11.9%. Also, according to the official data of the Republic Labour Market Bureau, there are more than 900,000 unemployed on the record, so the unemployment rate exceeds 27%.

The long-term trend of a moderate decline in overall employment and the growth of the unemployment rate from the previous decade also continued in the period 2000-2002. Despite the growth of GDP in real terms, overall employment dropped by 1.6% in 2002 compared to 2000. The decline in the overall employment rate in this period was predominantly due to reduced employment in the social and state sector, since the employment rate has grown in the private sector. Employment in the private sector grew in this period by 21.4%, and its share in overall employment grew from 23.8% in 2000 to 29.4% in 2002. In the same period the earnings of employees have grown in real terms by over 50%.

With regard to the trends and the structure of employment, it is important to point to the relative significance of the non-standard forms of employment, such as temporary employment, and occasional or seasonal employment. The data from SLSP indicate that these forms of employment are not negligible as in the previous period, because they represented 28.9% of overall employment[41]. These forms of employment provide for a higher flexibility in employment and more efficient satisfaction of the demand for work.

Hidden unemployment in government- and socially-owned enterprises, according to some former estimates, amounted to about one third of the employed. High protection of the employed caused inefficient utilisation of human resources, while the employed were protected from competition within their respective enterprises, as well as from competition between the employed and the unemployed. The high costs of dealing with the problem of redundancies of previous policies were borne by the enterprises, which were most often in a very poor financial situation, and therefore they postponed the process of dealing with the issue. Such conditions encouraged the spread of the grey economy among those employees who had full health and social insurance in the formal sector. In the process of structural adjustment, by dismissing those who are redundant, efficiency will be stimulated which will yield growth in the earnings of the actually employed workers, while the hidden unemployed will become really unemployed.

40 This datum on 745 thousand unemployed persons which was estimated on the basis of the Survey is very close to the number of the registered unemployed persons, and there were some 800 thousand of them in May 2002.

41 According to the data from SLSP for 2002, temporary employment and short time employment had a marginal significance in view of the fact that their share in overall employment is only 5%, and 1%, respectively.

A large number of the unemployed, the those made redundant, as well as a large number of refugees and internally displaced persons, exerted strong pressure on the formal labour market, thus creating a big labour supply as opposed to the low demand for labour[42]. The big discrepancy between the labour supply expressed by the number of unemployed and the demand for labour expressed by the number of vacancies can be understood through the analysis of quantitative and qualitative factors. The quantitative factors can be analysed through the ratio between the unemployed and the vacancies. The number of actually unemployed in 2002 was on average more than seven times as high as the number of vacancies or the demand for labour. The qualitative factor of the discrepancy is reflected in the fact that, despite this large discrepancy between supply and demand, 16.8% of vacancies remained vacant in 2002. The disproportion between the supply and demand for labour is explained by inadequate qualifications among the unemployed, which does not fully correspond to the qualifications required. This unfavourable process of harmonization of the supply and demand was additionally aggravated by the low geographic mobility of the labour force, which is predominantly the result of unfavourable regional development of the economy and an undeveloped property market.

In line with the decline of the overall employment rate in Serbia, there has been a continuous growth of unemployment in the period 2000-2002. The total number of registered unemployed persons in 2002 was 843 thousand, which is 16.8% higher than in 2000. However, based on the data from SLSP, only one third of the declared number of unemployed represents the actually unemployed persons, in view of the fact that a major number of the registered unemployed persons are registered with the Labour Market Bureau because of their entitlement to health insurance (and pecuniary compensation), but they actually work in the informal labour market. For this reason, we shall proceed with the analysis of the characteristics of the actually unemployed persons based on the data from SLSP, and not of those unemployed who declared themselves as such, while they actively participated in the labour market.

The structure of unemployment is very unfavourable. Its most significant characteristics in Serbia in 2002 are:

Long-term character of unemployment, because over one third of the unemployed have been looking for a job for more than a year. Such a long-term character of the unemployment in Serbia represents a major economic and social problem which may have deep implications both with regard to the obsoleteness of knowledge, and to the rate of use of the available human resources, and in particular to the social repercussions of unemployment.

Dominant share of the youngest age group (15-25 years of age) in overall unemployment (40.7%). This age group had an unemployment rate three times as high as the average unemployment rate (25.9% as opposed to 8.4%). This particularly high unemployment rate indicates that young people in Serbia are in a considerably more difficult situation compared to the countries in transition, but it also implies the waste of

[42] According to UNHCR data, the overall number of the persons displaced from Kosovo and Metohija amounts to around 220,000, whereby about half of them represent a potential growth of the supply of the labour force in the labour market in Serbia.

human resources of those age groups which should give the greatest contribution to the economic and social development of the society.

It is important to bring to attention another group of the unemployed who are especially at risk – young people. Stimulating economic growth and reducing poverty will also have a side effect of preventing the erosion of the existing labour resources as well as preventing young people from leaving the country. An estimated 300 000 have left the country in the last decade. The aggravating circumstance is the fact that a significant proportion of them are highly educated.

A relatively high share of the group having low educational qualifications (below secondary school qualifications) in overall unemployment. Those unemployed with qualifications below the secondary school level represented 19.2% of the overall number of the unemployed in 2002. Dominant among them are unskilled and semi-skilled workers whose employment will be aggravated in the process of restructuring of the economy and labour force since modern industries require skilled labour. Additionally, the share of the unemployed who had previously been employed amounted to 44% in 2002, and it has been increased due to redundancies.

Compared to the countries in transition, the highest educational qualifications in Serbia, judged by their earnings, are relatively highly valued[43] and considerably higher compared to the countries in transition.[44] The wages of the formally employed with university qualifications compared to the wages of the employed with secondary school qualifications were higher, *ceteris paribus*, by 56.2% in 2002.[45]

On the basis of these results the conclusion may be drawn that investment in human resources, i.e. in education, is one of the ways of escaping poverty, in view of the fact that the labour market rewards higher levels of education.

Unemployment by Gender

The rate of unemployment among women was higher than the rate of unemployment among men (9.6% as opposed to 7.5%). Women in Serbia were harder to employ than men, although the educational status of unemployed women was better than of men (8.3% of the unemployed men and 14.8% of the unemployed women have above the secondary education).

Women in employment in 2002 earned less than employed men, *ceteris paribus*, by 24.5%. One part of this difference can be explained by the higher number of hours worked by men compared to women. The results indicate that the estimated differences

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[43] The relative ratios between the wages of employees subject to their characteristics will be given on the basis of data from SLSP from 2002 based on Mincer's equation. Monthly earnings of employees in their main job expressed in Dinars are represented as a function of the following variables: gender, age, educational qualifications, location (urban/rural), region, activity, sector of property of the company in which they work and working hours.

[44] See Newell. A. and Reilly B. (1999), Returns to Educational Qualifications in Transitional Economies, Education Economics, Vol.14.

[45] In 2002, on the basis of data from SLSP, this difference in wages of the employees with the highest professional qualifications compared to the wages of the employees with secondary qualifications, provided that the other conditions are unchanged, was somewhat lower and amounted to 51.4%.

in the earnings of men and women are among the lowest compared to the other countries in transition.

Krstic explored wage determination and the evolution of the gender pay gap in Yugoslavia over the period 1995-2000 using the Labour Force Surveys[46]*. Men had an average pay advantage over women of 9.3% in hourly measures in 1995 and 9.9% in 2002. However, the gender pay gap adjusted for productivity characteristics between men and women (i.e. education, labour force experience, skill level, etc.), appeared slightly larger relative to the unadjusted measure suggesting that characteristics of employed women are probably slightly better than men's. The ceteris paribus hourly gender pay gap amounted to 11.5% and 16.9% in 1995 and 2002 respectively indicating a significant rise of the ceteris paribus gender pay gap by about one-half. Thus, the slow process of transition to a market economy was not neutral to the wages between males and females. Although the adjusted gender pay differential increased considerably over the observed period, this pay gap is still one of the lowest among transitional countries.*

Wages: State/Socially Owned Sector Versus the Private Sector

The wages of employees in the private registered sector compared to the social and state sector were higher, *ceteris paribus*, by 29.2% in 2002. This ratio between the wages of the employees in privately owned companies compared to the social and state sector is relatively high compared to the standards of other countries in transition[47] and can be significant for the attraction and keeping of a high-quality labour force in the private sector.

What are the effects of employment in the private sector on poverty? With a higher share of employed persons in a household, who work in a private registered company, it is noticed that their consumption rises compared to employees in the enterprises that are socially or state owned on average by 18%, and the poverty index is reduced. This effect rises if we go from the poorest to the richest section of the population. On the basis of these results, we may conclude that employment in the private sector is one of the ways to increase income and consumption of a household and take it out of poverty.

The Grey Economy and the Grey Labour Market

Causes of the grey economy

In the ten years of deep economic crisis in Serbia, the grey economy was the main means of survival for a considerable part of the population, a phenomenon which was therefore tolerated by the state and became a deeply rooted pattern of behaviour.

The establishment of macroeconomic stability in Serbia between 2001 and 2003, together with concrete economic policy measures concerning the unification of the currency market, setting up a new banking system, tax reforms, especially reducing the burden on earnings, and deregulation of working relations reduced the impact of the generators of the grey economy in Serbia. However, widely spread corruption and

[46] Krstic (2002), PhD. Dissertation, An Empirical Analysis of the Formal and Informal Labour Markets in FR Yugoslavia (1995-2000), University of Sussex, Brighton, the World Bank (2003), the Gender Pay Gap in the Transitional Countries, Mimeo, 2003.

[47] See Adamichik and Bedi, 2000, Wage differentials between the public and private sectors: evidence from an economy in transition, Labour Economics, 7, 203-224

criminality, that is, ineffective operation of the legal system, still stimulate the grey economy.

In Serbia, the grey economy is still one of the main means of survival of the poorest section of the population[48], but is also a way to increase profits by avoiding government taxes by those sections of the population who are not at financial risk.

Scope and characteristics of the grey economy

On the basis of data from SLSP, it has been estimated that about a million people in Serbia in 2002 were involved in the grey economy, which represents a little less than one third (30.6%) of those who actively participated in the labour market[49]. Apart from this, 10.8% of the persons that had a main job (either in the regular economy or in the grey economy) had an additional job in the grey economy. These figures certainly indicate that the grey economy in Serbia is still considerable. Examined by type of settlement, the grey economy was considerably less widespread in the cities (38%) than in other areas (62%), and examined by activity, it was most widespread in agriculture (49%), trade (13%), handicrafts, and services (10%). The grey economy was more widespread among those with lower educational qualifications as opposed to the formal sector, in view of the fact that 48% of people in the grey economy had the lowest educational qualifications, while in the formal sector this percentage is less than half that (22%).

The attractiveness of the hidden labour market lies in the fact that average earnings per hour were 28% higher than in the formal labour market, amounting to 83 Dinars or 1.3 USD. Higher earnings per hour in the informal than in the formal labour market, among other things, emanate from tax evasion. Another important characteristic of the grey economy is that it more adequately rewards educational attainment, in view of the fact that average earnings per hour of those with the highest educational qualifications were more than twice (2.7) as high as the earnings of those with secondary school qualifications, and more than twice as high as the wages of employees with university qualifications in the formal sector[50].

Influence of the grey economy on poverty

The incidence of poverty was higher among those working in the grey economy than among those employed in the formal economy. The poverty risk of those employed in the grey economy (Table 2) was more than a third higher than the average poverty risk of the employed population, and the depth and severity of poverty is greater than among those employed in the formal economy. Such a large share of the grey economy among the poor employed clearly indicates that the grey economy is still the main means of survival of a major portion of the poor population.

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[48] Avoiding payment of taxes to the state is not a primary motive, but a consequence of engagement in the grey economy by this poorest portion of the population.

[49] All categories of active population have been covered (except the unemployed).

[50] The earnings of those employed with university qualifications in the formal sector were higher by around 50% than the wages of those with secondary school qualifications.

Table 2. - Grey economy and poverty in Serbia in 2002 (in %)

	% Vulnerable	% of the poor	Relative poverty risk	Structure of those employed	Structure of the poor employed	Poverty depth	Poverty severity
Employed in:							
Regular economy	14.7	7.3	-16.4	69.4	58.0	1.4	0.4
Grey economy	22.7	12.0	37.1	30.6	42.0	2.5	0.8
Total	17.2	8.7	-	100	100	1.7	0.6

Note: Employed individuals are defined as persons who, in the reference week, did any job for money or any benefit in kind. The data refer to employees over 15 years of age. The relative poverty risk is calculated as a percentage growth (drop) of the poverty index of the reference group compared to the average poverty index of the employed.

Source: SLSP 2002.

The main characteristic of the labour market in Serbia is its segmentation into the formal labour market and the informal, i.e. 'grey' labour market. A relative inertia in the formal labour market, the recent rigid legislation in labour relations, and low wages and relatively high taxes and contributions on wages in the previous period were the main stimulants for the functioning and spread of the informal labour market. A high degree of discrepancy between the supply and demand for labour, a high hidden unemployment rate and the considerable size of the informal labour market, indicate that the formal labour market does not function adequately, i.e., that it does not allocate human resources optimally. Among poor employees, those involved in the grey economy represented 42% in 2002. Such a high share of the grey economy among poor employees clearly indicates that it is still the main means of survival of a major part of the poor population. The interconnections of the formal and informal components of the labour market confuse the real relationships in the market and make it more difficult for the government to pursue an efficient labour market policy. A high degree of segmentation of the labour market into the formal and informal sectors is of particular importance for the forthcoming reforms and future policy in the labour market.

1.1.2. Goals and Strategic Options for Employment Policy and the Labour Market

1.1.2.1. Starting Points

The basis for the reduction of poverty is improved economic effectiveness and economic growth. More rapid and large-scale employment represents an important goal of this strategy because unemployment is one of the main causes of poverty and exclusion in Serbia. Stimulation of employment does not represent an isolated goal of economic policy but a project of society. For its implementation it is important to have a «wide partnership». Employment policy encompasses all the measures that either directly or indirectly influence the scope and the structure of employment and should not be reduced to labour market policy (labour legislation, passive and active measures). It is necessary that measures concentrating on the stimulation of employment be placed in the context of a global economic reform in order to establish the elements of a consistent employment policy, at the same time coordinated with other measures. Any partial approach would be counterproductive and would incur additional costs.

The employment policy is founded on «four strategic pillars»:

- development of entrepreneurship,
- upgrading of the working skills of unemployed labour,
- improvement of the adaptability of enterprises and the mobility of the labour market and the unemployed,
- provision of equal opportunities for employment of both women and men.

Such a policy ought to promote an array of work-related rights (the right to fair and favourable working conditions, protection from all kinds of discrimination, the right to belong to a trade union, safety at work) and improve the position of certain categories of population especially at risk of poverty (women, persons with disabilities, Roma, young people).

The Structure of Existing Unemployment

Unemployment in Serbia is neither frictional nor cyclical, it is rather transitional and structural. The large-scale long-term unemployment indicates that the major problems lie in economic growth. The fact that in 2002, despite a high unemployment rate, 77,888 vacancies remained unfilled indicates that the above-mentioned structural problem exists in the labour market. The cause of these positions remaining vacant is partly because suitable people for them are engaged in the grey labour market.

Prevention of large-scale new unemployment («redundancies»)

Transitional unemployment is a special form of structural unemployment. It is not related to particular regions or branches of the economy, its causes lie in changes in the economic and social system and the process of structural adjustment.

Privatisation, deregulation, and the liberalization of the market, as well as a more consistent implementation of bankruptcy legislation, will increase existing unemployment. Structural adjustments will cause the loss of jobs for a part of the workers (the estimate is from 100 000 to 600 000 people). Those regions where «socialistic giants» were located and where the majority of workers were employed (around 60% of employees in industry are employed in large enterprises) will be particularly affected. It is of the utmost importance that those who lose their jobs in the process should not move into long term unemployment.

1.1.2.2. Institutional Changes in the Labour Market with the Aim of Stimulating an Entrepreneurial Climate

The establishment of a system of institutions that satisfy the requirements of the market economy and free enterprise also implies changes in the labour market. Any rigidity in this area, in the long run, results in unemployment and a decline in productivity. Labour market policy does not create new jobs, but rather assists in the development of an overall institutional climate, which stimulates new employment. The demand for labour also depends on the institutional characteristics of the labour market. This is usually neglected and it is considered that the only important thing is to stimulate economic growth and that the employment problem will thereby be solved. The situation is far more complex and the institutional policies that govern the labour market are of great importance for new employment. Economic growth is a prerequisite but it is not a sufficient precondition for new employment.

Change of the institutional framework in the area of labour market and labour relations should be concentrated on three goals:

- providing greater market flexibility with regard to wages and employment,
- stimulation of demand by entrepreneurs for labour,
- improving labour productivity..

The first step in establishing new regulation of relationships in the labour market was made by the Labour Law.

The Labour Law became effective on December 13, 2001. It has considerably simplified the process of employment. The Law governs only the basic employment criteria (age, working ability, it prohibits discrimination on the grounds of gender, nationality, religious affiliation and the like) and states the basic rights and obligations of the contracting parties, while employers have the freedom to establish all other parameters of the contracts of employment. It also provides for different forms of flexible employment (employment of workers to work shorter hours, temporary employment, employment for work at home, work on contract). The dismissal procedure has also been simplified, and the amount of severance pay has been reduced. The minimum wage is agreed between the Government of the Republic of Serbia, representatives of labour unions and representatives of the association of employers. If a consensus cannot be reached, the minimum wage is determined by the government of the Republic of Serbia. It is determined for the full working hours and an average performance for a period of at least six months. Other wages are subject to collective negotiation. Sick leave criteria and penalties for employers who do not observe the regulations have been tightened.

Despite the existence of formal preconditions for the operation of a more flexible labour market there are no notable changes in practice. The stipulations of the Law are not being applied because transformation of ownership has not yet been completed. The existing management structures in the companies not yet privatised do not provide incentives to change the scope and structure of employment.

An important step towards rounding off the institutional environment in the area of the labour market is represented by the new Law on Employment and Unemployment Insurance. Furthermore, it is planned to proceed to drafting the following: Law on Safety and Health at Work, Law on Trade Union Organisations and Employers' Associations, Law on Amicable Settlement of Collective and Individual Industrial Disputes, Law on Strikes, Law on Employment of Persons with Disabilities. <u>It should be born in mind that these changes do not require additional finances.</u>

1.1.2.3. Labour Market Mechanisms

The key to a more effective labour market lies in the improvement of conditions for the functioning of the mechanisms of work. Measures aimed at improving conditions have two directions: improving the quality of the labour supply and changes in its structure in line with a modern market economy, as well as improved flexibility.

Active measures for the stimulation of employment should be delegated to regional and local levels which will develop their own employment programmes, in keeping, as far as possible, with target groups.

Change from passive to active measures

Unemployment benefits[51] are received by only a small number of persons so that this measure does not fulfil its function as temporary social protection for the unemployed. According to the plan of the Republic Labour Market Bureau for 2003, the share of scheduled expenditures for insurance and servicing of entitlements of the unemployed in overall expenditures amounts to 85% and it should cover 81,000 of the unemployed. Such a distribution of allocated resources limits real possibilities for the use of active support to employment. Passive measures cannot do much to solve the social problems of the unemployed in Serbia, in view of the fact that unemployment is large-scale and long-term. This kind of financial assistance should be directed only to those who are really in the greatest need.

It is necessary to concentrate on active measures that involve the creation of prerequisites and opportunities for the easier employment of those made redundant and unemployed workers in new production programmes. For all active employment measures there are precise legal procedures specified. The Law on Employment specifies that the programme of active employment policy for the Republic is to be adopted by the Government, and that the relevant local self-government authorities can formulate the programmes for territorial autonomy and local selfgovernment. The funds for the financing of these activities are allocated from the budget of the Republic and from the budgets of local communities, as well as from other sources.

Raising the Value of Human Resources

Transition towards a market economy changes the type of skills required. This is why professional training, retraining and additional qualification should run in parallel with privatisation.

Within the labour supply more than a third of the workers do not have professional qualifications, while around 30% have secondary school qualifications. This is a category for which the demand has been drastically reduced. Additionally, among the unemployed those looking for a job for the first time are dominant (69.8%) – the percentage is higher in Central and Southeast Serbia (the region in which poverty is the highest) – as well as those unemployed for extended periods of time who have lost contact with the labour market. Without additional education it is not realistic to expect that these workers can again permanently join the world of labour.

The acceptance of the principle of lifelong education is the only strategy that guarantees flexibility and adjustment of the labour resource to a dynamic environment.

Refugees and internally displaced persons are in a specific position. The are allowed to register as unemployed, but a problem arises because a large number of these people cannot produce relevant evidence of their educational qualifications. This issue cannot be addressed in isolation from other former Yugoslav republics, but through governmental cooperation with the countries that these people fled from.

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[51] In accordance with the Law on Employment and Unemployment Benefits the right to compensation will be granted to an unemployed individual in the following circumstances: termination of the need for performance of work, bankruptcy, liquidation and all other cases when the employer ceases to operate, failure to meet projected objectives as well as confirmed inability to perform work, if the spouse has been relocated and if the individual has been working abroad.

The problem of poor education is particularly prominent among the Roma. The low educational level of this group considerably impairs their opportunities for inclusion into the world of labour, thus creating a vicious circle of poverty. This circle could be brought to a halt only through education and training in the broadest sense of the words. The fact that this population is most numerous in the regions that are particularly affected with poverty adds weight to the problem.

It is important for this process to be brought as close to employers and their needs as possible. All programmes of re-training, i.e. training in a wider sense, that are organised without the concrete participation of employers seldom result in new large-scale employment of the workers involved.

Upgrading of mediation

It is necessary to improve the system of counselling and mediation between employers and the unemployed since counselling and mediation are activities that result in positive benefits.

The Law on Employment and Unemployment Insurance was adopted on10 July 2003. It aims at creating an institutional environment, which is significantly different from the existing one. The position of all the key stakeholders is radically changed. It plans the setting up of the National Employment Service, as well as the possibility of establishing private agencies. The intention is to encourage competition and consequently raise the quality of services. Private agencies will be concentrated, subject to their profit orientation, on employment of those groups of workers that are easy to employ. The importance of the National Employment Service will still be great, and the groups of workers for whom there is a low demand will quite certainly remain in the domain of the activities of the National Employment Service. Within the National Employment Service there will be a business centre, providing different kinds of assistance in self-employment, as well as a job club in which the unemployed will acquire knowledge, abilities, and skills for their job search. The Law also introduces an innovation: the obligation that the National Employment Service and the person who has been unemployed for an extended period of time (a long-term unemployed person is someone who has been on the unemployment register for over two years), as well as the unemployed who are entitled to pecuniary compensation, conclude an agreement on the conditions, procedures, and measures for finding employment.

The intention is to bring those who offer and those who search for employment closer together (using employment fairs, the internet, etc.)

Characteristic measures for the stimulation of employment

In order to maximise their impact, the following measures should be brought in keeping with local circumstances.

Employment of those made redundant: The Ministry of Labour and Employment adopted, in 2002, the Social Programme for those made redundant through which measures for their re-employment are proposed.

- As unemployed, a worker may register with the Labour Market Bureau and be granted the same rights as all other unemployed.

- An employee may receive one-off cash compensation, which is not subject to taxation The compensation amounts to ten average wages or 6,000 Dinars for each year of service.

- The third option is financial compensation accompanied by additional training.

So far about 90% of workers have taken the second option, the purpose of which is to stimulate self-employment. For the implementation of this Programme the Ministry of Labour and Employment has allocated funds for this year amounting to 7.5 billion Dinars (around 125 million USD).

Although the problem of those made redundant is severe, it will not be dramatic for two reasons

- First: a great number of these workers have additional incomes, which are the result of their involvement in the informal economy, additional work in agriculture or some other activity. Some have even become entrepreneurs.

- Second, most companies employing large numbers of workers will not undergo privatisation and restructuring in 2003 and 2004, thus allowing sufficient time for the development of small and medium enterprises.

Retraining: There is no linear relationship between surplus labour and new employment opportunities. Because of this, together with the above-mentioned changes in the skills demanded, the workers who have lost their jobs may not automatically be those who will get a new job.

Privatisation and restructuring will most likely increase the number of least qualified unemployed, lacking the skills required by the new economy. This is why these groups need extensive retraining programmes – in order to be able to switch to those sectors of the economy that are expanding, both as employed and self-employed.

Subsidizing a portion of the labour costs: It is also planned to stimulate new employment by subsidizing employers during 24 months for contributions for pension and disability insurance, health insurance, unemployment insurance, when they employ an unemployed individual who has been waiting for employment for an extended period of time. If an employer employs a person who is over 50 years of age, then this subsidy can be obtained for 36 months. It is not realistic to expect employers to employ a greater number of persons over 50 years of age in a situation when there is a huge number of unemployed who are under 40 years of age (66%). This measure can be applied in situations where targeting is simple, for example, for an especially depressed region or city.

These programmes also involve incentives for the employment of trainees (i.e. young people), as well as persons with disabilities and other groups at risk. In the past year there were 2 000 trainees, of whom half had university qualifications. The trend of employment of trainees has been declining for two reasons: lack of financial resources and the requirement that a person has to be already permanently employed in the phase of intern training. The second reason has significantly reduced the interest of employers.

At the end of 2002 there were 19 302 persons with disabilities on the unemployment register of the Republic of Serbia. The National Employment Service has significantly supported the opening of new job vacancies for persons with disabilities (the Bureau participated in financing 71 investment programmes). The wages of persons with disabilities are subsidized by 80%, and the other at-risk groups by 30%. This covers a small number of the unemployed due to the lack of funds.

The drafting of the Law on Employment of the persons with disabilities is under way, and its passage is expected by the end of 2003. This Law focuses on the creation of a legal framework that would enable persons with disabilities to show their abilities and express their creative potentials, and acquire economic independence through active participation in the world of work. The goal to be attained is inclusion of persons with disabilities in society, rather than their exclusion. This law envisages the introduction of employment quotas for persons with disabilities. It will also provide for their special care, occupational rehabilitation and professional training (the Fund for Professional Training and Employment of persons with disabilities is to be set up), and safety at work.

Self-employment: Self-employment can be stimulated by paying one-off cash unemployment compensation, subsidies, and additional education and training, assistance by business centres. There are also special incentives for self-employment of those made redundant. If ten or more persons who have been made redundant pool together, and set up a business partnership, a cooperative or a similar enterprise, they can obtain non-repayable funds amounting to 150 000 Dinars. The amount of severance payment varies from one enterprise to another, and not even very high severance payments (several dozens of thousands of Euros) have contributed significantly to the establishment of new enterprises, since they have mainly been spent for different forms of consumption. Therefore, self-employment should be stimulated by other measures.

Public works: The goal is to employ those categories of the unemployed who are most difficult to employ, persons in social need, and the unemployed over 50 years of age. Public works should be, according to the Law on Employment, organized for carrying out works of general interest (for example, in the area of social, humanitarian, cultural, and other activities). The funds for this purpose would be provided from the budget of the Republic, from the territorial budgets and from local selfgovernment, as well as from other sources of financing. Such programmes can be applied on a smaller scale for specially targeted groups (with clearly emphasised social goals) with the necessary addition of different forms of education.

1.1.2.4. The Labour Market – stakeholders and their roles

Successful labour market reforms demand a wide partnership since the result of the above-mentioned measures will mostly depend on the overall economic environment along with the activities of all relevant participants.

Who are the main stakeholders in the process and what is expected from them?

The Government and relevant ministries should enable the establishment of an institutional framework that by its characteristics corresponds to the contemporary market economy and stimulates investments. The first step is to adopt key laws (among other things, to complete the initiated amendments in the labour legislation). The second part of the Government's jurisdiction is global economic policy which should encourage investment and economic growth. The third step consists of the above measures to actively stimulate employment. In the processes of institutional changes in the labour market the key role belongs to the Ministry of Labour and Employment. This Ministry will also implement the National Employment Strategy, as well as the Employment Action Plan. Apart from changes in legislation, this Ministry should also strengthen labour inspection.

The Ministry of Labour and Employment anticipates the adoption of the following laws: the Law on Safety and Health at Work, the Law on Trade Union Organisations and Employers' Associations, the Law on Amicable Settlement of Collective and Individual Industrial Disputes, the Law on Strikes, the Law on Employment of Persons With Disabilities.

The Ministry of Science, Technology and Development, the Ministry of Education and Sport, as well as all other stakeholders in the educational network, should actively participate in the process of the education of the unemployed for the purpose of achieving stronger and more functional ties between the requirements of the labour market and the educational system.

This process calls for a social dialogue. The establishment of socio-economic councils at national, regional and local levels will provide the institutional basis for a dialogue. In some municipalities socio-economic councils, planned to coordinate the activities of key local actors, are already being formed. This will also enable inter-sectoral cooperation. Apart from consultative activities and harmonization of measures, these councils will also perform evaluations of outcomes.

Mediation services: In the process of improving mediation, the key role lies with the Republic Labour Market Bureau and private agencies. It is necessary to undertake an organizational restructuring of the Bureau, its modernization and the upgrading of the quality of the work of its employees. Due to local specific problems of unemployment, the local employment services must be given greater freedom and authority to work out their own programmes to suit the situation in the field.

Familiarization with foreign experience and continuous training Bureau employees would professionally strengthen this institution and raise the quality of its operations. The business premises available to the Bureau are insufficient and inadequate. The number of employees should be increased (one counsellor works with some 2,500 unemployed persons), and the existing information system modernized.

Local selfgovernment is responsible for promoting local initiatives, the improvement of the entrepreneurial environment and the provision of public services. This also implies the need to establish strategies for regional and municipal development. Without these, efforts and resources will be dissipated, and the effects will not be concentrated on key aspects and on the most important areas.

It is also necessary to create the relevant local infrastructure for the implementation of these measures, in order to be able to implement the programmes based on local conditions and requirements. For their implementation local self-government institutions should be put in charge, which also must be followed by a certain financial autonomy.

For the undeveloped parts of the country (where the infrastructure as a whole is unsatisfactory) it is necessary to instigate concrete initiatives for the revival of production. This may also include giving special concessions to foreign investors with the aim of attracting them (the above mentioned «soft instruments»). It is necessary to create integrated models of professional adult education that link the labour market, the network of institutions for adult education, local authorities and the local economy. The social partnership that is a prerequisite of these activities on the local level involves the participation of the local labour market, enterprises, professional associations, trade unions, entrepreneurs and their associations, and institutions of informal education.

The unemployed: The unemployed are primarily responsible for their own employment and should assume a more active role concerning training, mediation and other relevant aspects. So far, some of the unemployed have demonstrated an extraordinary lack of action. According to the results of the Survey on the Living Standard of the Population, 45% of the respondents had not even tried to get a job, while 23% are not trying to get a job because they do not want to work (there are no major differences between the genders). The Law on Employment sets forth stricter regulations and the introduction of a measure whereby the unemployed who reject any adequate employment or participation in a programme of active employment measures offered to them are deleted from the records. Such a measure is justified. This is an attempt to make a distinction between the unemployed who are really looking for employment and others who are not. Thus, in a year, the picture of unemployment will be much more realistic.

Employers and trade unions: Employers and their associations should actively participate in these processes in different ways (particularly through cooperation in the process of training, as well as by informing the labour market of their actual needs). It is essential that parties taking part in collective negotiations should reach a consensus concerning new employment. The consensus ought to be reached and maintained both at the regional and at the local level. It is especially important to avoid a situation in which a union and an employer agree on pay rise, shifting the problem of new employment to the state. It is important to create favourable circumstances for new employment through a consensus.

Non-governmental organisations: Non-governmental organisations are an important partner in the processes at all levels and especially at the local level. They are an agent which can provide considerable assistance in the inclusion of unemployed individuals who have not been registered with employment agencies into programmes and activities intended for them. On the other hand, non-governmental organisations will also play an important role in the review of the effects of the implementation of certain measures, especially at the local level.

Limitations and necessary adjustments

There are three key limitations to the successful implementation of the above measures.

The first is related to the overall economic environment. Without a major inflow of foreign investment it will not be possible to increase economic growth to any major extent.

The second limitation is the high unemployment rate. The process of overcoming this limitation cannot be the result of isolated efforts but of a global strategy of economic development. Active measures for stimulating employment are less efficient in the initial periods of transition, because unemployment is not predominantly the consequence of unsatisfactory labour supply and its structure, but of a very low demand for labour. On the other hand, the high unemployment rate makes more difficult the stimulation of employment of particularly vulnerable groups of the unemployed.

The third limitation is the financial constraints. The funds at the disposal of the Republic Labour Market Bureau are limited. The active programmes and measures have not been able to influence the change of the unfavourable situation in the labour market to any significant extent, because of the lack of funds.

The funds allocated for the labour market ranged from 0.4% to 0.6% of GDP. The budget for 2003 amounts to around USD 199 million, whereby the planned share of expenditures for insurance and servicing of the entitlements of the unemployed in the overall expenditures amounts to 85.0% and the share of the expenditures for financing the active employment policy amounts to 8.7%. Certain problems have arisen regarding this disbursement. It has been delayed for five months now, while between 3.5 and 4 billion dinars are needed to cover the outstanding debts (in January 2003 alone, the debt amounted to 786,204,532 dinars).

Not much can be done with the modest funds available and some measures that have already been introduced are at risk of being discontinued). It should also be noted that a part of these expenses is financed from the Transition Fund (for example, a one-off severance pay to redundant workers).

The costs of the existing measures cannot be financed by the funds at the disposal of the Labour Market Bureau, and it is necessary to include funds from government and local budgets (for the local programmes), as well as funds from foreign donors. The major portion of these funds should be allocated to the training of the unemployed and those made redundant (in the past year such programmes covered only 11,300 workers.), the implementation of special programmes for persons with disabilities and those who are hard to employ, employment subsidies, programmes for active job search, stimulation of entrepreneurship, and other employment measures and programmes.

2. More Efficient Social Protection[52]

2.1. Current status and problems

2.1.1. Current status

There are two main programmes of social protection dealing with the alleviation of poverty in Serbia. They are: social assistance ('material support to families' - MOP); and child allowances. Their purpose is to ensure a minimum income to the families in need, and particularly to families with children.

Table 1 Number of beneficiaries of social transfers (in 000)

Year	2000	2001	2002
Social assistance (MOP)	67	115	125
Child allowances	494	665	497

Note: all the data are from December of the relevant year.
Source: the Ministry of Social Affairs

The number of citizens who receive **social assistance** is modest. During the nineties, it was reduced to 67 000 (December 2000), and this variation in the number of beneficiaries of social assistance was not the consequence of a reduction in poverty in Serbia, but of the restrictive policies in the system of social protection and of failure to finance even such modest support. In the past two years, the number of those entitled to social assistance has grown: from 115 000 in December 2001 to 125 000 in December 2002. The growth was partly the consequence of a supplementary programme of social assistance financed from donations (28 000 beneficiaries in December 2002), and partly of the regularity of transfers, which increased the formerly lost interest of the poor. The overall allocation for social assistance amounts to 117 million Dinars per month (December 2002).

The amount of social assistance is modest. In December 2002, an average amount per individual amounted to 1,092 Dinars (EUR 17). Such transfers can only to a limited extent improve the financial status of the poor.

Social assistance is based on the overall income available to an individual and a family and supplementing such income up to the poverty line, provided that additional criteria are fulfilled (small property, involvement in the labour market). The income test for an invidivual for entitlement to beneifits is relatively low (at the same time it is the maximum amount of social assistance) and, in March 2003, it amounted to 2,447 Dinars (EUR 38) in more developed parts of Serbia; in municipalities with low average salaries, the income test is even lower. The difficulties lie in the sensitivity of the methods to the grey economy, which is very widespread in Serbia, and the assumption of very high

[52] Social protection includes assistance to poor individuals or families to reach a minimum income level, care for the members of vulnerable groups (children without parental care, elderly persons who cannot look after themselves, diseased persons, etc.) and support the creation of young families, including encouragement of child-birth.

economies of scale within households, which discriminates against larger families.[53] The weakness of this programme also lies in establishing separate poverty lines in each municipality on the basis of average salaries, which means that the principle of the equality of the citizens of Serbia has been compromised and that the poverty line is relative. The latter weakness will be corrected by amendments to the Law on social protection which are currently in the parliamentary procedure - they set the single absolute poverty line (in Dinars) for the whole territory of Serbia, indexed to the cost of living.

Social assistance targets the poorest citizens relatively well. The analysis has shown that social assistance is the best targeted social transfer in Serbia and that the efficiency of targeting is higher than in some other countries in the region.[54]

Among those entitled to social assistance three categories are dominant: the unemployed, persons with disabilities, and their children. The other categories (employees, pensioners, farmers, etc.) have negligible representation among those entitled to social assistance. More than half of the beneficiaries have not completed elementary school. Examined by family size, single persons dominate (about half the total number), which is the result of excessively assumed economies of scale within households.

Basically, social assistance in Serbia has a small coverage, it is restrictive in terms of regulatory policy, pretty well targeting the poorest people, it favours small families and mainly covers those with poor educational backgrounds, the unemployed, and persons with disabilities.

In the Law or "Krmčija" of Saint Sava dating from the 13th century, great attention was paid to the poor and their protection within various regulations which treat social issues of men's life in detail (family law, obligations of the society towards the individual etc.)

In close cooperation with the civil authorities, the church was in charge of the creation of "honourable homes" for: the elderly, the poor, children deprived of parental care, foreigners etc. These homes had their administrative and managerial staff, as well as real estate and other assets that were bestowed upon them. The operation of these charitable institutions was closely monitored by the overseers, who were in charge of advocating for the poor, comforting the mourners, defending the abused etc. Among the vulnerable were also those with physical disabilities: the blind, deaf, mute, lame, etc.

It is characteristic of the Law of Saint Sava that, apart from the material aspects of poverty, equal attention was paid to the legal protection and equality of all before the courts, regardless of their material status. This principle of universal legal equity was also included in the Law book of Tsar Dušan from 14th century, which states: "Every washerwoman must be as free as the priest"; "a poor soul who cannot represent herself at court, may send a representative to speak in her name".

Child allowances represent the largest programme of assistance to the poor, financially 3-4 times as large as the programme of social assistance. Its purpose is assistance to poor families with children, i.e. creation of equal conditions for the normal development of children.

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[53] However, there is compensation for the families with children in the form of child allowances.

[54] B. Bogicevic, G.Krstic, B. Mijatovic and B. Milanovic – *Poverty and the reform of financial support to the poor,* CLDS, 2003.

Table 2 Poverty among children

	Total	Belgrade	Vojvodina	Western Serbia	Central Serbia	Eastern Serbia	Southeast Serbia
Poverty rate in %	10.4	6.8	7.6	14.5	11.2	9.7	16.8

Source: SLSP

Examined by region, the lowest number of poor children are in Belgrade and in Vojvodina, while the highest number are in western and southeast Serbia, while central and eastern Serbia are somewhere around the average. Children in families with several children are also in a less favourable position in Serbia. Thus children in households with one child have a poverty rate of 7.5%, children in households with two children – 8.7%, and children in households with three children – 18.9%. However, inequality among children is not particularly prominent – the Gini coefficient is 28.8, somewhat lower than for the whole population.

The new Law on Financial Support to Families with Children enacted in March 2002, allows a much more accurate targeting of poor families. This is accomplished through universal income testing as well as some moderate asset-testing. Similarly, differences in income thresholds between the communities in the poorer parts of Serbia have been eliminated. Finally, both child allowances and income thresholds were indexed to the cost of living in order to preserve their real value.

The child allowance is awarded on the basis of the income threshold that is set at a level of 3,030 Dinars per household member (March 2003), which is higher than for social assistance. This programme does not use an economy of scale, but applies the same threshold for all members of the household, which increases the number of families eligible for child allowance. This is a result of the view that this programme should cover wider strata of the population, i.e. include families with lower medium incomes as well.

Child allowance for all children amounts to 990 Dinars (December 2002), i.e.16 Euros. For single-parent children and children with special needs, this amount and the threshold are increased by 30%.

The number of children entitled to child allowance has grown from 494 000, at the end of 2000, to 665 000 in December 2001, i.e. by 35%, owing to the increased interest which was caused by regular payment and accelerated payment of the two year overdue child allowances. In the second half of 2002 there was a significant reduction in the number of children covered, which was due to the adoption of a moderate asset test and to the growth of incomes in real terms, which has placed numerous beneficiaries above the income test. In Serbia currently, every third child is receiving child benefits.

To the poor with new born children even the childbirth allowance is helpful, although it represents an almost universal transfer, except for the richest stratum. It has been paid since the summer of 2002 to the amounts of 55 000, 98 000 and 130 000 Dinars for the second, third, and fourth child in a family.

Outstanding debts in the field of social protection were inherited from the period before October 2000. Starting with the assumption that the first years of transition will be the most difficult for the poor and that as high as possible an amount of assistance should be directed to them, avoiding large dependence on donor resources, first the regular payment of social protection benefits was secured from the Republic Budget, and for additional payments a One-off Fund was established. Donor resources were directed through this Fund and inherited arrears were paid off: 26-32 months arrears in payment of child allowance, social assistance and carer's allowance, as well as one-off benefits to all beneficiaries of child allowances, single parents whose children are entitled to child allowance, and two one-off benefits to beneficiaries' social assistance and carer's allowance. Besides, the One-off Fund has for a whole year regularly supported 12 thousand poor families who could not become eligible for social assistance only because of the decentralisation of the income testing by municipalities. From the budget resources, 46 thousand poorest families were additionally supported to cover the rise in electricity prices, while donor resources were used to cover several years arrears in electricity bills of beneficiaries of social assistance.

The decision of Electric power company of Serbia on additional help to MOP users remains valid. They are entitled to a 30% discount to the value of spent electric energy up to 450 kw/h a month, on condition they pay their bills regularly.
The decision of EPS Managing board, with the consent of the republic Government, has approved another benefit. The housholds which were spending 70 – 300 kw/h a month in July, August and September, and which receive child allowance or whose total monthly income is under 6,000 dinars i.e. up to 2,500 dinars per household member did not pay the fixed part of the bill.

Social protection services An important part of social protection in Serbia is to assist children without parental care and to enable elderly persons and persons with disabilities to look after their own needs. The existing system of providing support to these vulnerable groups is predominantly concentrated on institutional (residential) accommodation. In the network of homes in Serbia there are 77 institutions, which accommodate 17 thousand elderly persons, children without parental care, and persons with disabilities. As an alternative to institutional accommodation, within the system there is also accommodation in another (foster) family, as well as day care centres and allowances for home care. These alternative forms of social protection are, however, insufficiently developed. Among them, the most common is foster care as a form of protection for children without parental care. Out of approximately 10 thousand children without parental care, almost 6 thousand are accommodated in extended families, 2 thousand in Institutions for children without parental care, and 2 thousand in foster families. The network of day care centres and advanced home help exists, first of all, in big cities; their capacities are insufficient and they do not represent the appropriate option that would ensure that the most vulnerable are supported primarily within their families and in their own homes.

The services in the domain of social protection, apart from the programmes of protection of persons who cannot look after their own needs, also imply the establishment of of entitlements to different forms of cash compensations (material assistance to families, allowance for providing assistance and care to another person), as well as providing assistance in the sphere of legal and family protection. In the past, a major part of the services were provided within the network of the Centres for Social Work, which cover all the municipalities in Serbia.

During the nineties, a large number of NGOs were providing care, but they were mostly engaged in the distribution of humanitarian aid targeting, first of all, refugees and internally displaced persons.

As with all other parts of the system, the system of service provision in social protection has been seriously damaged in the past period. The capacities of numerous institutions were destroyed, while the living conditions of beneficiaries were at an unacceptably low level. Social protection institutions dealt with their own problems, and being poorly paid, the employees were not in a position to provide adequate assistance to anyone. Development alternatives, new methods of work, and professional training were completely unavailable for the majority of the employees.

Progress has been made since 2000; the first steps were primarily aimed at the improvement of the living/material conditions in the social welfare institutions. With the assistance of the donors, just in 2001, much more was invested in facilities and equipment than in the previous decade. Even after three years, however, the situation is unsatisfactory in some social institutions for persons with disabilities (the mentally affected), which accommodate far more beneficiaries than they have capacity for.. At the same time, the paying back of debts and the beginning of regular payments of all social entitlements, as well as a slight, and yet evident improvement in the material status of the employees, have consolidated the system and created favourable conditions for simultaneous activities on the reforms in social protection.

The problem of incomplete coverage. Despite the fact that there are social protection programmes specifically intended for the poor, a not insignificant number of the poor are reluctant to use them even if they are entitled to them. The reasons for such reluctance vary and they include insufficient information about the entitlements, refusal of public welfare for psychological reasons (stigma), no permanent address (especially in the case of some Roma groups and the homeless), lack of skills to cope with the red tape, geographic inaccessibility (in the case of institutional forms of social protection), resignation to poverty, and the like.

A very special problem is poverty among refugees, who are not entitled to basic social transfers. This issue will have to be tackled through a comprehensive government policy for refugees, including the policy of granting citizenship.

2.1.2. Main problems and constraints

Social welfare is caught between the growing demands for the provision of provision and support to vulnerable individuals and groups, on the one hand, and material and financial constraints, on the other. The present status shows that the challenge exists and that it is a serious one. On the one hand, social welfare has deteriorated during the past decade, both with respect to the number of beneficiaries of social transfers and to the quality of the services in the institutions, and with respect to the available financial resources, despite the fact that the number of poor grew, that the wars and sanctions intensified the need for social protection of a growing number of people pertaining to the vulnerable groups. Additionally, the economic crisis limited the abilities of the state to finance those increasing needs, and therefore there appeared a great gap between what is necessary and what can be done. In other words, the legacy of the past is very unfavourable.

On the other hand, Serbia, which has not as yet recovered, is faced with the beginning of transition, which carries new risks and demands solutions to them. A wide economic liberalization, both internal and external, and privatisation are going to bring about restructuring of the economy, which will, at least in the short run, jeopardize the employment and incomes of a part of the population. The relative rise in the prices of the utility services have the same effect. Therefore, the social safety net gains importance, as a mechanism whose purpose is to provide basic living conditions to the citizens, as well as to those temporarily affected by the transition.

The major constraint is the financial in capability of Serbia to round off the financing of the required level of social protection. In the previous two years, the external funding (donations) represented supplementary financing of the local funds, but it is scaling down.

The country's financial status directly affects the financing of basic social protection institutions – residential institutions. Their rehabilitation and modernization, especially reconstruction and equipping, was to a great extent financed from foreign grants.

2.2. Goals and Strategic Options

2.2.1. Goals

The goal of the Poverty Reduction Strategy in the area of social protection is to alleviate the consequences of poverty in the entire population and, in particular, among certain vulnerable groups. The programmes of social protection certainly cannot eradicate poverty, but they can and must be a support for the most vulnerable, for those who are not in a position to provide basic living conditions for themselves. So, social protection cannot influence the causes of poverty – this needs to be done in the area of other economic and social policies – but it can, to a certain extent, cope with the consequences of the prevailing poverty.

Children are the most important among the vulnerable groups. Although they do not have an above average risk of poverty, by the nature of things children are entitled to greater protection than others. Therefore, the policy of additional protection of children through social transfers should continue to be conducted in the future, with careful targeting.

The goal in the forthcoming period must also be the widening of the coverage of social protection to include other vulnerable groups, such as children without parental care, the elderly and the diseased who are unable to look after themselves, and the like.

2.2.2. Strategic Options, Measures and Activities

The struggle against poverty in Serbia certainly cannot rest predominantly on social protection; instead it must be based on economic progress as the soundest and most efficient means to reduce the number of poor and the depth of poverty. Economic growth usually yields increased earnings of all social strata, even of the poor, and by employment of the unemployed it leads to increases in the wages of employees, and increased government support to the poor from the increased tax base. Reduction of poverty with economic progress is inevitable if the distribution of income, i.e. inequality of that distribution, remains unchanged or if it is changed a little.

Although necessary and most important, economic growth is still not a sufficient condition for the elimination of poverty. Despite the growth of income, it is necessary, on the one hand, to pursue different policies that will support or, at least partially, enable growth and, on the other hand, to help those individuals who are still unfortunate or unable to participate in the results of the progress. Therefore, the state will pursue a stimulating policy in the entire social sector, including education and health care and the pension system and social protection in a narrow sense. While education and health care contribute to the growth through development of human resources (human capital), the pension system and social welfare should represent the mechanisms of provision of income to those who, for various reasons, do not directly participate in economic activities.

Transition certainly does not include only the changes in the economy and in policy, but also in the social sector as a whole. A society founded on limited opportunities, but also on low risks, is turning into a new society in which the risks are higher, but the opportunities are also greater, and consequently, so is the responsibility of individuals towards themselves and their families. The old socialist concept of social policy, according to which the paternalistic state regulates, finances, and provides social services, requires a thorough reform. Therefore the overall social policy concept will change, and the new one could be as follows:

- **Extended sovereignty of individuals,** who are not only payers and service beneficiaries, but also individuals who have the right to choose, to make their own decisions that very much concern them, but also to bear the responsibility for the consequences of their choices. In Serbia, the widespread habit of expecting the state to provide protection from all risks is not realistic.

- **Assistance to those who suffer and who are in need**. The principle of solidarity means that everyone should satisfy his/her basic needs, but also to look after himself/herself as much as he/she can. Solidarity must be expressed by targeted assistance directed exclusively towards the poorest and those who are not in a position to look after themselves and their families.

- **Competition** must exist between different forms of ownership and different mechanisms of coordination, and it is good for two important reasons: the first is exercising of the individual's right to choose, and the second is increased efficiency.

- **New role of the state**. The state would no longer organize, keep in possession and collect all the moneys for the operation of the social sector, but would instead predominantly have a role of developing legislative frameworks, oversight, and ultimately provision of ultimate insurance and assistance.

- **Greater role of local communities**. While the government would continue to manage the main programmes for the purpose of maintaining equal status of citizens, other programmes should be assigned to local communities and organized, if possible, on a partnership basis with humanitarian, donor and non-governmental organisations, churches and others.

- **Sound financing** should go without saying, but it was often sacrificed under the pressure of social rights, which were untouchable. Serbia must not go back to the inflationary financing of the budget and, therefore, it must design a social sector within budgetary constraints and not based on a wish list.

In line with such principles it would be necessary to work out the changes in the entire social sector, but also in the social protection in the narrow sense, particularly in times of transition.

The very limited resources for social protection must be used in the most efficient way, so that society, and particularly the vulnerable groups, could get the most possible. The existing system of social protection – based, as far as the struggle against poverty is concerned, predominantly on child allowances and social assistance – is basically a good and a modern one. All of its major elements should be retained in future as well: 1) the poverty line, which represents the basic landmark for definition of the entitlements to certain transfers, 2) establishment of household means test, by which the vulnerability level and entitlement to transfer are determined, 3) topping up of funds to cover the difference between the poverty line and available resources,[55] if it is positive, and 4) regulation of the entitlements and financing on the republic level.[56]

Since social assistance is far more succesful in reaching the poor than other programmes, it would be good to earmark more public funds for social assistance in the future. This would help achieve the best possible ratio between the costs of the programme and the benefits to the poor.

And yet, the system of social transfers aimed to alleviate poverty suffers from numerous flaws, which are less the result of conceptual weaknesses, and more of the operational control and implementation. Therefore, reform is needed, particularly in the area of the targeting of social transfers.

The required changes in the area of social assistance are as follows:

- **Absolute "poverty line",** expressed in Dinars. The absolute poverty line would enable the number of poor who are entitled to social assistance to move inversely from the economic activities – the higher the economic activity and the higher the incomes are, the number of the poor would be smaller, and vice versa, the number of poor would grow with the decline of economic activity and reduction of income. The absolute poverty line must be based on the required level of consumption of individuals, and/or families, indispensable for basic needs, but also in accordance with the constraints of the budget of the Republic of Serbia, as the limiting factor which thwarts possible generosity. This would replace the existing relative poverty line in case of social assistance, which is linked to salaries in the economy and which, therefore, basically maintains the fixed number of the poor irrespective of the trends of the economic activities and incomes.

- **The new "poverty line" would be equal throughout the territory of Serbia**. Thereby, the existing differences between the municipalities would be eliminated and all the citizens of Serbia would be put in an equal position. The existing different poverty lines in different municipalities have no justification, because

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[55] This applies to social assistance only, and not to the child's allowances, in which case the amount is fixed.
[56] Local communities can additionally finance these transfers, which some of them actually do.

they cause discrimination against poor citizens who live in the poorer parts of Serbia.

- **Indexation** of the poverty line should be done with the cost-of-living index, which would preserve its real value, i.e. preserve the purchasing power at the time of inflation. This is already the case with the child allowances.

- **"The poverty line" should be raised with respect to the present one in the case of social assistance**, so that a larger number of citizens could be covered by the programme of state support to the poor. In that way larger number of the poor would be covered by social assistance programme.

- **Better respect of sustenance expenses of multi-member households** (coefficients of the economy of scale) is needed in order to relieve the current deprivation of those families; in other words, it is necessary to increase the current particularly low coefficients for the other members of a household when calculating the required funds for minimum living requirements.

- **For the working-age population, support by the state can only be a temporary means of survival.** Therefore, it should be necessary to specify that working-age individuals are entitled to allowance/support only for a limited time period. The discouragement of employment of working-age persons, brought by any social assistance to a certain extent, should be avoided as much as possible. Serbia is not in a position to grant generous transfers to those who calculate whether it is better for them to work or to live on social welfare.

- **Reconsideration of the existing restrictive policies regarding the means test**; this means test should certainly be retained, but it should also be tied to the possibility of using property to earn income, because the existing policy thwarts entitlement to the rights to those who possess real estate, but cannot use it either for sale or lease (in mountain or depressed regions).

- **Strengthening field monitoring**, in order to be able to assess the actual poverty level by a closer, first-hand insight into the state of a family. This is required because of a considerable share of the grey economy in the income of citizens, which makes it impossible to evaluate income on the basis of formal records only.

Further advancement of the social protection of the poor will be enabled by the amendments to the Law on Social Assistance and Social Protection, currently in the parliamentary procedure. The suggested changes will include the 90% increase in the carer's allowance and assistance to persons with the gravest disabilities, as well as the introduction of the absolute "poverty line" and unique eligibility criteria for the whole territory of Serbia and their indexation based on the costs of living, restraint of entitlements of working-age people and the increase of the coefficient of the economy of scale.

In the reform of child allowances, the basic dilemmas are always of conceptual nature: 1) whether to put a stress on the population or social goals, 2) whether the desired goals are more easily achieved by the means of (almost) universal child allowance (with the same amount for all) or by targeting the poor (with a differentiated amount). In Serbia, child allowance was previously conceptualised as wide in coverage, emphasising the population policy component, but the reform in 2002 has shifted the emphasis from the population to social goals and to some extent narrowed the coverage of children to the poorer population strata, providing the same amount of child allowance regardless of family income.[57]

A more consistent policy for child allowance with the emphasized social function would be as follows:

- **Keeping the existing targeting of the poorer strata**, with the income and asset test; coverage with child allowances should still be wider than the coverage with social assistance, i.e. the citizens who do not belong to the poorest strata would also be included; therefore, the eligibility criteria would be set higher than for social assistance, the same as now;

- **The amount of child allowance should be differentiated** depending on family characteristics and characteristics of a child; differentiation could be based on the family income level and/or the child's age; differentiation by family income would respect the social component of the programme, so the poorer would receive more than the less poor, while the differentiation by child's age (for example, 0-6 and 7-15) would respect the real difference in costs of raising children of different age.

In addition, the existing policies regarding eligibility criteria (in Dinars), which are unique for the whole territory of Serbia, and indexation based on the costs of living, should be kept. As for social assistance, the means test should be linked to the possibility of selling or leasing of property, in order to enable those whose property, though exceeding eligibility criteria, cannot be commercialised, to become eligible for child allowance.

One of the options for further basic conceptual improvement in the area of transfers aimed at poverty reduction should be the ***integration of the social assistance and child allowances*** into a single unique transfer that could be called ***family allowance***.

The main reasons for the integration are the need to increase the sensitivity (elasticity) of the system to the income of the poor,[58] so that those less poor would get less, and those more poor would get more, and improved targeting of the transfers.

On the following chart there is an illustrative comparison of the existing basic transfers to the poor – child allowances (DD) and social assistance (MOP) - with the family allowance, based on the presupposition of the equal level of transfers in both cases.

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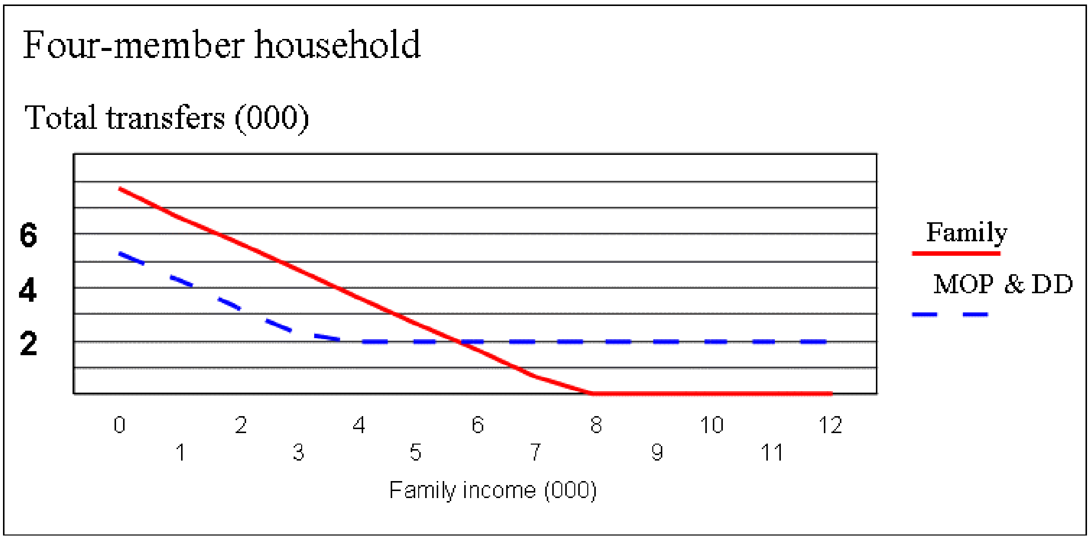
[57] The exception are single parents, who are entitled to the amount increased by 30%

[58] According to the existing policies, these two transfers are, considered together, very inflexible with regard to the movement of income of the poor, owing to the fixed (flat rate) child allowances.



The family allowance would allocate more transfers to the poorest, i.e. to those families with an income up to 6 thousand Dinars per month, while to those with a higher income it would allocate less or nothing. In other words, the coverage of the poor with the family allowance would be narrower than in the present system, and the resources saved would be distributed to the poorest.

The potential introduction of the family allowance requires additional research of different conceptual issues and the impact of this system change, as well as new complex technical policies that cannot be introduced in the short term.[59]

Reform of social services

As early as 2001, the work on the reform was initiated in the domain of social services, particularly those provided within the Social Welfare Centres, and especially the ones provided in institutions (residential homes) and through alternative forms of protection. The main goals of the reforms are deinstitutionalization and development of alternative forms of social protection, definition of the role of different sectors and their inter-linking (health care, education, employment, police, judiciary), involvement of different stakeholders in the sphere of service provision, first of all those from the NGO sector and greater reliance on day care, organised within local communities, instead of institutional placement with the categories of beneficiaries where that is possible.

[59] For some issues see B.Bogićević, G.Krstić, B.Mijatović, B.Milanović, A. Pošarac - Poverty and financail Support to the Poor, CLDS 2003 (currently being prepared for editing)

The reforms of social services are directed at putting the user and his/her needs in the focus of the social protection system. Basic guidelines in the reform process are deinstitutionalisation and development of open, i.e. alternative forms of protection

- *decentralisation;*
- *abolishing discrimination which exists with particular categories of users;*
- *development of professional standards,procedures,protocols and norms;*
- *establishing partnership between governmental and non-governmental sector;*
- *creating an environment for the involvement of the private sector;*
- *introduction of permanent education principles for the service providers.*

As the result of this effort, by the end of 2001, 7 reform projects had been formulated, which deal with the development of an integral social protection on the local level, organization and standards of work in the Social Welfare Centres, promotion of foster care and adoption, transformation of the institutions, and screening of children with special needs. A number of these projects are under way, in concrete local communities, with the idea of, after the initial phase, of transforming the piloted experiences into the models that would be applied at the national level. Although they are more widely based, in the first stage the projects are mostly targeted on children without parental care, juvenile offenders, child victims of violence, as well as protection of children in families at risk.

A special mechanism that should contribute to the reforms in the area of social services is the Social Innovation Fund. The Fund will finance on the local level those projects that are in compliance with the strategy and whose expenses are transitional in their nature. Projects that enable deinstitutionalization, either by offering support to the natural families or by way of the development of alternative services,will be given priority. A number of projects will be clearly defined in advance, while others will be the result of the innovation/inventiveness of the local stakeholders and based on local specific features and problems. Preference will be given to those local projects that require funds in the initial phase only, while the continuation of their financing can be provided from local sources. Additionally, this Fund would not only be concentrated on NGOs but all social welfare institutions would also have access to it., which would help to stimulate the reform of the system from »within«. Thus the Fund will at the same time be a mechanism for reforms and a mechanism for decentralization and of partnership (between governmental and non-governmental organisations). In the course of 2002, the idea of the Fund was piloted by way of allocation of funds to organizations of the persons with disabilities. There were 97 projects that were supported, including the opening of day care centres, the development of daily activities and the inclusion of persons with disabilities. The Fund started operating in 2003, and the financing of the initial projects is expected in mid 2003.

In parallel with the reform projects, the amendment of the legislation is also expected in the course of 2003. By the end of 2002, the Government had adopted a draft of the amendments of the Law on Social Welfare. Within the framework of the proposed amendments a smaller number of them are related to the changes in the area of services (the possibility of formalizing foster care, inclusion of the beneficiaries in the management boards of the social welfare institutions, delegation of the authorities to set up shelters to the local level and so on).However, it should be pointed out that the specified change of the transfers for the care of the persons with disabilities by almost 90% should contribute to the provision of material support to the families, and thereby to deinstitutionalization as well. Apart from that, the drafting of the Family Law is in the final stage; it should eliminate obstacles to the adoption of children without parental care, change the role of guardianship authority, introduce for the first time regulations related to violence in families, and harmonize the Law with the Convention on the Rights of the Child.

There is also a need to reconsider and improve the overall system of social protection of persons with disabilities, which would involve issues such as: allowances and social assistance (due to higher personal and familiy expenses), institutionalized care, technical aids, providers rendering services to persons with disabilities, and so on.

3. Improved Status of Pensioners and Elderly

3.1. Current status and problems

3.1.1. Current status

The majority of the elderly in Serbia receive pensions because the pension insurance of the majority of the working population is compulsory. The remaining number of the elderly either depend on informal, family arrangements or they are forced to work until an advanced age in order to be able to ensure for themselves the means of sustenance (particularly in rural areas, in elderly households).

Therefore the pension system of Serbia represents the basic method of ensuring income for old age, at the time when the capacity for work of an individual is significantly reduced. It has wide coverage: it covers not only those employed, but also the employers, self-employed (including the freelance professions) and farmers. It consists of three separate funds: of the employees, self-employed, and farmers. That ambitious approach that was intended to encompass all those who work has also resulted in the expected and worldwide known difficulties due to incomplete coverage of the self-employed and, in particular, farmers.

The 'maturity' of individual funds also varies: the fund of self-employed is still relatively 'young', with 5:1 ratio between the number of the active insured persons and pensioners and it easily finances the pensions of its pensioners despite the fact that the contributions are not so regularly collected; the fund of the employees is very, very 'mature', with a low 1.58:1 ratio (in 2002) between the number of the active insured persons and pensioners and suffers inevitable deficits; the farmers' fund has been in great difficulties since the beginning, so that the budget finances about one half of the farmers' pensions. The farmers have not accepted the compulsory old-age pension insurance in the best way and they pay their contributions very irregularly.

During the past decade, in times of numerous crises and hyperinflation, the pension system played a very positive role in provision of income to the elderly population and preventing it from falling into complete poverty. There were also political calculations by the former regime involved in this, which relied on the decisive votes of the pensioners in the elections. An average old-age pension was quite close to the average wage of employees and even reached it at times. The entitlements were granted very generously, starting from the low criteria for entitlement to old-age, disability or survivorship pension, a generous indexation mechanism, to a relaxed implementation of the system. However, it was too expensive, and the pensions became a great burden on GDP, reaching as much as 15%. On the other hand, the pensions were not paid up quite regularly or they were reduced by illegal tricks, which was the manifestation of the policy 'maximize the rights, and we shall see about the financing' at the time, not only with regard to the pension system, but also regarding medical care, social affairs, and education. For a long time the pension system had served as a solution to numerous and various social problems, unrelated to pension insurance in the usual sense. Thus it was used as a means to stimulate employment, by too early retirement of the elderly; or as insurance against the consequences of injuries outside the workplace, etc.

Pension system reform has been initiated. First (in June 2001) the pension contribution rate was reduced from 32% to 19.6%, for the purpose of lowering labour costs; it was the Serbian Budget that bore the burden of the decrease. In December 2001, the retirement age limit was raised by three years, so now it is set at 63 years for men and 58 years for women; indexation with wages was replaced by the so-called Swiss formula, i.e. by a combined index of wage growth and costs of living (with equal weight); a unique minimal (net) pension amounting to 20% of the average gross salary was also introduced. The purpose of these changes was to achieve the fiscal sustainability of the system. In March 2003, a new Law on Pensions and Disability Insurance was adopted by the Republic Parliament. Instead of the best ten years, the pension is now based on the earnings from the whole working career; the possibility of voluntary insurance was introduced; the mandatory pension obligations of farmers have been reduced, by narrowing the mandatory pension insurance to only one household member; certain benefits that do not belong in the pension system have been excluded; the eligibility criteria for disability insurance, which have previously generated one third of the total number of pensioners, have been tightened (now they are based on the principle of general disability), and a strict inspection of medical committees was also established, together with mandatory revision of disability pensions. The main data on the pensioners and their pensions are given in Table 1.

Table 1 Nov. 2002

	No. of pensioners, in 000	Average pension in Dinars
Fund of the employees	1,254.0	6,676
Fund of the self-employed	42.9	6,833
Farmers' Fund	212.2	1,801
TOTAL	1,509.1	6,078

The total number of pensioners in Serbia[60], in November 2002, amounted to 1.509 million, which means that every fifth inhabitant of Serbia is a pensioner. The growth in the total number of pensioners in the period November 2000-November 2002 is 1.8%, and particularly owing to a considerable increase of the number of farmer pensioners – by 15.1%. The number of pensioners formerly self-employed was increased in the same period by 9.2%, while the number of pensioners of the fund of the employees has stagnated, i.e. it was reduced by 0.4%.

In the course of 2001 and 2002, pensions were considerably increased in real terms and the standard of living of pensioners significantly improved. Now the pensions are paid up regularly, and the former major delay in paying up of the farmers' pensions has been reduced. An average pension in Serbia has been increased in real terms by as much as 88.2% in the past two years and, in November 2002, it reached 6,078 Dinars, i.e. USD 98.[61]

[60] Without army retirees (53000 persons) whose pensions were financed from the federal budget.
[61] Calculated by the estimated parity of the purchasing power, this is around USD 300 per month.

Table 2. Poverty among the elderly persons

	Poverty rates						
	Total	**Belgrade**	**Vojvodina**	**Western Serbia**	**Central Serbia**	**Eastern Serbia**	**South-east Serbia**
Pensioners	10.9	8.3	9.6	12.6	8.5	13.2	19.2
Elderly persons, 65+, without pension	19.8	23.0	20.2	13.7	18.7	9.4	32.7
All the elderly, 65+	14.8	12.7	13.7	12.1	13.6	12.0	26.1

Source: SLSP

Among the pensioners there are somewhat more poorer persons compared to the entire population (10.9% as opposed to 10.6%). On the other hand, among them there are considerably fewer poor persons than among the elderly persons (65+) who are not pensioners (10.9% as opposed to 19.8%), which confirms that the pension system is a strong obstacle to poverty. Among all the elderly persons of over 65 years of age, the poverty rate amounts to 14.8%.

Examined regionally, elderly persons have the lowest standard of living in southeast Serbia, and every fifth pensioner and every third elderly person without a pension are poor. It is unexpected to a certain extent that the poverty among elderly persons who do not receive a pension is higher in Belgrade and in Vojvodina, in the most developed regions, than in the wide stretch of the western, central, and eastern Serbia. The cause of this is probably the security the rural environment still offers in basic living conditions compared to urban environments.

Table 3. Poverty among pensioners by the type of household

Type of household	Poverty rate
Single-person pensioner's household	10.4
Two-member pensioners' household	9.0
Mixed households without employees, with pensioners as the main breadwinners	16.7
Other mixed households	8.1
Average	11.0

Source: SLSP

The analysis of poverty among pensioners subject to the type of household in which they live indicates that pensioners living in the single person or two-member pensioner households are in a somewhat more favourable position, measured by a lower poverty level, as well as in mixed households in which someone else also brings in some income. The most vulnerable are the mixed households in which the pensioners are the main breadwinners (16.7% of the poor).

However, the consumption of the entire population of pensioners is moderately uneven: the Gini coefficient is 29.0 and it is insignificantly lower compared to the entire population.

Of the elderly who do not receive a pension, the highest proportion are housewives (55.5%), and followed by farmers (21.5%) and the persons with disabilities (11.2%).

Table 4. Poverty among elderly persons (65+) by type of household

Type of household	Poverty rate
Single-person elderly household	13.7
Two-member elderly household	16.9
Mixed households*	13.8
Average	14.1

* with at least one household member over 65 years of age

Source: SLSP

Among all the elderly persons those who live in two-member elderly households are in greater need compared to those who live in single-person and in mixed households. The cause of the lower risk of single-person compared to the two-member households is the predominance of pensioners (83%), who have an income and thus a lower poverty rate, in the first type of households. In the two-member households, there are fewer pensioners (64%) and more supported persons, which causes the higher poverty rate.

Considerably more vulnerable than the average of the elderly persons are certain narrow groups, such as two-member elderly households or mixed households in which the elderly person is the provider of the basic income.

Apart from them, there are groups of the elderly persons who need assistance from the state. Those are either elderly persons who have no one to look after them or diseased elderly persons who require constant care. State support for these persons does exist, and the most important forms are accommodation in institutions (homes for the elderly, gerontology centres) and financing of advanced home help. Home help is an insufficiently developed form of assistance and it should be developed further as a more favourable form of social service.

Around 9,000 elderly persons are accommodated in state-owned homes for the elderly, of whom as many as 60% are bed-ridden. Among them there are poor persons for whom accommodationexpenses are paid by the state, relatives, or humanitarian organizations, but there are also citizens who are better off and who bear their own expenses. In the past two years, the homes for elderly have been equipped and generally refurbished with donor assistance. There have also appeared the first private, commercial homes for elderly.

The programmes of funding of advanced home help cover around 60 thousand of the elderly, two thirds of them from employees' the pension fund, and one third from the Republic budget. Payment of the allowances for advanced home help is not tied to the level of income, which results in poor targeting.

3.1.2. Main problems and constraints

The main obstacle to more thorough and extensive government support to the poor pensioners and other elderly persons is certainly financial. At the present stage of development of Serbia, as a country with a low income, it is hard, even impossible, to allocate more. Now the share of pensions in the Gross Domestic Product (GDP) is already 11-12%,[62] and the very funds of pension insurance (except for the fund of the self-employed) to a great degree depend on budget donations. Thus the budget covers around 40% of the pensions from the employees' fund of the employees and about one half from the farmers' fund. More generally speaking, the existing budget deficit is not sustainable in the long run, because servicing of foreign debts will increase considerably in the years to come , while revenues from the privatisation and donations and favourable foreign credits will be reduced. Therefore it will most probably be necessary to reduce the share of public spending in GDP.

The second obstacle is the drawbacks of the existing pension system. The inherited system was too generous in granting rights and it was also badly managed, both with regard to the collection of contributions, and with respect to its relaxed method of granting rights. The result was too many young pensioners, particularly those with a disability, poor collection of pension contributions, too high a replacement ratio (ratio between the last salary and first pension), a high ratio between an average pension and an average wage on the macro level, high deficits of the pension system, and so on.

In the past two years a reform of the public pension system, based on the pay-as-you-go system, was initiated. The problem is, naturally, that the effects of the reform, due to a great inertia, are seen only in the long run, so that neither the reforms to date nor the forthcoming reforms will consolidate the pension system of Serbia in the near future. Therefore, neither can the goal – a smaller, but better financed public pension system – be achieved in the following years. For the next stage of the pension reform – introduction of voluntary and, probably, mandatory pension insurance based on capital funding – the initial preparations are only now being made.

The main problem still is the ageing of the population. Serbia is a country in which the fertility rate has been insufficient since the sixties (the fertility rate now ranges from around 1.5 to 1.6), so that the number of elderly persons also continually grows. The number of the elderly over 65 is, according to the 2002 census, 16.6%, with the trend of further growth. Rapid ageing of the population, expressed in the aggravated ratio between the number of the elderly and working persons, will certainly make the problems of the elderly and the obligations the government has towards them more acute in the future, but also the possibility for the government to finance them in the conditions of a decreasing number of the younger generations of working persons.

3.2. Goals and Strategic Options

3.2.1. Goals

The primary goals of government policy with regard to the elderly should be:

- Raising of the standard of living of pensioners and other elderly persons, in accordance with the growth of standard of the other citizens,

[62] Without other transfers to the pensioners, expenses of administering of the funds and health care of the pensioners.

- Reduction of poverty among pensioners and other elderly persons, both with regard to the share of the number of the poor in the overall number of this population, and with respect to the absolute number of the poor,

- Reduction of the poverty depth among the remainder of the poor elderly persons, and

- Strengthening of the non-institutional and service protection of particularly vulnerable elderly persons.

The position of the older categories of citizen does not depend only, or does not even predominantly depend, on direct government policy in the given field (pension policy, protection of the vulnerable elderly persons), but also on other factors and policies (economic development, health care policy, support by an extended family, cooperation of different stakeholders, such as local communities, the Church, humanitarian organizations and NGOs and so on).

3.2.2. Strategic Options, Measures and Activities

Given that the pension system is the prime source of income of the elderly generations, the financial status of that part of the population to a large extent depends on the future features and performance of the pension system. The latest changes (dated December 2001 and March 2003) have to a considerable extent improved the pension system and made it not only more efficient and equitable, but also more financially sustainable. Yet, the process of its reformation has not been completed and there is a need for its further structural upgrading.

The main **goals of the structural reform of the pension system** should be:

- Providing of stable and sufficiently high pensions for all,

- Creating of a financially viable pension system,

- Increase of the local saving and acceleration of the economic development,

- Improving the equity of the pension system, and

- Extending the options for choice by the pension insured persons.

The above goals imply a thorough reform of the pension system, which would include both the government and private insurance, both compulsory and voluntary insurance, and the pay-as-you-go system and the system of capital funding. Such a combination would also bring a possibility of choice, and different answers to the different risks, and efficiency and equity, and higher pensions.

The pension reform of the public system should yield to the financial consolidation of the existing pension funds, primarily the fund of the employees, while setting up of the private pension insurance should ensure additional pensions and savings for a more rapid economic growth, as well as a long-term viability of the pension system in the unfavourable demographic conditions and better security in the old age than an “pay-as-you-go-system” can provide in the unfavourable demographic conditions.

From the standpoint of poverty reduction, there are two characteristics of the pension system that are important. The first is the redistributive component within the pension insurance, and the other is the mechanism of relatedness of trends of pensions and economic progress of a country.

The existing pension system carries out the basic redistribution in favour of the poor through the institute of the minimum guaranteed pension. Net minimal pension currently amounts to 20% of the average gross salary in Serbia.

The main issue of the redistribution nowadays is whether to introduce the minimum social pension also for those elderly persons who are not pensioners, as it is done in a number of developed countries. If a social pension were instituted for all the elderly persons of over, for example, 65 years of age who do not have a sufficient income from other sources, then the redistribution within the pension system would not be required, because this social pension would play that role in a more general and wider aspect than does a minimum pension. However, it is probable that in Serbia on such a low development level it is not possible to introduce a social pension owing to the serious budgetary constraints, so that the elderly persons who are not pensioners will still rely on the family arrangements, their own property and, ultimately, on a modest social assistance. Therefore, the redistribution through a minimum pension is for the time being going to remain the solution within the pension system.

The relationship between the pensions and the overall economic development depends on indexation mechanism for determination of the pensions. In Serbia the so-called Swiss formula is applied, where changes in pension amounts depend on changes in wages and inflation. The pensioners thus share the benefits of the development, but to a lesser degree than the employees.[63] This indexation mechanism yields positive and balanced results and they should not be changed at least in the foreseeable future.

Extending the retirement age limit. Early retirement burdens the pension funds very much, because it thus reduces the number of those who pay contributions and increases the number of those who receive pensions. Therefore, in the long term, entitlements to full pensions should be given to both men and women of 65 years of age. This extension sometimes creates opposition from the older workers, since earlier retirement suits them more, and also of the young persons, because they believe that postponement of retirement affects the reduced opportunities for their employment. Some arguments in favour of raising of the age limit are:

Currently employed retire too early; average retirement years was 58 in 2001, which means that a large number of relatively young people retire. Raising the retirement age limit by three years by the end of 2001 will raise the average retirement age to around 60, but even that is a too early age, bearing in mind extended average life expectancy, the health status of the population, decreasing share of hard physical work, and the like. *In the whole world the retirement age limit is being extended;* in the developed part of the world it is minimum 65 years of age for men and 65 years of age or a year or so less for women and in some countries (the USA, Norway) it is being further extended; similarly, in the countries in transition there is the same tendency.

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[63] Same as their pension is more slowly reduced at the time of reduction of the wages of the employees.

Increasing of the productive capacity of the country; later retirement means more labour and increased potential GDP.

Financial unsustainability of the present pension system. The system in which about 40% of the expenditures for the pensions are allocated from the budget of Serbia, even despite the high contribution rate of 20.6%, obviously requires a thorough reform; further increase of the pension contribution is not a good alternative, because it would additionally burden both the employers and the employees and it would endanger the competitiveness of Serbian enterprises in all markets.

The concept of unemployment reduction through early retirement has proven out to be a bad solution, both for fiscal and for economic reasons. In addition to that, annually, only about 2 percent of the overall number of the employees retire every year (some thirty thousand in the period of 1990-2000), which means that the problem of high unemployment (over 900 000 of unemployed) cannot be solved through early retirement.

Equalizing the position of men and women, which means that the retirement criteria for men and women should be equalized both with respect to the retirement age and the years of service, as well as when determining the amount of pensions.

A compromise solution that would take into account the number of children (borne and/or raised), and that would thereby be stimulating from the standpoint of child-birth and increase of the fertility rate, should specify some kind of differentiation of the position of women, i.e. exercising of their right to retirement subject to the number of the children borne.[64] Thus it would be a combination of abolishment of a general privilege for women and adoption of a wide privilege for mothers, subject to the number of children.

Equalizing the position of men and women in the pension system should be carried out gradually, over a longer time period.

Abolishment of the preferential status of certain categories of pension insurance. So far, a significant number of insured persons were entitled to some form of accelerated retirement scheme, which has caused early retirement of insured persons in their middle years and increase of the expenditures of the pension insurance. The beneficiary (accelerated) retirement scheme should be retained only in special justified cases, i.e. only for those employees who are not practically capable of doing *any* job (for example, miner), but not for those who are no longer capable of doing *their* job. For certain categories of employees, mandatory supplementary pension insurance should be introduced, instead of the previous system of accelerated retirement scheme.

Review of the farmers' pension fund operation, which has been in great financial difficulties ever since it was established. The main problem with this pension fund is massive non-payment of the pension contributions by the farmers, despite their legal obligation. The cause is 1) belief of numerous farmers that they do not need the pension insurance because they possess the immovable property and produce their own food, confidence in traditional family ,but also due to the delays in the payment of pensions, and 2) constant absence of will and attempts of the state authorities to ensure a more

[64] *The system of measures of the policy of the fertility rate in Serbia*, Economics Institute, Belgrade, 1999

regular payment of the pension contributions, which directly stimulates further non-payment.

The new Pension Law from March 2003, introduced significant changes into the pension insurance of farmers: from now on only one household member must be insured. The future obligations of farmers towards the pension fund have been reduced, i.e. the degree of the pension system obligatoriness has been reduced, which means that some of the farmer's requests have been met. Also, the Law allows the farmers not to pay off their existing debt to the pension fund, which is large with the majority of insured farmers, under the condition that the exempted years are not calculated. This allows the farmers to start regular paying of contributions, without having paid off their arrears.

The system would have better chances of success if the government would invest the required (major) funds in the consolidation of this pension fund and provide for paying up the arrears (14 months), so that it could try, with a credible approach, to prove to the farmers that their pension fund functions and that it makes sense for them to join in, but provided that the government ensures far better collection of contributions from the farmers. The success of this program would counteract the idea of completely abolishing mandatory pension insurance of the farmers and of switching of those who wish to the voluntary insurance.

The above measures of the parametric reform of the pension system will still have a limited effect, mainly due to the unfavourable age structure. Therefore, the current way of financing requires continual parameter changes.

Voluntary private pension insurance. An important step in a long-term pension reform is the new regulation of the pension and financial system in order to enable setting up of private pension funds, based on individual savings and funded with capital.[65] In view of the fact that in this system it is probable to have a higher rate of return compared to the pay-as-you-go system, there is a probability of a positive influence on the national savings, labour supply and joining in pension insurance and that it is probable that politics would be less involved, the voluntary private funded pension insurance represents a good supplement to the existing public pay-as-you-go system.

The private pension insurance would be voluntary because such an approach imposes less complex requirements for regulation than the compulsory one. The usual incentive for insurance would be given by tax benefits. Contributions and returns to investments would be tax exempted, while the pension would be taxed through the standard personal income tax. That system actually represents a mandatory savings, whereby in the individual account the paid in contributions and returns to investments are accumulated, so that, upon retirement, pension could be paid up from the collected moneys.

In Serbia the preparations are under way for adoption of the Law on Voluntary Private Pension Insurance, funded with capital. It is necessary to resolve two main obstacles: firstly, there should be provided a serious and competent supervision over the operations of the private pension funds; and secondly, the development of this segment of pension insurance should be harmonized with the development of the financial markets, and due to the fact that private pension insurance, on the one hand, contributes to the

[65] Any fund would be liable to have sufficient capital to cover the future pension related obligations.

development of these markets and emergence of new instruments, but that it also, on the other hand, depends on the development of the financial markets.

Stimulation of working activity. Working activity of the members of the older generations that have become eligible for retirement is good not only for the preservation of their self-respect and vitality, but also for increase of their current income and avoidance of possible poverty, as well as for the financial position of the pension funds. The extension of possibilities for employment of the older generations is enabled by technological progress, which reduces the share of physically hard jobs, as well as by the improvement of health and life expectancy of the elderly persons.

The most direct way of extending the working life is increasing the retirement age limit, as already mentioned. The second option is voluntary postponement of retirement, even despite eligibility. The regulations in the area of labour relations and pension insurance go in favour of increased working activity of the elderly persons, since there is no mandatory termination of employment upon entitlement to the old-age pension. And yet, in the new Law on Pension and Disability Insurance there is an unfavourable solution: it sets forth that for the years of service over full career service one gets only half of the points for the pension definition with respect to the years of service up to the career service. Thereby deferred retirement will be significantly discouraged in favour of employment after retirement. Still, this is a step forward, since working after 40 years of service was not previously taken into account.

In view of the fact that the public pension funds have been in a long-term financial crisis, the state could, by changing the instruments of pension policy, influence the choice of the elderly workers as to the time of their retirement, i.e. stimulate them to opt for a later retirement instead of the early one and re-employment. Two suitable instruments are the pension accrual rate due to later retirement and additional pension contribution for the employed pensioners. By such a combined approach, on the one hand, postponement of retirement would be made more attractive and, on the other hand, employment after retirement would be discouraged.

Strengthening of the social protection of the elderly persons. To the elderly persons who do not receive pensions or who are not in a position to work any longer, the main support is rendered by their families. However, this is not enough, because there is an increasing number of elderly persons who live alone and do not have the support from the younger generations, and there are many persons who require care their families are not in a position to provide.

Basic direction of further development of support to elderly citizens should be deinstitutionalisation i.e., development of home help and in the local community. There are various forms of such help:

- day centres, which offer support to elderly citizens while the members of their families work,
- day rehabilitation centres, where the help is provided to the ones who were released from the hospital, but they need improvement in functional abilities;
- personal help at home, which includes feeding, personal hygiene, washing clothes and cleaning the house, transport and the like;

- medical help at home, intended for ill elderly people, etc.

These and similar forms of supplying services have two important advantages compared to having the elderly placed in an institution: the elderly prefer it this way, because they remain in their own environment and its cheaper. These programmes for the elderly can be organised at local level, through the co-operation between municipalities, civil sector and humanitarian organisations.

The two most important forms of state support to the elderly citizens are accommodation in homes for the elderly and carer’s allowance. These two programmes are of general nature, i.e. they are intended for all elderly persons, and not only for those who are poor.

In spite of the new orientation towards deinstitutionalisation, further development of accommodation institutions for the elderly is necessary. The main changes regarding the accommodation in the homes for the elderly should be the following:

- Upgraded efficiency and standardised quality of accommodation and services,

- Transformation and expansion of the network of the residential institutions (more smaller facilities), in the wide regions of the western, eastern, and southern Serbia,

- Conversion of the refugee centres into homes for the elderly, because of the particularly difficult situation of the elderly refugees ,

- Engagement of the private sector in accommodation of the elderly persons, primarily on a commercial basis.

4. Health Care towards Poverty Reduction

4.1. Present Status and Problems

4.1.1. Present Status

Socio-economic environment for health

The deterioration in health status has been a consequence of cumulative effects of a great number of critical events to which the population has been exposed during the last ten years, starting with the breakdown of the former Yugoslavia and the wars on its territory, the sanctions imposed by the international community, hyperinflation, and the NATO bombing of the FRY in 1999. Besides these effects, there has been significant aging of the population, a huge number of refugees and internally displaced persons, high pollution of the living and working environment, unemployment and social privation, as well as widespread risky lifestyles (smoking, alcoholism, drug addiction, risky sexual behaviour), particularly among adolescents and adult men.

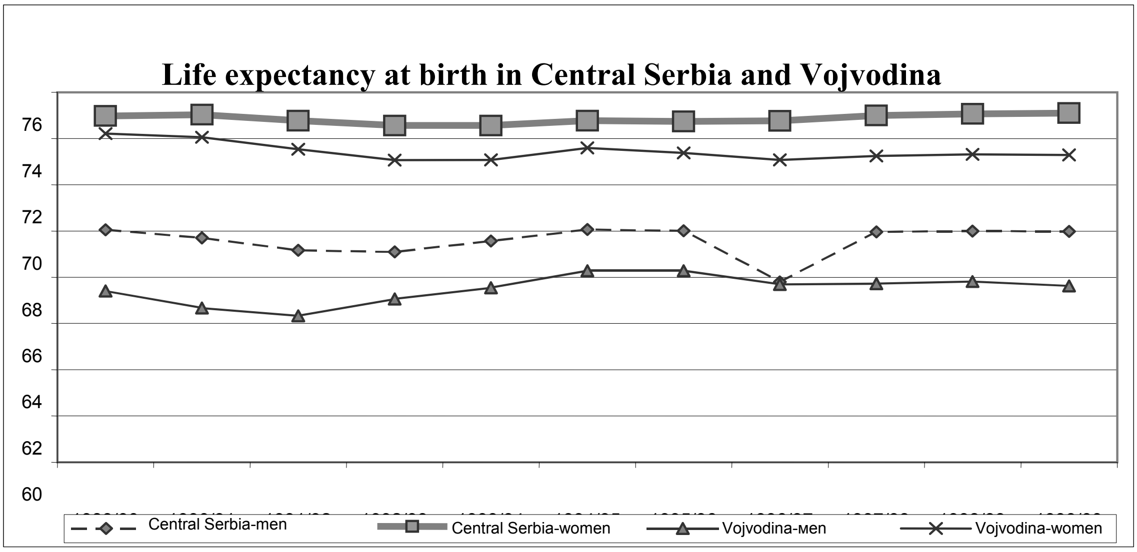
The health care system with its structural weaknesses, poor health educational outreach and health promotion, and with the insufficient attention that has been paid to health risks in the living and working environment, has not been able to meet all these challenges. Although Serbia has evaded the drastic deterioration in the health status of the population which occurred during the transition period in most Eastern European countries, all this has contributed to the widening of the gap between the health status of the population of Serbia and the population of European Union.

Basic health status indicators

In 1999/2000 life expectancy at birth was 75.16 years for females in Central Serbia and almost two years less in Vojvodina (73.46); the corresponding figures for men were 69.93 years in Central Serbia and over 2 years less in Vojvodina (67.86 years). As a comparison, life expectancy at birth in the European Union is 75.4 for men and 81.6 for women. In the period 1990/91 through 2000/01 the values of this indicator for male and female newborns in Central Serbia remained practically unchanged, while life expectancy increased in Vojvodina by almost a year for males and reduced by a year for females.

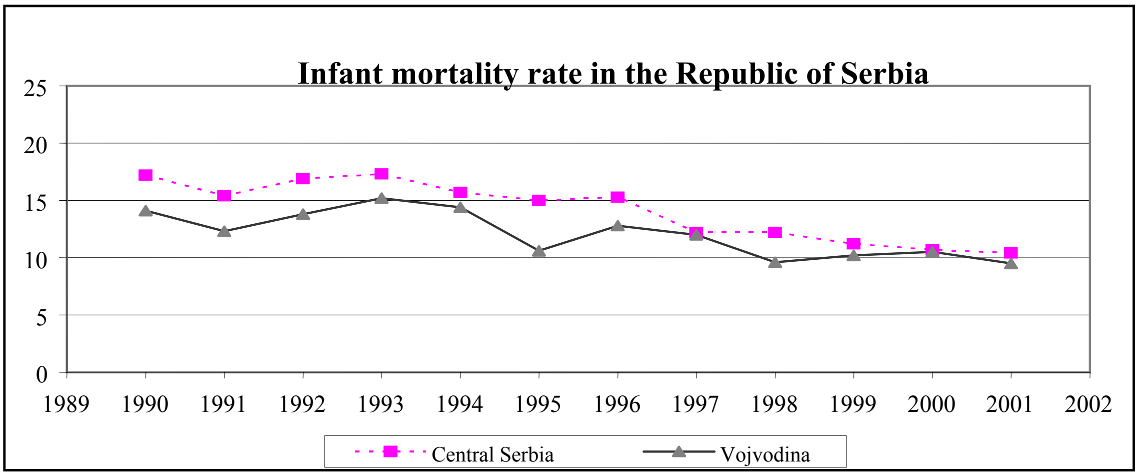
An analysis of the linear trend of life expectancy at birth in the ten-year period (1990 – 1999) shows one critical period in which the values of this indicator declined, 1992/93 and another somewhat less sharp in 1996/97 (Chart 1). The difference between the municipality with the highest value of this indicator for both genders (Sjenica, 77.65) and the municipality with the lowest value of in the indicators for both genders (Aleksinac, 65.94) in central Serbia is 11.71 years, whereas in Vojvodina the equivalent figure is half that at 5.60 (Sremski Karlovci, 72.57 and Nova Crnja, 65.97).

Chart 1: Life expectancy at birth in Central Serbia and Vojvodina



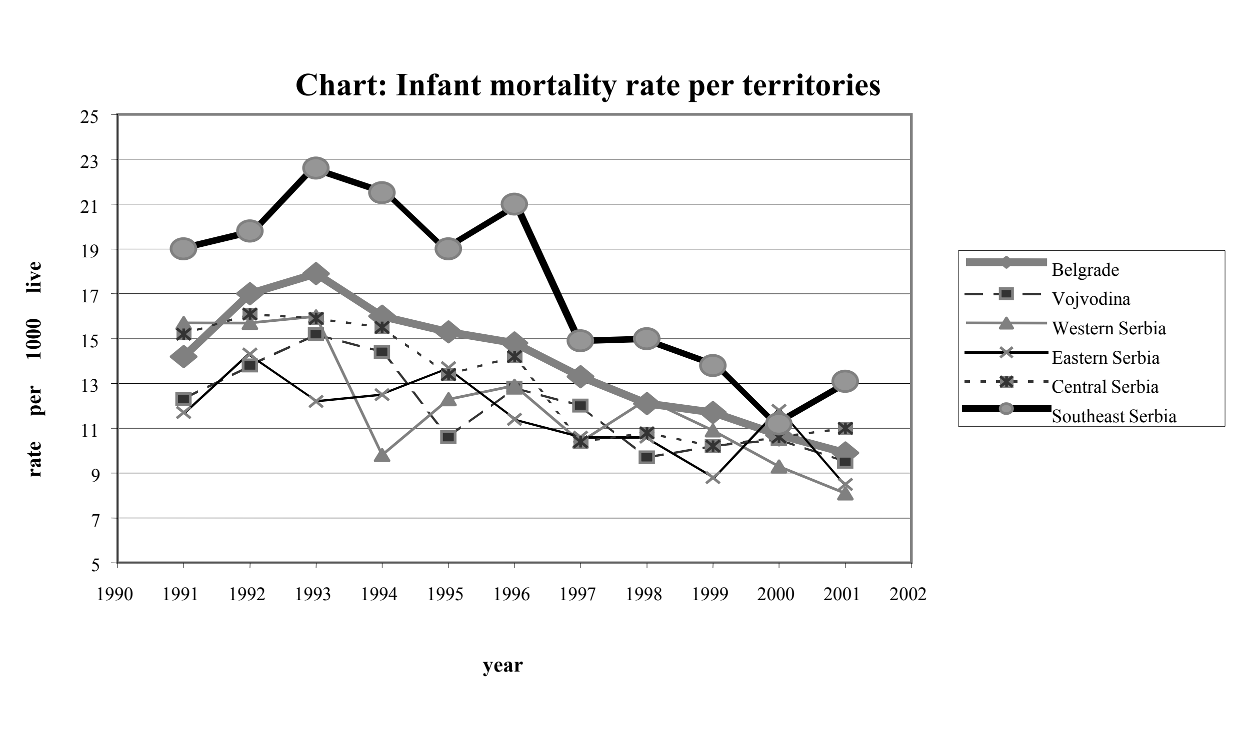
After a continuous decline in the seventies and eighties, in 1992 infant mortality started rising and in 1993 the infant mortality rate in Central Serbia and Vojvodina was higher by two infant deaths per 1000 live births. After a short decline, in 1996 it rose again (Chart 2). Despite the declining trend in the period between 1989 and 2001, the average rate still remains twice as high as the average in the European Union countries, which is 4.8 newborn deaths per 1,000 life births. In the mortality structure of the newborns neonatal mortality is predominant (from birth till the 27th day of life). It amounts to 72.2%, i.e. 59% of the newborns died during the first week of life. However, 27.8% newborns who died in the post neonatal period (from the age of one month to one year) show that there is still a great significance of the environment to the mortality of newborns.

Chart 2: Infant mortality rate in the Republic of Serbia



An analysis of the infant mortality rate by region shows differences in the values of this indicator. Observing the period 1991-2001, we can see that the absolute difference in the infant mortality rates decreased (mainly because of the drop in the rate) but the relative differences remained. There was the same rate ratio in the territories with the highest and the lowest infant mortality rates in 2001 (Chart 3).

Chart 3: Infant mortality rate by territories



In the ten-year period the average maternal mortality rate in the territory of Central Serbia was 14 maternal deaths per 100 000 live births, while the average value of this indicator in Vojvodina was 9, with significant variations from year to year because of the low probability of the occurrence of this event (see Chart 4 in the Annex).

The analysis shows that the structure of the causes of death in the ten-year period remained practically unchanged. In 2000 more than half of the population died from cardiovascular diseases (56.7% in Central Serbia, 58.4% in Vojvodina); malign diseases are in second place (17.1% in Central Serbia, 17.6% in Vojvodina), insufficiently defined illnesses and conditions are in third place (symptoms, signs, pathological clinical and laboratory findings), and injuries, traumas and consequences of the influence of external factors are in fourth place. Chronic widespread non-contagious diseases (heart diseases, vascular diseases, malignant tumours, diabetes, obstructive lung disease, injuries, mental health disorders and other diseases) have been dominating the national pathology for years. Just two groups, cardiovascular diseases and malignant tumours, account for over two thirds of all causes of death.

The high percentage of cardiovascular and malign diseases in the structure of the causes of death indicates a prevalence of behavioural risk factors (smoking, alcoholism, inadequate diet, insufficient physical activity) and external environmental factors (air, food and water pollution). Insufficiently defined illnesses and conditions are in third place due to unreliable and improper reporting on the causes of death throughout the territory of the whole Republic, and the external factors, which take the fourth place in the structure of the causes of death, indicate inadequate protection at work, in traffic or at home.

Communicable and parasitic diseases do not represent a major health problem in Serbia, but they still occur sporadically or epidemically. For the territory of Republic of Serbia without Kosovo and Metohija the rate of incidence of these diseases was 1200.3 newly-registered cases per 100,000 inhabitants. During the same year 101 person died from the consequences of acute contagious diseases, with the mortality rate of 1.3 per 100,000 inhabitants, which is lowest in the last five years. The decline in the rate of people who were affected by or died from contagious diseases is the result of the decrease in the number of people affected by intestinal contagious diseases and sexually transmitted diseases.

Among communicable diseases HIV/AIDS and tuberculosis, in particular, deserve special attention. The occurrence of new cases of AIDS has stabilised during the last few years with 5 to 9 newly affected per million inhabitants. According to the latest data available on 1st December 2002 there were 1,189 cumulatively registered cases, out of which 80% were in Belgrade. There is no reliable estimate of the number of the HIV positive, but the WHO estimates that there are about 10,000 HIV positive, which is more than in other ex-Yugoslav republics and surrounding countries, apart from Rumania. We should mention that there is a tendency for a rise in HIV infection risk factors such as drug abuse, risky sexual behaviour, migration, and social and economic instability. The number of people affected by tuberculosis with an incidence of 37.2 per 100,000 inhabitants has slightly increased compared to the previous years.

- *Over 90% of the young report having tried various kinds of drugs, while 11.1% have used marijuana more than three times.*
- *34.5% of the young aged 15-25 are habitual smokers, while 18.5% smoke occasionally.*
- *Among the sexually active young, aged 15 through 19 yrs, 43% of girls and 20% of young men never use protection, while 51% of sexually active university students do not use a condom regularly.*
- *40% of young women aged 15 through 24 report having been pregnant at least once; one out of five had one or more abortions, and only 40% of the young women visited a gynecologist.*
- *One out of four adolescents reports not having proper information on HIV/AIDS.*[1]

Some population groups are more sensitive than others to socio-economic living conditions. They are normally referred to as vulnerable population groups. According to the existing legal regulations and the latest data available, identified vulnerable groups and marginalized persons make up a considerable proportion of the population of Serbia (Table 1).

It is normally considered that poverty and marginalization account for the specific pathology of such population groups and individuals. However, contrary to popular opinion, the research data show that there are no special poverty-caused diseases. It has been demonstrated that vulnerable and marginalized population groups are more likely to become ill and die from the usual causes, including tuberculosis, AIDS, malign diseases, traffic accidents, violence, etc. We have no data of the routine health statistics on morbidity according to socio-economic status.

The Survey on the Living Standard of the Population (SLSP) has shown that among the persons below the poverty line there are 30.3% of those with a diagnosed chronic disease, while this percentage is 26.6% among those who are above the poverty line. The percentage of persons declaring a mental health disorder as their most acute health

[66] Source: Brave New Generations – Young in FRY, UNICEF, 2002, PRONI, Youth Study

problem is significantly higher among persons who are below the poverty line than among other population (18.9% versus only 9.4%).

Table 1. Some groups of diseases in Serbia(Central Serbia and Vojvodina)

Groups	No. of persons	population	Data source
Affected HIV/AIDS	1,198 AIDS	0.02%	Federal register of the AIDS affected
Tuberculosis	7,065	0.09%	Health care statistics
Chronic renal insufficiency	15,000	0.20%	Health care statistics
Diabetes	200,000	2.67%	Health care statistics
	28,117	0.37%	Health care statistics
lation	7,498,001		Final census results

Inherited infrastructure and medical staff structure in the Health Care System

A well-developed network of 275 independent health institutions (with legal entity status) was providing health care for the population within the state health sector in 2000.

The coverage of the population with medical staff is on the level of the developed European countries, with 390 inhabitants per medical doctor, 140 inhabitants per health worker with higher and secondary professional education, 2250 inhabitants per dentist, and 5760 inhabitants per pharmacist. While the coverage of the population with medical doctors and medical staff with secondary education remained practically the same during the last decade of the 20th century, the coverage with dentists and pharmacists in the state sector declined because many of them have gone over into the private sector. Considering the low national income, there is a surplus of the employed in the health sector, and serious problems are encountered in ensuring funds for their salaries and for covering other costs of such a developed health service.

The average number of inhabitants per medical doctor in primary health care is 621, ranging from 770 children under 6 years per medical doctor in the preschool child health service to 5390 women over 15 years of age per gynaecologist in the female health care services.

During the last ten years there has been a policy of preserving all the capacities and the employees in the health care system in Serbia as well as the legal rights of the insured. As the socio-economic situation dramatically deteriorated, the health care system spontaneously adjusted itself to these changes, but sustained significant deterioration of its fixed assets (buildings and equipment), a drastic fall in the quality of medical services, a decrease in their utilization, lack of medicines and medical material, bribery and corruption, transfer of patients and a part of equipment from the state to the private health sector, resulting in deteriorated accessibility of health services especially to the poor.

Utilization indicators

The utilization of health services in primary health care varies, from more than 6 visits by a preschool child up to less than one visit by women over 15 years of age to a doctor of a corresponding health service per year, visits for curative services prevailing over prevention services, which include visits to counselling centres or early detection of growth and development disorders with children (regular systematic check-ups).

Inadequate adjustment of the structure of hospital beds to the changed needs of the population is also reflected in the differences shown in their utilization. Decreased utilization of beds (below 60% days per year) is marked in the wards for treatment of infectious and parasitic diseases, respiratory diseases, hospital treatment of children, gynaecological and obstetrical wards, ophthalmological, otorhinolaryngological and dermatological facilities. At the same time there is a shortage of beds for extended treatment and care of elderly, patients in terminal phases of their illness, or in specific institutions such as nursing homes. Also, due to the changed pathology of the population in the 20-year period, the number of patients hospitalised for cardiovascular diseases and endocrine disorders has increased by about 50%, because of problems with the nervous system and senses by about 35% and malign diseases by about 25%, and there are insufficient bed capacities for the treatment of such patients. Most of the capacities of the tertiary level facilities are above-averagely overloaded, and long waiting lists have been formed for those in which expensive imported materials are used, such as heart surgery facilities.

Funding of health care and the health insurance system

The most important source of health care financing in Serbia is the institution of the compulsory health care insurance, through the Republic Health Insurance Office of Serbia. Additional sources of funding are, primarily the budget of the Republic of Serbia and the individual participation of the insured in covering the costs of health care services. Funds for the health care of the insured persons are provided from the Republic Health Insurance Fund, while funds for the health care of the uninsured citizens, health promotion, prevention of illnesses, special programmes and health protection measures for the whole population are provided from the Republic budget. The expenditures on health care per capita in the Republic of Serbia ranged from USD 121 in 1996 to USD 74 in 2001, including refugees and internally displaced persons, and USD 81 in 2001 and USD 103 in 2002 without refugees and internally displaced persons (See Table B4 in the Annex).

Marked lack of funds has resulted in low salaries of medical workers, poor investment in the infrastructure and equipment of medical facilities and a large deficit in the Insurance Fund, created by health-care costs. All this has jeopardized accessibility, the basic principle of the health care of the population. The Survey on the Living Standard of the Population (SLSP) has shown that there is a significantly higher number of persons who are below the poverty line who say that the reason why they do not use health services is that these are expensive. As most of the income is spent on food, the poor can spare only minimum funds for additional payment for health services (10% of the poorest families allocate only 290 dinars or 3.3% for these purposes). The contents and the scope of the right to the health care, funded from the Health Insurance Fund, included nearly all health services. A great imbalance occurred between the rights to health care and the limited funds for meeting these rights but also the possibility of realizing such rights by the socially vulnerable groups.

4.1.2. Problems and constraints

Routine data on health status and on the utilization of the health services according to socio-economic status are not monitored in Serbia. Therefore, it is not possible to analyse health trends according to social status and health differences among different social groups. This makes it difficult to set and quantify targets for the improvement of health status and the reduction of differences in the health status of different social groups.

The existing data on the flow of the funds in the health sector are superficial and mainly focused on social expenditure. The flow of funds from the Health Insurance Fund to the providers of services is mostly well-documented, but information on expenditures for health care from the budget is incomplete and there is no reliable information on the out-of-pocket payments, and particularly on the informal fund flows (bribery, corruption, direct payments, etc.). Smaller funds, such as expenditures of private companies, NGOs and foreign agencies are not recorded at all.

4.2. Goals and strategic options

4.2.1. Goals

The aim of the poverty reduction strategy in the health sector is to promote the health of the population and, particularly, to reduce inequalities in health by the improvement of the health of vulnerable groups of the population. This objective will be achieved by the development of health programmes adjusted to the vulnerable groups and fairer redistribution of resources in the health sector by geographic region.

In late 2000, the United Nations set the Millennium Development Goals, as an expression of the political dedication of nations to widely accepted international developmental objectives that could be used to direct countries towards their own long-term developmental priorities. Out of the eight Millennium Development Goals, four relate directly to improvement of the health status of the population by the reduction of the under 5 mortality rate, reduction of the rate of maternal mortality and the prevention of the spread of HIV/AIDS, malaria and other diseases, as well as by providing a sustainable environment, while others are indirectly related to achieving better health and quality of life.

In 1998, the WHO Regional Office for Europe proposed a political framework "Health for All" on this continent with 21 objectives for the 21st century to be reached by 2020. The document highlights the importance of achieving fairness in health by reducing differences between socio-economic groups within the member countries by at least one quarter, and by significant improvement of the level of health of all vulnerable groups.

In the Government document entitled "Health Policy of Serbia" objective no. 2 also accentuates the importance of fair and uniform access to health care for all citizens of Serbia for the same needs, as well as the promotion of health care for all vulnerable groups. The aims within this objective relate to definitions of national targets for the reduction of inequality in health and the promotion of health care of disadvantaged groups of the population, which makes them particularly vulnerable. The third objective of the Health Policy proposes focusing the health care system on the beneficiary, i.e. the patient, which should contribute to better education of the population on their rights and their more active participation in decisions on health care issues.

The future system will enable equal accessibility of primary health care services and scope of health care for all insured citizens where the financial basis for these services will be provided by the Republic Health Insurance Fund. Financing of the basic package will be provided from the national budget for all other citizens, regardless of their social and economic status.

Providing financially accessible health care services for vulnerable groups

The basic principle in the reform of the health care system is to provide access to necessary services of appropriate quality to the population at large, with no financial barriers. Health care services for the basic package will be selected on the basis of cost effectiveness to reduce the country's burden of disease, while the primary health care funded by the Republic Health Insurance Fund will be accessible and provided in an effective manner. The principle of reciprocity and solidarity in financing and providing health care will be preserved, where the mandatory health insurance will be the basis of the health care system. Budgetary share will be increased to cover the health care of uninsured individuals, while the sources of financing will be expanded by the development of additional forms of insurance, either non-profit or profit (private). Personal participation of people with insurance in the costs of health services will be reconsidered, and current exceptions which are very wide ranging will be reduced and focused exclusively on the people who really cannot participate in the expenses. Likewise for participation in the costs of expensive diagnostic and therapeutic procedures, which will reduce bribery and corruption in public health care.

Raising efficacy and effectiveness in resource utilization

In the light of limited resources available for health care, efficacy and effectiveness in utilization of resources need to be improved. This objective can be achieved by better distribution of resources effected in the reform of primary, secondary and tertiary health care, development of health IT systems and improvement of managerial functions. The Serbian Health Policy points out that " primary health care as the basis of the health care system" will be based on individual doctors in primary health care and their teams who will be the "gate keepers" for entry to the higher levels of health care, while hospital capacities will be restructured according to the needs of the population, by redistribution of hospitals and/or hospital wards into hospitals for short-term hospitalization (for acute diseases and conditions), prolonged care and treatment (including patients in terminal stages of diseases), hospitalization of chronic diseases and conditions and specialized rehabilitation and continuation of hospital treatment.

Improving the quality of health care services for vulnerable groups

The Government of the Republic of Serbia in the objectives of the Serbian Health Policy includes the need for improvement of the quality of health care provided, particularly for the vulnerable population. Socially disadvantaged persons frequently receive health care services of poorer quality than the rest of the population. Permanent improvement of the quality of work in the health care sector will be achieved by the development of the quality system, accreditation of health institutions and programmes, licensing (issuing and renewal of work licences) of medical professionals and strengthening of the role of professional associations of health workers (chambers) in the improvement and provision of high quality health services. Secondary medical schools and faculties will be included in continuing education, additional education and re-education of medical professionals, and will participate in their professional development. Special care will be paid to the acquisition of new knowledge and skills in the sphere of constant improvement of quality in health care, dealing with the quality and management of health care institutions.

4.2.2. Strategic options, measures and activities

Reform of the funding system – basic package of health services

The current system of health care is characterized by major disproportion between the formal rights of beneficiaries and the capacities to actually provide them. This results in the occurrence of corruption and different forms of informal modes of payment for the use of health care that particularly affect socially and economically disadvantaged groups. Therefore, it is necessary to design system solutions that precisely define the status of private practice, as well as the public sector role in the provision of health care services to the population.

In order to provide for a sustainable basic package of health care services, systematic review and evaluation of the current health services will be undertaken, including those that may be included in the package of services of mandatory health insurance. In this way, the relevance of health services from the point of view of actual health will be evaluated together with the cost effectiveness of these services and other benefits resulting from evidence-based medical interventions, and information will be provided for decisions on the review of the existing land the adoption of new legislation.

Defining the basic package will include the following considerations: who is going to provide these services, at what level of health care and under what conditions. The basic package of health care services should be formulated having in mind two vulnerable groups: those that pay health insurance contributions (but belong to the group of the poor) and the poor who are not even socially insured. Since the funds for the health care of uninsured individuals, internally displaced persons and refugees have been insufficient over the whole of the last decade, the Government of the Republic of Serbia has recognized this problem and in 2003 it has increased funds from the republic budget allocated to this purpose.

Better distribution of resources (by health care levels and districts)

It is not sufficient to identify basic diseases responsible for the national burden of diseases; it is equally important to find the most cost-effective means of protection from these diseases. Very often, interventions such as early detection and treatment of these diseases in primary health care appear to be an obvious choice, but preventive, public health interventions over longer periods of time may also be profitable. Prevention and primary health care will be given top priority in the future health care system. The funding by the Republican Health Insurance Office will support implementation of this principle by the basic package of health services, while in primary health care the package will include the most important preventive measures such as alternative protection, immunization programmes, programmes for the protection of newborns, infants and children, etc. The preventive services will be formulated and promoted by the setting up of task forces in preventive health care and guidelines for providing these services to the population, as well as guidelines for good clinical practice in defining the role of preventive health care services.[67]

Sustainable funding of the health care system will be achieved by the establishment of a fairer distribution of health insurance funds. Activities on the review of the geographic distribution of funds for Belgrade and districts will be supported. In the light of the accessibility, availability, fairness, efficacy and quality of the required health care the distribution criteria will be established, and the distribution system elaborated in order to enable redistribution of available resources from the higher to the lower level of care.

Financing of public health services is an important part of funding of the overall health care system that will help to establish public health priorities relating to health promotion, prevention and treatment of disease and early detection, particularly of malignant and cardiovascular diseases. Public health includes community oriented programmes and activities that will either be beneficial to all (e.g. clean air and safe water) or only to some (screening programmes and counselling services for change of risky behaviour). In order to develop and implement mechanisms for the control of health related costs and provide the means for money to follow the patient and actual results, instead of the number of employees or modern equipment, a new model of payment of compensation to service providers for their work on a per capita basis will be introduced (capitation) (pursuant to the list of patients subscribed for treatment of one physician) in the primary care and prospective budgeting for hospitals, while tertiary care would be paid by the service.

Reform of Primary Health Care and Restructuring of Hospitals

The guiding principle of the future system of health care stated in *Vision of the health care system of the Republic of Serbia* points out that the «health care system will be clearly organized on three functional levels in order to provide an acceptable and efficient health care of the population whereby it will be provided at the lowest possible level which has sufficient expertise and equipment».

Certain parts of primary health care fall under the new jurisdictions of local governments and are transferred to them by the new Law on Local Self–Government. Transfer of competences includes the opportunity to participate in decision-making related to the management of health institutions, formulation of local health care programmes accounting for local specificities, as well as the option to transfer funds for implementation of programmes and projects in primary health care. At the level of

[67] The Ministry of Health has supported the project of the International Red Cross Committee «Package of Basic Health Care Services in the Medical Centre in Kraljevo» which was initiated in July 2001 and deals with the planning, development, and operationalization of a unique package of basic health care services to satisfy the needs of the population of one municipality for primary health care, with the stress on the most vulnerable groups. After completion of the project and its evaluation, it is expected to develop and spread further with the support of the Ministry of Health.

primary health care, specialist consulting services will be rationalised. At the same time the role of general practitioners and nurses will be encouraged and strengthened, primarily by adequate post graduate education, and subsequently by the introduction of new methods of funding.

The new Law on concession opens the possibility of the inclusion of the private sector in the system in which the state and local self-government will set the standards and monitor the quality of work.

Adoption of accreditation and licnsing

For the purpose of implementation of the instruments for control of expenses and the quality of the health care services, professional bodies for licensing of health workers and bodies for accreditation of health care institutions will be established. As far as issuing of operating licences is concerned, it is necessary to change the present method of licensing of health workers together with the doctors' and nurses' chambers. Licensing should develop into a system in which compulsory and continuous medical education will represent an integral part of licence renewal. Accreditation of health care institutions and health care programmes represents an important prerequisite for raising the level of the quality of services in health care. In order to establish the accreditation system it is necessary to set up the agency for accreditation as an independent body. Among the activities that should be undertaken for the purpose of implementation of the health care policy of Serbia which is related to the improvement of the professional staff base in health care (human resource for health) are the licensing and periodic assessment of professional competence.

Development of national programmes for extremely vulnerable groups

Recommendations of experts of the European Health Care Committee for protection and improvement of health care of marginalized individuals propose an inter-sectoral approach, preventive actions, and the creation of a supportive environment for social reintegration, avoidance of stigmatisation and increase of knowledge.

The Government document "Health Policy of Serbia" stresses the importance of the health care system in the preservation and improvement of health as well as in the prevention of diseases among the disadvantaged population groups. It pinpoints as the most significant activities the following ones:

Identification of special medical requirements of those groups as well as their relation to social needs and adoption of programmes for synchronized action at all levels of the community;

Liaising of the primary health care institutions – health centres, with the social welfare institutions – social welfare centres, and development of multidisciplinary, team work;

Liaising of the primary health care institutions – health centres, with educational and other institutions.

The measures for protection of such groups should be integrated into the regular health care services. It is necessary that the programmes aimed at improvement of the health status of the population and strengthening of the health potential of the nation reach persons who are in a deprived position. Disadvantaged individuals are often insufficiently informed. It is important to improve information to those groups with regard to existing programmes and services and possibilities of their use.

Raising accessibility, quality and efficiency of youth-oriented services

- Initiate and support foundation of Youth Counselling that would foster a holistic approach and be open for all relevant issues that could advance the quality of life of the young.

- Organize service providers and programmes that would support programmes of youth to the youth

- Open the doors of Counselling for parents and adults

- Organize actions promoting health, responsibility and healthy life styles

The programmes should be planned with the active participation of target groups in order to ensure their acceptance. Apart from the programmes planned at the national level, it is necessary for local communities to engage in planning of programmes that would be tailored to local specificities.

The Government of the Republic of Serbia t has established the Republic commission for the fight against AIDS on the basis of a multi sectorial partnership. The main task of this body is to develop an adequate state response to the HIV/AIDS epidemic, at all levels, to set a strategy and action plan, to co-ordinate the existing ones and new initiatives and projects on the Republic territory.
According to the experiences of other countries, there is no prospect of stopping the epidemic, but it can be stabilised with good preventive measures. The severity of the illness can be reduced with well organised treatment, care and support to the HIV positive and AIDS affected persons. The Republic commission has started implementation of the project funded by Global fund of WHO.
The Ministry of Health has formed the National tuberculosis commission which applied to the Global Fund of WHO for the project of direct monitoring of the tuberculosis affected – DOTS (Directly Observed Treatment – Short course), which improves the successful and permanent recovery of affected people and reduces the resistance to tuberculostatics.

Particular attention should be paid to programmes for the improvement of mental health because, according to international experience, as well as according to the data obtained from the Survey on the Living Standard of the Population, mental health problems are often present among persons living in unfavourable socio-economic conditions, poverty, and exclusion.

Persons from vulnerable groups are often reluctant to approach state institutions, including the health care services, which on their part are often insufficiently prepared to identify the needs of those groups and to meet them. NGOs have a significant role in the working out and implementation of programmes for disadvantaged individuals and in compensation for social inequalities in the health sector. NGOs have the capacities to create programmes tailored to particular situations of socially deprived groups in terms of content (they propose feasible measures), language (mother tongue, everyday language), organizational framework (outreach programmes), cultural sensitisation, activation of the target population (by including members of a group as trainers or facilitators in the programme), all of which has a positive influence on attitudes to health.

Introduction of Health Information System (Suited to Monitor the Influence of Transition on the Poor and Vulnerable Groups)

In the recommendations issued by the Council of Europe, it has been stressed that governments should particularly focus on improvements in information on the health of people who live in poor conditions and their specific health needs. The need for regular, routine collection of standardized, comparable data based on common definitions has been recognized. The data recorded on a regular basis should include social and economic characteristics of monitored individuals in order to enable analyses of morbidity, mortality and utilization of health care services according to the socio-economic status of citizens. Along these lines, it is also important to change the way in which the data are collected and set up regularly updated public databases. It is also important to emphasise the need for co-operation between the health care sector with other institutions responsible for collection of data in order to include issues relating to health and payment for health care services in surveys based on sample households.

In order to avoid discrimination and provide protection, anonymity of patients has to be strictly respected, i.e. confidentiality has to be provided for information on the health status of beneficiaries in the databases or medical records.

Institutional and legislative changes required

Amendments to the laws and by-law and regulations are currently being drafted in order to support all the above-mentioned goals and strategic options. The achievement of these goals requires a change in laws in the health system such as the Health Care Law, Health Insurance Law, Law on Medications and Medical Substances, as well as co-ordination with other sectors in order to modify laws concerning environmental protection, protection at work, workers' health and others.

5. Education and poverty

5.1. Current status and problems

5.1.1. Current status

Low and inadequate levels of education have been identified as one of the main causes of poverty in Serbia. The link between education and poverty and the importance of education for the reduction of poverty, is best demonstrated in the following table. According to the Survey on the Living Standard of the Population (SLSP) the majority of the poor (over 60%) only have primary school education or are primary school drop-outs, while only 2% of the poor are highly educated.

Table 1. - Poverty in relation to education level in Serbia in 2002.

population over 15 years of age -

	% Population at risk of falling below the poverty line	% of the poor	Relative poverty risk	Structure of all Population over 15	Structure of the poor	Depth of poverty	Severity of poverty
Unfinished primary school	36.1%	21.5%	102.5%	17.5%	35.4%	5.1%	1.8%
Primary school	25.4%	14.3%	33.9%	23.3%	31.2%	3.1%	1.0%
Secondary school	15.1%	6.9%	-35.1%	47.5%	30.8%	1.2%	0.3%
College	7.8%	2.9%	-72.8%	5.1%	1.4%	0.4%	0.1%
University deg.	5.6%	2.0%	-81.4%	6.6%	1.2%	0.4%	0.1%
Total	20.0%	10.6%	-	100%	100%	2.2%	0.8%

Source: SLSP 2002.

The results of analyses carried out demonstrate that the economic status of education in general in Serbia is unfavourable. This is primarily a consequence of the situation deriving from the 1990s, when the country suffered a drastic fall in GDP. In 2000, compared to 1990, the GDP of the formal sector, calculated in USD[68], was 70% lower.. This fall in GDP had the following consequences:

- A reduction of total expenditures for education by 74.5% – from USD 585 per primary school pupil in 1990, to USD 144 in 2000, from USD 832 to USD 179 per secondary school pupil and from USD 1581 to USD 333 per student in post-secondary and university education;

- A reduction of the share of education expenditure in the GDP from 3.62% in 1990 to 3.14% in 2000.

Today, Serbia's system of education funding is to a great extent centralized. The budget share in total revenues of the education sector was 72.4% in 2001, which covers the gross salaries of those employed in the education sector. Direct contributions by the

[68] The World Bank methodology was applied in the calculation. Source: Federal Statistics Office.

population accounted for 9.3% of the total revenues of the education sector, while donor funding accounted for 5.2% in 2001.

The low level of expenditures for education has a negative impact on the accessibility of education for poor children, on the non-compulsory levels of education (after primary) and on the quality of education. Municipalities with below-average GDP cannot provide even the legally prescribed obligatory share of funds for education.

The education sector includes pre-school, primary, secondary and university education.

Statistical data on primary and secondary education are contained in Table 2.

Table 2. - Source: Statistics of primary and secondary education 2001. (Ministry of Education of Serbia)

	Primary schools	Secondary schools
Number of educational institutions (including detached classes)	3,607	475
Number of students	711,954	323,490
Number of teachers	43,767	24,694
Number of staff associates	1,858	1,171
Student/teacher ratio	16.2	13.2

The legal basis of the educational system in the Republic of Serbia

Serbian educational policy is in accordance with the United Nations Convention on the Right of the Child which guarantees the right to education of all children, in accordance with Millennium Goal no. 2 – Achieve universal primary education.

The legal basis of the education system in the Republic of Serbia includes: the Constitution of the Republic of Serbia, the System Law on Education, the Child Protection Act, the Law on Primary Schools, the Law on Secondary Education, the Law on Post-Secondary Schools and the Law on University Education. The Federal and Republic constitutions lay down the basic principles on which the education system in the Republic of Serbia is based. They guarantee equal access to education for all citizens. Primary education is compulsory. Citizens do not pay for regular schooling, which is financed from public revenues. Members of national minorities are entitled to education in their own language at all levels.

Current legislation represents a step towards decentralisation, democratisation and depoliticisation of the education system. Although the first step has been taken towards democratisation of the education system (e.g. the establishment of school board), it is necessary to take measures aimed at further strengthening of the capacities of these bodies by giving greater authority to parents and teachers in the decision-making process.

Lower education

Enrolment and coverage

The total preschool education coverage rate for children aged 0 to 7 years is approximately 22%. This figure applies to children enrolled in public preschool facilities.

Data on the enrolment of children in private preschool facilities and various informal preschool programmes is not available and is not monitored. The highest preschool enrolment rate is recorded in Vojvodina, and estimated at 90%. The enrolment of children aged 0 to 3 is generally low throughout the country.

The official enrolment rate in primary schools in 2000/2001 was 98.31%, and the dropout rate was 0.62. However, as official statistics do not follow up pupils by cohorts, it is estimated that the dropout rate during primary school is about 15%. Dropping out is most frequent among the rural population, Roma, children with special needs and refugees and internally displaced persons. 7.46% of children do not continue their education after primary school. According to official statistics, the secondary education enrolment rate is 79.6%, with a total drop-out rate of 6.91%. Other research shows that some 30% of students enrolled in secondary schools do not complete their secondary education.

Even though the statistical variation in terms of boys and girls enrolled is insignificant, the drop-out rate for girls from the most vulnerable populations (the Roma, children with special needs, the rural population), is significantly higher (20-80%).

The reform of primary education is under way, and one of its main directions is curriculum revision and the extension of the duration of education. The need for this reform, among other things, has occurred as a consequence of the fact that under the old curriculum a large number of children needed private tuition (17.7% of students had private tutors) which had a discriminatory effect on poor families. The implementation of this reform will bring the system of primary education closer to European standards, and at the same time curriculum modifications will result in lowering the drop-out rate resulting from the previous demanding curriculum.

The existing network and equipment of educational institutions

The existing network of educational institutions dates back to the 1960s, and no longer corresponds to demographic and educational needs. The main problems can be summarised as follows:

- pre-school institutions are organized as very large institutions, which limits their flexibility and their ability to adjust to local needs;
- the network of primary schools includes large schools on the one hand and small village schools on the other, which encounter completely different problems;
- the structure and focus of secondary education are completely inadequate for the needs of a modern economy;
- the network of pupils' and students' boarding facilities does not provide sufficient accommodation.

The condition of buildings and their equipment is still very poor, even though there has been much investment in reconstruction, construction and equipment of educational institutions during the last two years.

Post-secondary and university education

The system of higher education includes the curricula of post-secondary schools as well as university education which leads to BA, MA and PhD degrees. There are 6 universities in the Republic of Serbia encompassing a total of 81 faculties and 158,525 students. There are 50 post-secondary schools with a total of 50,740 students. The traditionally highly respected professions (doctors, lawyers, economists, etc.) are oversupplied. In addition, the data show that current curricula do not satisfy the needs of modern society and the new market economy. The high percentage of dropouts and the fact that many students prolong their studies show that the general efficiency of the system is far from satisfactory.

6.1.2. Education of children from marginalized social groups

Education of children with special needs

Children with special needs requiring long-term assistance due to irreversible disability account for approximately 7%-10% of the total student body. The majority of children with special needs are usually not covered by rehabilitation programmes until their enrolment to primary education,

Pre-school education is organised in three forms:

1. special pre-school groups in special schools;
2. special development groups in regular pre-school institutions;
3. pre-school education undertaken together with other children in the same pre-school group, without a special programme.

Only 1% of pre-school children with special needs are covered by early childhood education and other preparatory programmes, whereas 22% of pre-school children in the general population are included in this form of education.

The current education system for children with special needs is organised in three basic forms:

1. special schools for children with mental, physical and sensory disorders and children with behavioural disorders (some 15% of children with special needs are enrolled in special schools);
2. special classes in regular schools;
3. classes in regular schools where children with special needs of all categories are educated together with other children, without special support.

There are 85 special schools in Serbia, of which 5 are in the territory of Kosovo. Excluding Kosovo, the capacity of these institutions is 8,829 students. 61 schools are for mentally challenged children. In terms of organization and space, primary and secondary schools are normally located together. In 8 students' residences serving schools for children with visual and hearing disabilities, accommodation is provided for 480 students. The available data show that special schools do not fulfil their basic functions.

They isolate children with special needs and do not prepare children for inclusion in regular life.

Table 3. – Number of students in special schools in Serbia, for the school year 2000/2001

	Total number of students	Boys	%	Girls	%
Primary	7,560	4,488	59.37	3,072	40.63
Secondary	1,269	806	63.51	463	36.49
	8,829	5,294	59.96	3,535	40.04

The network of special schools and special classes in mainstream schools is not evenly distributed across the regions of Serbia. These schools are located in major cities so that rural children and children from small towns are separated from their families and placed in boarding facilities which are most often located with special schools.

There are several problems related to the education of children with special needs:

- There is no unified data concerning persons with special needs;
- Only 30% of children with special needs who have completed primary school continue their education, in comparison to 79% of the total population.

Education of Roma

The lack of data not only on the educational status of the Roma population but also on the number of Romas in Serbia is the main obstacle to carrying out a precise analysis of the current state of education among the Roma population. Data quoted are often estimates and are not based on sound statistical information.

According to the 1991 census, the educational structure of the Roma population over 15 years of age was as follows: 78.7% had not completed primary school, 34.8% had no education or had completed fewer than four grades of primary school (these can be considered as illiterate), 17% have primary school, 4% have secondary school, and 0.2% have post-secondary school or university education. The 2002 census data show that 62% had not completed primary school, 32% had no education or less than 4 grades of primary school, 29% had completed primary school, 7.8% had completed secondary school and 0.3% had post-secondary or university education.

The illiterate and the uneducated are mostly women because they marry young and are oriented towards housekeeping duties in their primary and secondary families. Poor families with numerous children cannot provide financial support for the education of their children and there is therefore a cycle of poverty and lack of education among the Roma.

Participation of Roma in education

An insignificant number of pre-school children are covered by institutional and other educational programmes (0.5%).

It is not possible to determine precisely the number of primary-school age Roma children who do not attend school. However, available data indicate that it could be between 3 – 10% of the total number of enrolled children.

A great number of Roma children do not enrol in compulsory schools (80% of children are not included in primary education).

When tested for the enrolment in the 1st grade, many of these children are wrongly categorized due to language problems and sent to special schools (according to some data 50-80% of children placed in these schools are Roma children)[69].

Children enrolled in 1st grade encounter considerable problems due to an insufficient knowledge of the language in which the lessons are performed and they do not attend school regularly. They start dropping out of school from the very beginning, while in higher grades the drop-out rate is very high, particularly in the case of girls. Due to late enrolment and poor achievement in school, Roma children are often sent to schools for the education of adults, which use methods inappropriate for children of that age, also resulting in dropping out.

The Roma covered by secondary education come mainly from families who are well off and already integrated into society. It is mainly two- and three-year lower-ranking secondary schools that are accessible to them.

There is an exceptionally small number of highly educated Roma who attend post-secondary schools and universities (0.3%). In some professions, there are no Roma graduates or Roma students. There has been an increased number of Roma students in the past few years as a result of scholarships provided by different organizations, but their number is still significantly lower in percentage terms compared to other populations.

5.1.1.2 Adult Education

The educational structure of the adult population in Serbia is rather unfavourable. According to data from 1993 almost one quarter of the unemployed are unqualified or partially qualified, while 60% of the employed have completed secondary education. According to data from 2001, 40% of the unemployed are unqualified or partially qualified.

The major problem of adult education is its marginalization. It is not treated as a strategically important component of economic and social development. In educational policy adult education and learning are treated as a matter of personal interest. The formal education system is practically closed for adults. There are 19 schools for adult education at present (compared to several dozen during the 1970s) and they are attended mainly by adolescents with educational and behavioural problems, as well as by adults from marginalized social groups.

These schools work on the basis of the curricula of regular primary schools which do not take into account adult education criteria. There are no adequate textbooks, trained

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[69] A Comprehensive Analysis of the Primary Education System in FRY, UNICEF, Belgrade, 2001.

teachers or standardized programmes for these schools. There is no systematic monitoring of data on institutions, curricula, students or teachers.

Secondary education for the adults is organised sporadically, at the request of the Labour Market Bureau and companies, mostly in the form of a final exam for adult (non-regular) students. Neither the contents of classes, nor their organisation are in harmony with the needs of life and the working environment from which the adults originate.

The above discussion clearly shows that the existing educational system is itself a source of problems which are in a special way reflected in adult education. On the one hand, the education system is not adjusted to the needs of the labour market, and on the other hand it is not adjusted to the needs of adults – the labour force, whose education requires a different approach and different institutional arrangements.

Taking into account the position of marginalized groups, it is important to provide through the implementation of the PRSP measures of affirmative action aimed at the improvement of their status in educational system.

5.1.1.3. The link between the education system and the labour market

An analysis of the unemployment rate, the number of unemployed and the length of their unemployment, shows very clearly that structural unemployment as the general characteristic of unemployment in Serbia is a result of the rigid and inadequate network of secondary vocational schools.

According to the unemployment records, there were on average 223,000 unemployed persons with who had completed three years at secondary vocational school (out of the total number of unemployed persons of 842,652), while there were on average 236,000 unemployed persons who had completed four years at vocational secondary school.

A possible cause for this can be found in the **lack of connection between** secondary vocational schools and the existing economic environment and its current and developing needs. Consequently, deprofessionalization – loss of knowledge and skills – is a feature of structural unemployment.

Specific characteristics of education in Serbia are as follows:

- There are a great number of educational institutions with planned enrolment capacities which do not reflect the needs of the labour market;
- the same number of students keep enrolling in the first grade of secondary schools, which shows that there is no adjustment to the needs of the economy and to the existing number of unemployed professionals;
- on the basis of the above, a number of profiles are classified as the so-called »homogenized diversified profiles with surplus professions«. This means: a high territorial percentage of the unemployed in these fields of work; long waiting periods for employment, equal to the schooling time period itself; a slow rate of employment take-up; the so-called poor concentration of the unemployed in large cities, poor mobility of the unemployed.

Education in secondary vocational schools is characterised by a high share of general subjects, fewer generally vocational subjects, and even fewer highly specialized vocational subjects as well as limited practical work in the curriculum, which by itself does not guarantee a good preparation of students for work. That is one of the basic comments by employers. The absence of technological innovations and information about modern work processes in the curriculum – in other words, obsolete programme content, as well as insufficient practical work skills, are another dominant characteristic of the curriculum, which affects the position of secondary school graduates in the labour market.

Most often local secondary technical schools are not open to the requests of the employers nor for the enrolment of adults ready to join the school in regular term-time, except for the usual cases of retraining or additional training organized at the request of the Republican Employment Bureau (and these requests are rare). Schools are also not open to the educational needs of those already employed and to educational innovations. At the same time, no serious effort has been made to introduce computer training and basic entrepreneurial training, which would modernize the curriculum at least to some extent, despite the fact that as much as five years ago, entrepreneurship and the development of small and medium-sized companies were defined as the main generators of employment during the period of transition and transformation of ownership in the economy.

5.2. Goals and Strategic Options

5.2.1. Goals

The strategic contribution of education to poverty reduction is twofold:

First, it increases the opportunity for high quality employment through an improved level of education of the population by gaining higher and more suitable qualifications (both for young people and adults) and by obtaining higher levels of education by the insufficiently educated groups (particularly Roma and children with special needs). In both cases investments are required for:

- prolonging compulsory education to 9 years;
- widening the education system to include marginalized groups;
- the reorganization of the system of vocational education in compliance with the new needs of the economy;
- the provision of systematic opportunities for adults to gain qualifications.

Second, it increases the efficiency of the education sector through:

- Greater effectiveness of teaching, by achieving higher quality of education. For that it is necessary to develop a system which will ensure teaching quality, a system of professional development for teachers and a reconstructed curriculum which will be focused on acquiring lasting and transferable knowledge and skills, and values and patterns of behaviour suited for a modern society;

- Strengthening the role of parents and students, by improving user services in the education system. ;

- Considering the possibility of introducing compulsory pre-school education. This is particularly important for the successful integration of vulnerable children into the regular education system;

- Optimisation of the primary and secondary school network, which should provide rational spending of resources in order to release funds for other material demands of schools;

- Proper equipping of schools, which provides efficient teaching and makes possible the acquisition and transfer knowledge.

However, the strategic contribution of education has been blocked by financial restraints in the education system itself. Another constraint is the poverty of a relatively large number of parents, whose children therefore live in poor families and surroundings. The implementation of current social and economic reforms will have a positive impact on all these constraints.

5.2.2. Strategic Options for the Education System Reform from the Perspective of Poverty Reduction

New System Law on Education

In accordance with European educational standards, the goal of the changes encompassed by this law, which was adopted in June 2003, is threefold:

1. Increased relevance of curricula and their adjustment to new social and economic needs at the republican and local level;

2. Increased coverage of children by education – by extending compulsory education to nine years while keeping 12 years of pre-university education;

3. Increase efficiency of the system through better use of existing investments and the professionalisation of human resources in education.

The reform package which aims to achieve these three goals by 2010 is contained in this law in the following ways:

- Optimisation of the current institutional network, in order to provide equal access to everyone, in the whole of Serbia;

- Establishing a new framework and procedures for the implementation of a new type of curriculum with an emphasis on results and the acquisition of applicable knowledge;

- In addition, the introduction into the system and the regulation of the possibility of approving other curricula at pre-school level and the education of adults through training and professional improvement;

- Introduction and regulation of professional standards concerning education, on-the-job training, work and the professional improvement of staff working in education;

- Compulsory attendance of a free-of-charge one-year preparatory programme prior to enrolment in first grade starting in 2007;

- The creation of basic legal conditions for the inclusion of marginalized children into the education system by establishing a centre to deal with their problems.

Pre-School Education Reform

In view of the figures on the coverage of children by pre-school education, particularly those from marginalized, poor, and vulnerable families, the strategic activities for the development of pre-school education, from the aspect of poverty reduction, include several main trends:

- increasing the coverage for all age cohorts, in particular for the excluded groups.

- inclusion of all children in a pre-school preparation programme, lasting at least six months, for four hours a day;

- development of alternative half-day programmes for children aged 5 to 7 years.

The new System Law on Education provides a framework for compulsory and free-of-charge attendance at preparatory pre-school programmes starting in 2007. The implementation of such strategic options includes: linking state, private and NGO initiatives, participation of parents and local communities (in particular local self-governance authorities), introduction of good practice and experience gained from NGO programmes into the public system, and teacher-training courses in the form of action and intervention research.

Concrete tasks in the implementation of the strategic goals of poverty reduction would be:

- To review the current situation and problems in the government, private, and NGO sectors and to assess the needs (of children and parents on one hand, and of practice on the other).

- To provide the legislative framework for a further process of reform: the Law on Pre-school Education instead of the prevailing Children's Protection Act.

- To secure a framework for integrated early childhood development through inter-sectoral co-ordination and co-operation.

- To create preconditions (material, financial, human, and programme) for a greater coverage of the marginalized and excluded children and children at risk (child refugees, Roma children, children from poor and socially and educationally underprivileged and rural environments, children with special needs) by regular free-of-charge pre-school education, for a minimum of one year prior to enrolment in the first grade (up to 5 classes a day, 5 days a week).

Primary Education Reform from the Perspective of Poverty Reduction

The reform provides a new framework in education as stated in the System Law on Education:

- Extension of primary education to 9 years aimed at achieving functional competence of the whole population in language, mathematics, science, and culture and health matters;

- curriculum reform aims at:

- focusing on educational outcomes – results and their transfer value in further education and in life.

- change of teaching/learning methods (teaching to think, analyze, communicate, acquire problem-solving skills, enabling integration into the labour market and further education - instead of learning by rote).

- flexible programmes based on personal experience, the needs and conditions of local community and the interests of the child.

- greater openness for the inclusion of marginal groups by excluding physical capacities as a criterion for enrolment in school.

Secondary Vocational Education Reform

The system of vocational education should enable and offer both short-term and long-term flexible solutions that would enable pupils to qualify for a profession which would lead to employment, but also make it possible to continue schooling. In that respect, the proposed measures are as follows:

- The introduction of a graded system of secondary vocational education which means that certain levels of vocational education and the curriculum offer both a completion of education and the opportunity to continue education. In this way the principle of lifelong education is being implemented which includes both the embarkation of individuals into the world of labour and their return from the world of labour to education.

- Ensuring both vertical and horizontal flexibility within secondary education.

- Liaising with non-formal education and opening of vocational schools for non-formal education.

- Liaising with forms of work-based education. In that context a special emphasis will be placed on educational services and centres in enterprises, i.e. companies.

- Provision of professional orientation and strengthening of the role of the counselling service within the Employment Bureau and within schools themselves.

Higher education

The process of reform and harmonisation of the higher education system in Serbia with European standards, as defined in the Bologna Declaration, has begun. In the coming period, the reforms should be strengthened with this as the main goal, and, at the same time, measures will be taken to link all activities of the university with the current needs of modern society, including the reformed economy.

It is necessary to increase the efficiency of the higher education system, by reducing the number of students who drop out of university and reducing the time necessary to graduate. Among the measures which are being discussed are various financial reforms and measures to encourage students to graduate on time.

With the goal of linking the university with economy reforms in Serbia, there is a need to move the focus from theoretical to practical, applied knowledge at lower levels of education. It is important to intensify applied research with the goal of supporting economic growth and development based on technological progress at higher university levels (MA, PhD) and among scientists/professors. This requires better integration and the strengthening of partnerships between the University and the private sector.

Adult Education within the Poverty Reduction Strategy

The current system of financing adult education includes the financing of compulsory primary education only, for which adults are not motivated because for their professional and working status this level of education does not have any significance. Only a small number of schools in the formal system (146) organise some forms of adult education, but without clearly defined conditions on which the programme can be executed. It is necessary to consider setting up a fund for financing primary education for adults by means of which they could acquire the basic qualifications for their first occupation or professional training and greater opportunities for employment would thereby be provided. This would in turn provide a strong motivation for uneducated adults to resume education and acquire at least basic qualifications. For unemployed beneficiaries of material support to families who have only completed primary education, special programmes should be launched for additional education and re-training.

Legislation, particularly by-laws, should open the education system to these kinds of options (such as, for example, the possibility of completing primary education at the same time as acquiring qualifications for the first profession), obtaining a free-of-charge first qualification, the same quality of education for all those included in the system, support to informal forms of education and obtaining qualifications required for employment and poverty reduction.

For the purpose of optimal utilization, schools and other educational institutions should be equipped both with regard to the requirements of adult education and specific opportunities for adults in the educational process (distance education, tutorial system, patronage teaching, consultative-instructional forms, etc.).

The issues of sufficient or insufficient qualifications, and qualifications that are or are not in demand, are addressed by the labour market. From the perspective of the poverty reduction strategy, this is one of the key factors for long-term strategic planning and planning actions.

In order to upgrade the qualifications of the unemployed (347,522 unskilled labourers) and provide for the qualifications of employees (143,272 unskilled labourers), it is necessary to improve the capacity of the education system so that:

- The formal education system provides regular opportunities for adult education and develops curricula and forms of education that satisfy the needs of adults who are insufficiently or inadequately qualified;

- The non-formal education system is included as a significant back-up to the educational curricula that support the poverty reduction strategy;

- A specific network of institutions for adult education is established and strengthened, particularly the centres for vocational and continuing education which continuously develop programmes for training, additional training, re-training, as a flexible and adequate response to the requirements of the labour market.

Established institutions, forms of education and educational programmes for adults should be networked with the formal institutions as a means of educational support to young people at risk of dropping out of school. Alarming numbers of pupils who do not complete primary and secondary education appear in a significant percentage on the labour market as unskilled labour. This target group and the problem of its lack of education should be given priority within the poverty reduction strategy.

In adult education, the underdeveloped regions are the priority, while support to the poor rural population requires practical education of adults for the purpose of raising their labour productivity.

Reform of the Education of Marginalized Social Groups

Primary education of Children with Special Needs

More efficient and greater inclusion of children with special needs in the education system, particularly in inclusive education, is necessary. Measures which can contribute to this include:

- Putting in place legislation for the compulsory education of this category of children.

- Establishing the National Centre for Care of Persons with Special Social Assistance Requirements, whose inputs will be used for the projections of education, health and material and social assistance policies. The aim of establishing an intersectoral government institution for the planning and coordination of all activities relating to the care and assistance of persons from marginalized and disadvantaged population groups is to treat simultaneously and comprehensively their educational, health and other special needs which have up to now been treated separately and in a fragmented manner and have been the responsibility of various line ministries. Such an approach ensures that these activities will be dealt with more economically and efficiently.

- Implementing reform of education for children with special needs with the focus on their integration in normal schools to the greatest extent possible.

- Ensuring wider coverage of children with special needs by early development programmes.

- Providing functional literacy courses and other education for adults with disabilities.

- Close liaison between the education system and the labour market, with legally binding provision of workplaces specifically allocated for persons with disabilities and benefits for employers who give them jobs.

Children/young people with special needs in secondary education

Strategic reform of secondary vocational education for students with special needs should take into account the following requirements:

- Vocational education for students with special needs must be based on the scope of their functional abilities, which represent the basic criterion for the selection of curricula intended for any one student or a group of students.

- There should be closer co-operation between the education sector and the labour market, to ensure the needs of the economy for particular types of workers are met. This can be achieved by a rapid restructuring of the education system.

- Within the structure of the curriculum, ensuring possibilities for the completion of a part of the curriculum through a training course, and for vertical mobility, but also keeping students back in lower grades if necessary.

- Creating the conditions for extended rehabilitation in school upon the completion of one year of vocational education, in cooperation with the Employment Bureau.

- Creating the conditions for a rational, efficient regional network of schools by linking primary and secondary vocational education in a unique educational institution.

- Providing adequate educational standards and adequate education of staff and their professional upgrading.

Education of Roma

The emancipation of the Roma community is not possible without a major improvement in the educational level of the Roma population, although activities in the field of education alone are not sufficient to reduce poverty among the Roma. According to the draft Strategy for the Integration of the Roma in the education system in Serbia, it is necessary to:

- Provide the largest possible coverage of Roma children by pre-school educational programmes, particularly programmes preparing for school;

- Inclusion of Roma children of a specific age in regular compulsory schooling, with an adequate preparation for school even if they have not been included in pre-school education;

- Inclusion of a greater number of young people in secondary and higher education;

- Support to training of Roma teaching staff, through support of Roma students studying to become teachers and professors;

- Integration of Roma culture into educational programmes and the curriculum;

- Creation of an atmosphere of acceptance and support for Roma children and young people in addition to mutual respect and acceptance of differences.

- Through specific education, current and future teaching staff should be trained to carry out activities of relevance to the Roma community, which will facilitate and support educational integration.

- Supporting the inclusion of adults in formal and informal education.

Prerequisites for the accomplishment of the above goals include:

- Professional support to Roma parents;

- Professional support to institutions and employees;

- Co-operation with the Roma community and the development of partnerships in the implementation of programmes;

- Inter-sectoral co-operation of all relevant government and local institutions;

- Achievement of interculturality in the educational curricula and institutions;

- Learning from the experiences and results of NGO programmes dealing with education of the Roma, and utilisation of their capacities.

- Development of relevant second chance educational programmes for children who have dropped out of the system, particularly to encourage girls' education.

The benefits of implementing this strategy, in relation to poverty reduction among the Roma population, will be:

- Increased overall level of education of the Roma community;

- Greater opportunities for the employment of Roma, not only as unskilled workers; it is necessary to implement fully the guaranteed right to free choice of profession and accessibility of employment for everybody on equal terms;

- Raised living standards of the Roma;

- Greater integration of the Roma into society,
- Better social and health care of Roma children;
- Increased awareness of the existence and significance of specially guaranteed minority rights.

6. Regional, rural, urban and housing aspects of poverty

6.1. Regional aspects of poverty

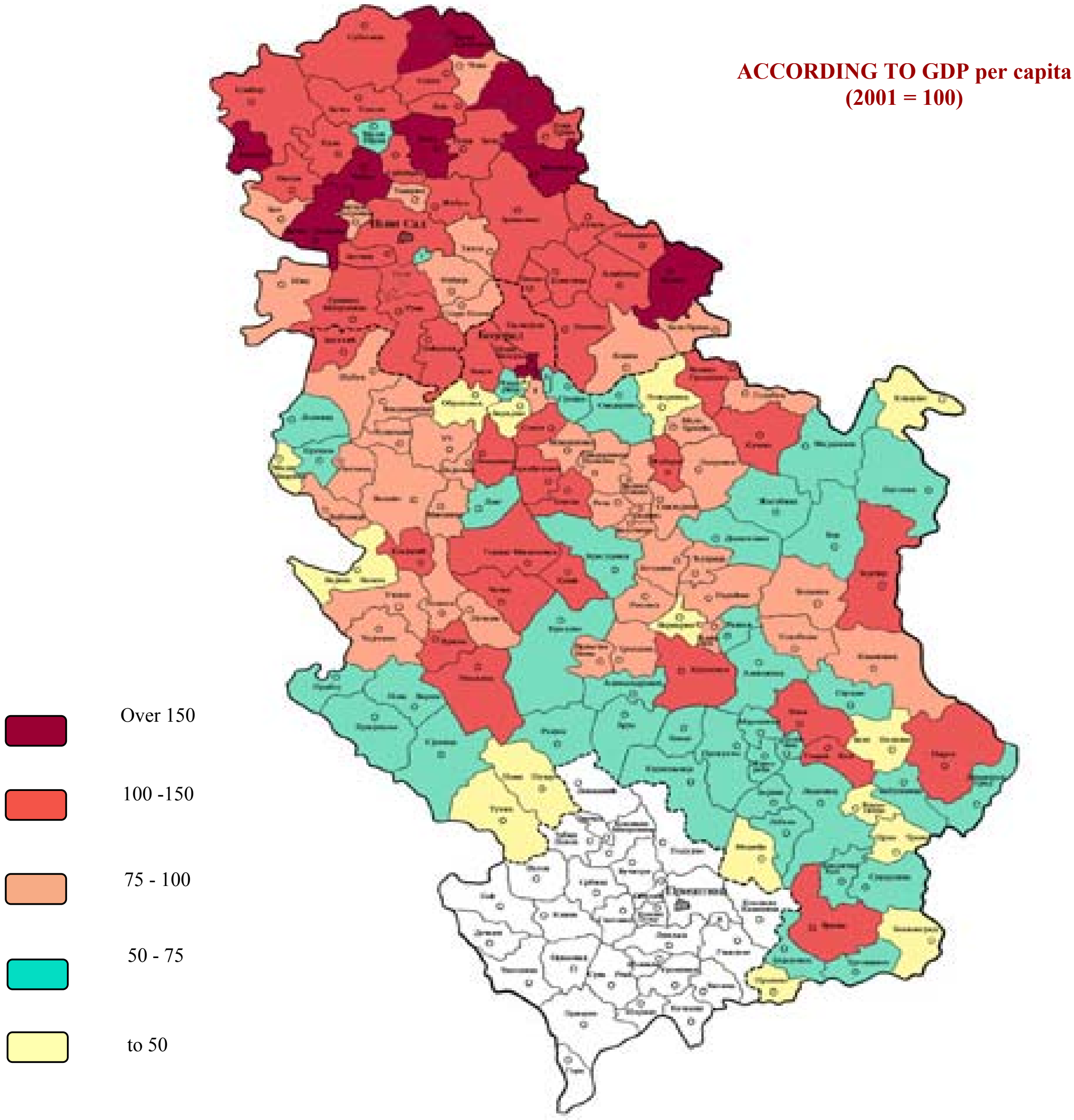
6.1.1. Status and problems

The scope of regional differences

The available data show that Serbia ranks among the group of European countries with the greatest degree of regional differences. Regional differences between developed and underdeveloped regions have deepened during the recent years[70].

[70] According to the Law on Underdeveloped Regions of the Republic of Serbia, 37 municipalities are defined as underdeveloped regions of Serbia, and out of those, 12 are defined as least developed. The following criteria were used for establishing the level of underdevelopment: GDP per capita, employment level, retail trade turnover per inhabitant and the number of PTT connections per 100 inhabitants. Municipalities whose development level does not exceed 50% of the Republic average are considered underdeveloped.

Development level of municipalities (index)



The map shows the development level of municipalities in Serbia according to GDP per capita in 2001, so both traditional and new poor areas are clearly marked.

Regional specificities of poverty are not manifested only in the economic sphere. Inhabitants of under-developed and least developed areas have limited or no access to public services (educational, health, judicial etc), which results in their inability to exercise these rights. Vulnerable groups living in these areas are in the most unfavourable position.

The extent of regional urban and rural poverty is shown in Table 1 below.

Table 1. Urban and rural regional poverty of Serbia (2002)

	% Vulnerable	% of the poor	Relative poverty risk	Structure of all the population	Structure of the poor	Depth of poverty	Severity of poverty
Belgrade - Total	**15.0%**	**7.9%**	**-25.5%**	**21.1%**	**15.8%**	**1.5%**	**0.5%**
Urban	13.2%	6.9%	-34.9%	17.2%	11.2%	1.2%	0.4%
Rural	22.9%	12.2%	15.1%	4.0%	4.6%	2.9%	1.0%
Vojvodina - Total	**18.4%**	**8.8%**	**-17.0%**	**27.1%**	**22.5%**	**1.9%**	**0.6%**
Urban	16.0%	6.8%	-35.8%	15.4%	9.8%	1.3%	0.4%
Rural	21.5%	11.5%	8.5%	11.7%	12.7%	2.6%	1.0%
Western Serbia Total	**23.9%**	**13.5%**	**27.4%**	**11.2%**	**14.2%**	**2.8%**	**0.9%**
Urban	22.7%	12.1%	14.2%	4.3%	5.0%	1.9%	0.5%
Rural	24.7%	14.4%	35.8%	6.8%	9.3%	3.4%	1.2%
Central Serbia Total	**19.5%**	**10.2%**	**-3.8%**	**17.3%**	**16.6%**	**2.2%**	**0.7%**
Urban	15.2%	6.9%	-34.9%	8.5%	5.5%	1.4%	0.5%
Rural	23.7%	13.2%	24.5%	8.8%	11.1%	3.0%	1.0%
Eastern Serbia Total	**17.4%**	**10.1%**	**-4.7%**	**9.3%**	**8.9%**	**2.3%**	**0.8%**
Urban	14.3%	9.2%	-13.2%	4.4%	3.8%	2.0%	0.7%
Rural	20.2%	10.9%	2.8%	4.9%	5.1%	2.6%	1.0%
Southeast Serbia Total	**29.8%**	**16.6%**	**56.6%**	**14.0%**	**22.0%**	**3.6%**	**1.2%**
Urban	21.3%	10.0%	-5.7%	6.7%	6.3%	2.2%	0.7%
Rural	37.7%	22.7%	114.2%	7.3%	15.7%	5.0%	1.7%
Total	**20.0%**	**10.6%**	-	**100%**	**100%**	**2.2%**	**0.8%**

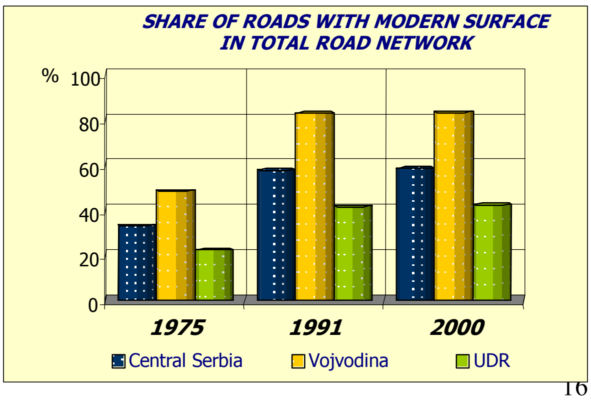
Source: SLSP 2002 (around 800,000 poor individuals, and around 1,600,000 vulnerable)

Note: Relative poverty risk is calculated as the percentage increase (decrease) in the poverty indices of each group in comparison with the average poverty index of the entire population.

Extensive development and the dominance of sectoral over structural and regional criteria, over a period of several decades, have contributed to: uneven development, uneconomic regional distribution of economic activities and population, and greater polarization between larger areas of the country, and between municipal centres and rural areas in their levels of development.

The interdependence of economic factors and the overall underdevelopment of large areas of the Republic of Serbia has resulted in three basic outcomes: (a) depopulation of rural areas; (b) interregional demographic differences; (c) atomisation of settlements in underdeveloped rural areas.

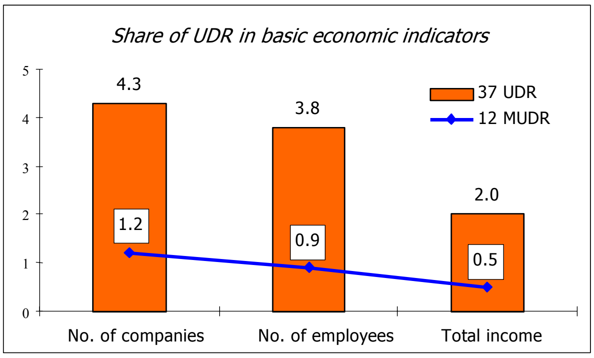
Undeveloped infrastructure



Inadequate road infrastructure is one of the basic problems in underdeveloped regions. The structure of roads in the 37 underdeveloped municipalities includes mainly local roads - 66.6%, then regional roads – 24.7% and regional highways – 8.7%, which is below the Republic average (59.7% local roads, 27.7%

regional roads, and 12.7% trunk roads). A modern road surface is applied on 42.4% of the road network in the underdeveloped regions, or on 33.9% of the road network in the most underdeveloped municipalities, which is half that of the Republic average (62.6%).

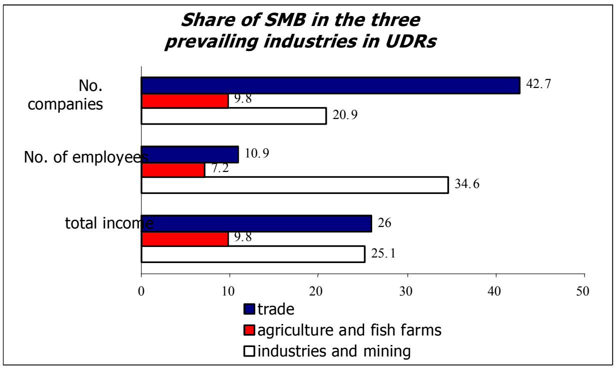
Imbalance of industrial capacities and development factors



Only 4.3% of the total number of companies in the Republic are based in underdeveloped regions (37 municipalities) and only 1.2% in the most underdeveloped regions (12 municipalities).

Out of the total number of employed in Serbia, 3.8% work in companies in the 37 municipalities, and only 0.9% work in companies in the 12 most underdeveloped municipalities.

Relative regional economic strength is illustrated best by the low share of underdeveloped regions in the total income of the Republic (only 2%), while the most underdeveloped regions' share in total income of the Republic is only 0.5%.



Importance of small & medium enterprises (SME)

The business results of small and medium businesses, which constitute 99% of active businesses in underdeveloped municipalities, employ 75.4% of all those employed in these regions, employ 71.9% of all capital, and account for 78.2% of total income and 82.2% of profit, have a decisive influence on the functioning of economy in the underdeveloped regions.

The cause of material devastation and impoverishment of particular regions may frequently be found outside the economic sphere, i.e. in inadequate education and technical training of the population. For example, within the structure of the unemployed in all the municipalities of the underdeveloped regions and in the south of Serbia, 45.5% are unskilled persons.

6.1.2. Goals and strategic options

The basic method of reduction of regional poverty is integrated development, i.e. decentralized development that basically includes three interrelated tasks: mitigation of the structural problems and regional differences; rational use of the development factors of all the regions; suppression of the trends of excessive urban concentration of economic activities and population.

6.1.2.1. Goals

The main goals are:

- Competitive economy,
- ***Investment in human resources*** (increasing of the level of knowledge and employment, improving working and living conditions),
- ***Improvement of infrastructure*** (roads, telecommunications, utilities), particularly the building of regional development infrastructure (incubators, technological parks, entrepreneurial zones),
- ***Relevant institutional organization*** (development network of Republic, regional, and local levels) that would enable comprehensive, long-term, and strategic mobilization and channelling of the strategic potentials and development of the regions through national and international development programmes.

6.1.2.2. Strategic directions

The main strategic course of action for the regional poverty reduction strategy harmonized with EU principles includes:

- ***Comprehensive formulation of regional policy*** – the concept of the regional poverty reduction policy refers to the entire Republic, with different activities for stimulating development in individual regions in accordance with their specific developmental problems.
- ***Partnership*** – partnership between the local communities as social partners and civil society.
- ***Subsidiarity*** – implies gradual territorial decentralization, transfer from central government to the regions and municipalities.
- ***Harmonization*** – harmonization of activities between ministries, with the governments and legislation of the European Union, WTO, and other international partners.
- ***Programme orientation*** – harmonization of regional strategy and policies.
- ***Support and Evaluation of Results*** – necessity to establish a system of incentives for even regional development (through stable sources of funds) and monitoring and evaluation of results.
- ***Co-Financing*** – financing of development programmes and projects together with local communities.

Legislation

The exiting Law on Underdeveloped Regions of the Republic of Serbia (1995) should be amended, and new mechanisms, measures, and institutional solutions should be proposed for the purpose of stimulation and orientation of the development of poorer regions, especially Southern Serbia.

The EU accession process includes primarily harmonization of local regulations with the relevant regulations and programmes (European Charter on Local Government, European Charter on Regional and Minority Languages etc.), requiring institutional policies in the field of regional development such as those that have produced positive results in the majority of transition countries.

The possibility should also be investigated to offer new policies within the framework of the existing Republic Development Fund, for the purpose of stimulating regional development, including stimulating the development of underdeveloped, i.e. poor, regions.

In view of the current fiscal limitations, the new policies will mainly aim at stimulation and creation of favourable conditions, while more efficient instruments for helping enterprises in underdeveloped areas will be investigated:

- Capacity building through rendering of various forms of technical assistance to poor regions:
    - Preparation of development programmes,
    - Stimulation of professional staff to work in poor regions,
    - Opening business incubators in cooperation with municipalities.
- In partnership with local government, providing a favourable framework for private investments, including development of small and medium enterprises and entrepreneurship in underdeveloped areas
    - Development of sites with adequate infrastructure for communal services and public utilities
    - Technical documentation for elaboration of capital investment projects

Bearing in mind budgetary limitations, special programmes for development of underdeveloped regions could be selectively introduced, and until then such programmes could be financed from donor funds.

Financial Framework

Financing of local self-government shall undergo substantial reform in the upcoming period. The core of this reform is the replacement of the sales tax that so far has represented the main source of income for the local level with a Value Added Tax (VAT). In view of the current democratization process and the increasing importance of including local level into economic and social development trends, it is important to set out the fiscal relations between the Republic and local government in such a way as to a secure reliable and sustainable level of income for the local level.

Greater availability of credits for the SME sector, as well as micro-enterprises, will present the main vehicle for overcomming regional poverty. Establishment of a Guarntee

Fund of the Republic of Serbia presents an important step in the development of the private sector. External assistance in the following areas will also be very important:

- Financial assistance directed to the SME sector through the commercial banks;
- Non-financial assistance to government agencies for SME development;
- micro-credit support through commercial and non-commercial institutions.

The Agency for Municipal Infrastructure Development, recently established at the initiative of the Ministry of Finance, can also become an important instrument for raising investment in municipal infrastructure at the local level.

Incentive Mechanisms as a Function of Poverty Reduction

It is indispensable that the Government stimulates regional poverty reduction through economic and systemic policies which would enable bring underdeveloped regions up to a similar level of development as other regions. One of the tasks for the PRSP is the reduction in the cost requirements for investment in the underdeveloped regions, i.e. giving incentives to enterprises that invest in those regions. The focus should primarily be placed on infrastructure development and stimulating tax policy.

Activities of the Local Communities in Reduction of Regional Poverty

The primary responsibility of local communities is the mobilization of local resources and the creation of an environment to overcome underdevelopment and poverty. The priority tasks of the local communities are:

- Adoption of development programmes and urban development plans
- Stimulation of development of SMEs and entrepreneurship,
- Rational management of the development sites/premises,
- Development of communal/public utility services,
- Policy of land rental,
- Construction and maintenance of local roads,
- Improved access to social, health care, educational, and cultural services

6.2. Rural Aspects of Poverty

Higher levels of poverty in rural areas represent a change compared to the nineties, when urban poverty was more prominent due to the deep economic crisis and the considerable drop in revenues from industry and other sectors of the formal, urban economy. On the other hand, the decrease in income in rural areas during the last decade was slower, thanks to the maintenance in the level of agricultural production, especially farming. During the last two years overall poverty in Serbia was reduced, both in urban and rural areas, and the faster decline in the number of poor in urban areas points to the fact that increased economic activity and external assistance were unequally distributed both territorially and by economic activities (i.e. between agriculture and other sectors).

6.2.1. Status and causes of poverty of the rural[71] population

Around 45% of the population of Serbia lives in rural areas[72]. Rural areas occupy nearly three quarters of the national territory. For decades, rural areas have economically and culturally been stagnating, a significant factor in increasing poverty. Possibilities for work outside agriculture are extremely limited. This stimulates migratory movements in which the most capable and most vital people are the first to leave. Hence, this negative spiral further results in problems of even deeper economic declines and further deepening of poverty, not just in rural areas as compared to urban, but much more within rural areas themselves.

Around 58% of all the poor live in rural areas. The share of the poor in the rural population in is around 14.2%, which means that every seventh individual is poor. This is higher than the rate for the whole population (10.6%). In accordance with this, poverty in rural areas is twice as high as with urban poverty (7.8%).

Observed by regions, rural poverty is most widely distributed in parts of Serbia which are most vulnerable in terms of overall poverty.

Table 1. Rural poverty by regions in Serbia in 2002

	Poverty rate	Structure of the poor	Poverty depth
Belgrade	12.2%	7,7%	2.9%
Vojvodina	11.5%	21,7%	2.6%
West Serbia	14.4%	15,9%	3.4%
Central Serbia	13.2%	19,0%	3.0%
East Serbia	10.9%	8,7%	2.6%
South-east Serbia	22.7%	26,8%	5.0%
TOTAL	14,2	100	

Note: poverty depth marks a lack of consumption in relation to the poverty line
Source: SLSP 2002

The rate of rural poverty is highest in south-east Serbia and amounts to 22.7%, followed by west Serbia (14.4%) and central Serbia (13.2%). It is also high in Belgrade (12.2%) and Vojvodina (11.5%), while it is at its lowest level in southeast Serbia (5%).

The basic cause of higher poverty levels in rural areas lies in the ageing of the population and the resulting reduced working ability and lower earning possibilities; the other factor is the lower level of educational achievement of the population, as well as the unfavourable economic structure, which results in longstanding unfavourable status of agricultural production and difficulties preventing its revitalisation in the short term.

[71] The character of settlements in the SLSP was determined according to the differentiation of settlements outlined in the Law on Territorial Organization of the Republic of Serbia, so smaller urban settlements were also included in rural settlements
[72] According to SLSP

Today around 60% of the active population in the agriculture sector is older than 60 and more than 15% belong to households with no active member on the estate. The result of these features is that, out of 159 municipalities of central Serbia and Vojvodina, 147 belong to the category of deep demographic old age, which presents a significant cause of rural poverty. Depopulation of rural areas due to industrialization has caused the decrease of the share of rural population in the overall population (from almost 80% at the end of World War II to around 45% in 2002).

Among the poor in rural areas[73], at greatest risk are elderly one- and two-member households, with the poverty rates of 20.9% and 21.9% respectively, as shown in Table 2.

Table 2 Poverty of elderly rural households in Serbia in 2002

	Poverty rate	Structure of the poor	Poverty depth
Elderly one-person households	20.0%	17.5%	4.7%
Two-member elderly households	21.9%	14.7%	4.6%
Other households	12.8%	67.8%	3.0%
Total rural	14.6%	100%	3.4%

Note: Elderly households were defined as households with members who are all 65 years of age and older.
Source: SLSP 2002

Almost one third of the poor in rural areas live in elderly households, although there are elderly persons in the other two thirds as well. The process of ageing of the rural population will continue in the future, unfavourably affecting villages' vitality and poverty of the remaining population.

Poverty of the rural population according to their socio-economic status is shown in the following table.

[73] The rural poor are old, small producers (up to 2 hectares of land), small lease-holders, sharecroppers and day-labourers as well as other workers with or without land and their families.

Table 3 Rural poverty in Serbia according to socio-economic status
- self-declaring-

	Poverty rate	Structure of the poor	Depth of poverty
Employed	9.0%	14.5%	1.9%
Employers and self-employed	12.4%	3.6%	3.2%
Farmers	10.7%	8.6%	2.0%
Other active	15.4%	2.3%	3.3%
Unemployed	20.0%	17.1%	4.9%
Pensioners	15.7%	23.7%	3.6%
Other inactive	17.2%	30.2%	4.1%
Total	14.3%	100%	3.3%

Source: SLSP 2002

Around 70% of the poor from rural areas belong to the category of the inactive population, either due to their age or inability to engage in productive activities. Among the poor in rural areas the greatest share (30%) is of supported persons (elderly persons with no income, housewives, children). The share of pensioners share is also very high (23.7%), due to the low level of farmers' pensions, shorter working careers and lower qualification structure, which are often characteristic of rural areas. The next largest group is the unemployed.

One of the causes of rural poverty is also the distribution of production capacities. Agricultural land is most often fragmented, with a tendency to further fragmentize. The average estate in Serbia is around 3 ha in size, consisting of five to seven separate parts; this fragmentation significantly affects production capacities and often provides for the needs of one household only.

The position of agricultural production on private agricultural estates was very unfavourable during the last few decades, because of the deliberate policy of equalizing incomes between agriculture and other activities, primarily industry, and the tendency of authorities to protect the standard of living of the urban population through low food prices and the policy of increasing "social ownership" of agricultural production which led to the abolition of the private sector. This policy led to the economic lagging behind of the agricultural sector and the households which live from it, and thus of whole rural area in which agricultural production represented the dominant economic activity. The abandonment of such an agricultural policy over the last two years through gradual liberalisation of the foreign trade regime and the complete abolition of state intervention in regulating prices of agricultural products could not lead to significant changes in agricultural production, primarily because of the devastated countryside and elderly agricultural producers.

The new role of agriculture in the rural economy

Viewed historically, agriculture dominated the rural economy and still represents the most important land user. However, technological progress enabled increases in work productivity and decreases in the number of people required in food processing, thus freeing the labour force for the industrial and service sectors . Agricultural production will in future employ fewer people, while a larger number of people will be engaged in agriprocessing and a more diversified rural economy. The goal of rural development is to facilitate this change and thereby contribute to solving social problems and other challenges of the transition process.

6.2.2. Rural development and poverty reduction

In addition to initiatives in the sector of agriculture, the reduction of rural poverty shall also include initiatives in various other sectors. The objective is to stimulate employment and economic growth and raise living standards in rural areas, especially in the depopulated border and mountain areas. Particular attention shall be paid to elderly agricultural workers and other vulnerable categories.

These goals will be achieved through:

- Higher income levels and employment rate in rural areas;
- Improved health protection, educational and social services;
- Improved infrastructure; and
- Protection and preservation of environment.

Implementation

Achievement of these tasks will be supported through:

- Establishing the Agency for Rural Development, with capacities for identifying, planning, approving and implementing initiatives in the field of rural development, as well as performing financial management and control;
- Emphasizing the importance of *partnership* in the field of identification, planning and implementation;
- Engagement of line ministries and agencies in the preparation of programs and policies
- Establishing an adequate legislative framework.

The National Rural Development Plan shall be prepared. The basic idea will include an emphasis on investment and local comparative advantage. The plan shall also consider the significance of non-agricultural employment in rural areas and distinguish between economic and social goals. Special efforts will be put on including all line ministries, agencies and local government bodies in the formulation of the plan, while implementation will require the engagement of all local social partners, in order to secure a transparent framework for development goals and selection criteria.

An important principle will be the establishment of administrative capacities and procedures, consistent with potential access to structural adjustment funds upon submission of a formal application for EU membership.

Implementation of the abovementioned goals shall be carried out through the following activities:

Raising income levels and the employment rate in rural areas, support to development of SMEs; establishing producers' associations; securing market infrastructure; improved processing and marketing of agricultural products; development and diversification of economic activities; development of forestry (including afforestation and wood processing). The emphasis shall also be placed on professional training.

Improving health care, education and social services. The objective is to provide higher quality services in small towns to serve the inhabitants of neighbouring rural areas.

Improving infrastructure. The focus shall be on the improvement of public transport and securing reliable water supplies in rural areas, with a gradual raising of water quality standards to those of the EU ; providing capacities for processing waste water (this will have positive impact on environment protection) and construction of plants for waste management (in household and industry).

Protection and preservation of environment. The measures to be adopted shall include preservation and development of villages; water management and preservation; and measures for the protection of agricultural production that at the same time include environment protection and preservation of village areas.

6.3. Urban and Housing Aspects of Poverty

6.3.1. Status and problems

According to SLSP data, the urban population of Serbia has a somewhat lower poverty rate (7.8%) than the rural population (14.2%). As for urban poverty, former industrial centres present the greatest problem: Kragujevac, Bor and other larger cities. In particular, restructuring and privatisation of large loss-making companies create unemployment and new pockets of poverty.

Urban poverty includes: unemployment, limited access to health care, education and other services discussed above. Therefore, we shall discuss the **spatial dimension of poverty** here, covering housing poverty and poverty-stricken city quarters (districts or localities) where numerous aspects of poverty come together.

Urban segregation denotes processes leading to territorialisation of social, ethnic, demographic and other differences in urban settings. However, in Serbia, which is at the beginning of the transition phase, a larger problem is posed by the process of pauperisation of the city population due to the loss of jobs and low income – leading to the inability to pay for public utilities and other services and therefore the potential for migration to other areas.

Housing and poverty

Housing deteriorated in the 1990s due to: (i) around 600 000 refugees and internally displaced individuals moving to the cities, with most of these becoming permanent; (ii) privatisation of socially/state owned flats, which did not improve the situation of the homeless; (iii) economic crisis and fall in living standards halted the maintenance and reconstruction of the housing stock; (iv) several thousand housing units were destroyed during the NATO bombings in 1999: (v) the constant decline in housing construction; (vi) rising illegal housing construction (in Belgrade in 1996 the number of illegally built flats reached the number of legally built ones).

Changes in housing since the year 2000 point to the beginnings of a distinction made between social and economic policies in the housing sector, including attempts to fight against illegal construction as well as strengthening local self-government and its housing branch. However, the creation of other institutional preconditions of serious housing reform is slow, and various types of tenant status cannot be confirmed without this.

The housing crisis in large cities still exhibits four, inter-connected aspects: the shortage of flats (for example, Belgrade has a housing gap of 50 000 to 70 000 for the past few decades); housing is inadequate for individual and family needs (small, poorly equipped flats) and lastly, inequalities concerning housing status.

In addressing the various aspects of housing poverty one faces numerous problems.

- Limited financial resources of individuals and families;
- Limited acess to finaces (Buncruptsy Law);
- Limitated resources of the Republic and town budgets;
- Housing has not been sufficiently taken into account in deciding on the eligibility criteria for social services;
- Non-existence of a law on social housing;
- The lack of data necessary for efficient, targeted support to social housing.

A Survey conducted in 1995 showed that in 16 Belgrade municipalities, in 202 poverty-stricken localities there were 113 240 inhabitants,constituting around 7% of the population. To this number, we should add those who live in unsanitary basement and attic flats as well as the homeless who use the services of the only Centre for the Homeless in Belgrade. All together, about 15% of the population of Belgrade can be considered to be vulnerably housed.

Homelessness is the extreme form of social exclusion. The homeless “who do not know where they will spend the night and where they will live tomorrow” are the smallest, but most conspicuous, group among the homeless population. Special research is needed to assess the extent of the phenomenon in Belgrade and other cities.

Housing Problems of the Poor

Lack of adequate utility infrastructure due to:

- Illegally built temporary settlements
- Rural areas incorporated into the urban ones without provision of adequate infrastructure
- Urban development without urban planning and infrastructure

Most of the urban poor do not have a secure roof over their heads due to the fact that they live in a flat which:

- Lies on public land, not intended for residential purposes,
- Was built without building and urban planning permits or
- Is rented without an appropriate contract on renting

Many of the urban poor are forced to live in illegal flats because:

- Land policy does not provide simple access to land
- Urban planning methods are not adequate and cannot keep pace with the rapid pace of urbanization and therefore cannot provide accessible land. The result is the shortage of construction land and the consequential rise in prices.
- Regulations and standards concerning housing are outdated and inadequate.
- High costs of the right to use land, and the costs of infrastructure and construction make legal construction of cheap flats virtually impossible (urban land is public property).
- Complicated procedures concerning urban planning and technical documentation pose an obstacle to the poor.
- Financing is impossible since the poor are not eligible for housing loans due to low income and small or no savings.

6.3.2. Goals and Strategic Options

6.3.2.1. Reduction of Urban Poverty

- Encourage local governments to take responsibility for the overall and sustainable economic and social development
- Initiate close cooperation with the civil society, including the poor, as well as with the private sector, for the improvements in the management and decision-making process
- Promote social cohesion through social and economic strengthening of society
- Initiate housing system reform with the purpose of
    - Securing affordable housing to the poor

- Identifying innovative and efficient financing methods, including the pooling of resources (utilization and improvement in the existing housing fund), maintenance system, clearly defined housing policy for vulnerable groups.

- Provide precise definitions of minimum housing standards through adequate regulations.

- Advance urban planning and infrastructure by ensuring urban planning programmes and plans are in keeping with the needs of the poor.

- Learn from international best practice for the reduction of urban poverty

The new Law on Urban Planning and Construction (2003), among other things, provides for simpler procedures for issuing building permits and gives cities the right to set aside land for cheaper housing construction. The Law also provides legalisation of all illegally built structures which will provide a clear picture of the legal status of the property of the poor.

Management and decision-making system

Flexible programmes and plans should be defined at town and municipality level, including representatives of the poor.

Improved co-operation should take place between institutions responsible for providing services for health care, education, social protection and transport sector to improve access to urban services and reduce urban poverty.

Urban planning should deal with urban poverty within the overall strategy of city development, and not only tackle particular, isolated areas. It also must be more in keeping with the needs of the poor.

6.3.2.2 Social Housing

Ensuring Government support through social housing programmes should address the problem of affordability of dwellings to the poor. The first draft of the document »National Housing Policy«, which will also include the social housing, is currently being prepared.

Social housing, which includes government's management of housing construction, is an important housing policy programme and it should be oriented towards:

- Construction of social flats for certain target groups of the population that cannot buy flats or rent them in the market, which are then rented on the basis of the means test of each household. These are cheaper flats for construction, built on more moderate standards, modestly equipped and of a smaller square area per individual, intended for the financially (most) vulnerable categories of population. Construction of flats for this purpose will enable the creation of a social rental sector which excludes the possibility of privatisation of flats and includes means testing of the beneficiaries, constant monitoring and assessment of the justification of renting the flats to the current tenants, in accordance with their prevailing material and social status;

- Government subsidizing of housing expenses to certain target groups, on the basis of the means test. With regard to the provision of housing subsidies, these flats would be either social flats or rented ones in private ownership;

Support to Affordable Rented Housing

For numerous poor urban people, including young couples, single-parent households, settlers, refugees, and displaced persons, rented housing is practically the only form of housing available to them.

Thus, the availability of cheap rented housing is a vital element in any poverty reduction strategy. Support to the activities that stimulate rented housing should include:

- Allocation of building sites for development of low-cost rented housing units through lower investments;

- Revision of civil construction and planning standards that facilitate rented housing;

- Tax exemption for construction of rented housing units and provision of rental income;

Improvement of Spontaneously Developed Settlements

Improvement of spontaneously developed settlements in many cases implies that the legal status of such settlements in general as well as of the buildings in them will have to be resolved[74].

In solving the problems of such settlements it is necessary to coordinate the economic and social programmes as well as programmes for improvement of the environment.

Various types of poor urban areas (illegal, planned, spontaneous) need to be addressed in different manners, starting from re-settlement when necessary through constructing public utility infrastructure to full rejuvenation. Since projects such as these demand considerable amounts of time and money, it would be advisable to select a few localities in several cities in Serbia and to design programmes and provide funds for their reconstruction from domestic and foreign sources.

The City Government of Belgrade invested nearly 10 million euro in the re-settlement of those living in unsanitary settlements in 2003. Construction of 1 500 small housing units for 6 000 poor residents of Belgrade in 40 new locations with public utility infrastructure is currently under way. The location of these new blocks will also facilitate access of the poor to social services and assist in their social integration.

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[74] Spontaneously developed settlements include "a group of settlements, dwellings, hamlets, Turkish Quarters, and the like, which has a number of common features that allow us to classify them in one group. Those common features are as follows: autarchic by origin and partly in development as well, absence or poor reliance on the legal system, location on the present or former urban fringes, self-constructed settlement (division into plots, detail planning, construction of buildings, not seldom construction of infrastructure and streets), with poor utilities, of low density of and low-rise buildings, predominantly intended for dwelling mixed with small businesses. The plots may be covered with several buildings/facilities, for dwelling or for other purposes. The building was predominantly carried out by households alone and often without the building licences" (Draft Master Plan of Belgrade, 2002).

The programmes should be based on a combination of self-financing (household resources, voluntary taxes, credits) and additional financial aid (available government and town resources, public funds, external assistance, etc.).

Poor inhabitants should be engaged in the construction of housing infrastructure – this would provide an additional source of income for them and enable their participation in the improvement of their living and housing conditions.

7. Environmental Aspects of Poverty Reduction

7.1. Status and problems

As in the majority of transition economies, in Serbia causal linkages have been found between poverty and the status of environment, namely: a) health and environment; b) vulnerable social groups and environment degradation; c) poverty and natural resource degradation; and d) poverty and vulnerability to natural disasters.

Health and environment

Water supply and sanitation. Health status data indicate that in Serbia water related diseases are not a significant contributor to the burden of chronic or acute disease (WHO, 2000; UNICEF, 2001). Mortality among infants and children under five, a common indicator of water supply and sanitation conditions, has declined by one half during the 1990s and is associated with improved household sanitation and improved treatment for diarrhea and acute respiratory disease. The under-five mortality rate for diarrhea declined by 38.2% during the 1990-97 period (UNICEF, 2001).

However, there are some indications that the situation is changing. Deterioration in the quality of drinking water may well reverse the positive trend in the under five mortality rate. Recent epidemiological studies on health and the environment have found linkages between living conditions, drinking water quality and health. The situation is particularly acute for urban slums, populated by refugees, Roma and IDPs, as they lack the resources to purchase bottled water.

Air Pollution. High ambient concentrations of pollutants, especially particulate matter, have been associated by international epidemiological studies with various negative health impacts. The concentrations of particulate matter, soot and SO_2 in some Serbian industrial settlements are within the critical range that has been associated with negative health impacts.

Air pollution does not affect only the poor population, but, as in other parts of the world, it is certain that vulnerable and poor people are the least capable of protecting themselves from exposure by moving to cleaner and safer areas, and therefore suffer the highest consequences of such exposure.

Lack of proper *waste management* creates public health hazards for the poor in a number of ways. First, as described in the section on waste management, hazardous waste is not sorted out, but dumped without any prior processing on regular, mostly illegal, waste dumps. Urban poor, notably Roma, who make a living by scavenging on waste dumps without any kind of protection or training in the handling of waste, are exposed to risks of injury and infection from sharp material. Second, considering the lack of leachate collection and treatment plants in the dumps, leakage from waste dumps can contaminate groundwater, which constitutes the drinking water source for poor communities living nearby. Third, inadequate incineration or incineration of unsuitable materials can result in the release of pollutants in the air and constitute a health hazard to nearby Roma, refugee or IDP communities.

Vulnerable social groups and environment degradation

Roma, refugees and IDPs residing in special camps and / or near waste dumps in urban areas are among the most vulnerable social groups in Serbia.

The poor, especially women and children, are generally the most vulnerable to environmental problems, and traditional environmental risks – the lack of drinking water and sanitation, closed space air pollution, and exposure to routes of disease – have by far the most important role among those groups. The Roma minority is a key priority risk group in Serbia and Montenegro. Within Roma settlements, access to utility and public services is nonexistent or limited and the most serious problems are lack of access to electricity, water, sewage, and garbage collection. The prevalence of communicable disease associated with poor living conditions such as hepatitis and trachoma was confirmed[75]

Poverty and natural resource degradation

The rural poor in southern Serbia are highly dependent on the quality of natural resources. Land degradation, as a result of overgrazing and deforestation, could be a significant cause of exacerbated poverty in these regions.

In addition to the effects suffered by the poor population as a result of environmental degradation, in specific circumstances, the poor can also be the cause of environmental degradation. One mechanism that could lead to that is the increased reliance of the rural poor on fuel wood for heating in the face of increasing electricity prices. As they are not serviced by district heating or natural gas networks and are unable to bear the burden of electric heating, they resort to uncontrolled woodcutting, exacerbating land degradation. Fisheries is another area where poverty can cause resource degradation through over fishing leading to a spiral of lower yields and increasing poverty.

Poverty and vulnerability to natural disasters

Serbia and Montenegro are severely exposed to earthquakes and flood risks. During the 1990s, more than 200,000 ha were affected by floods, which resulted in significant economic, social and environmental losses.

The poor are particularly exposed to flood and earthquake risks notably due to the location of settlements on riverbanks and poor quality housing construction. The country lacks a comprehensive strategy, which would include preparedness, mitigation, recovery and reconstruction.

7.2. Objectives and strategic options

7.2.1. Objectives

Ensuring environmental sustainability is one of the eight UN Millennium Development Goals (MDG).

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[75] World Bank, 2002

- **Sustainable access to improved water sources and access to improved sanitation**. While statistics indicate a very large part of the population had access to safe drinking water in 2000, there are unsatisfactory trends in quality, coverage and service, especially in rural areas and urban slums. Similarly, the majority of rural households have septic tanks, many of which have been found to be improperly situated.

Table 1: Millennium Development Goals and the Environment

Indicator	1990	1995	1999	2000
Ensure environmental sustainability				
Forest area (million ha)	2.995*	2.934*	N.A.	2.887**
National protected areas (% of total land area)	N.A.	3.24	N.A.	3.23***
GDP per unit of energy use (USD / koe)	1.85	1.28	1.28	
CO_2 emissions (MT per capita)	3.6^^ [1]	2.9		4.6***

Notes: [1] 1991 statistic
Sources:
^^ Chapter 12, “Breaking with the Past: The Path to Stability and Growth”, 2001
* Statistical Yearbooks of Yugoslavia; Federal Statistical Office, "Bulletins Forestry”
** FAO Global Resources Assessment, 2001, *** The Little Green Data Book, 2001.

- **Environmental sustainability.** GDP per unit of energy used declined from USD 1.85/cec in 1990 to USD 1.28/cec in 1999, showing a 13 % increase in energy intensity. This compares poorly with the ECA average of USD 2.4/koe and underlines the need for improved energy efficiency and reduced demand through the elimination of energy price subsidies. CO_2 emissions of 4.6 MT per capita were less than the ECA average in 2000. However, these emissions appear to have increased since the early 1990s, and should be reduced to their previous levels.

- **Sustainable use of land.** Soil pollution and eutrophication problems are connected with excessive application of fertilizers, as well as with uncontrolled effluents from livestock farms. The consumption of fertilizers in Serbia declined from 115 kg/ha of NPK to only 40 kg/ha in the period from 1991-2000. Some studies show low levels of analyzed pesticides in Serbia, and conclude that the soil is not contaminated with pesticide residues. While in central mountainous regions, the after effects of intensive (conventional) agriculture have caused water erosion, wind erosion is predominant in Vojvodina. The level of agricultural erosion is 3 to 4 times higher than that of erosion caused by natural processes. Evidence of moderate or high levels of erosion caused by other effects is visible on 26% of Serbia’s territory. Such effects include open-cast mining and uncontrolled disposal of various types of waste. Larger areas in the vicinity of industrial complexes (Bor, Pancevo, Novi Sad, Smederevo, Belgrade and Kragujevac) are polluted with various toxic substances and have been declared environmental hot spots.

- **Sustainable management of forest resources.** Forests cover 28% of the land area. This percentage is lower than the ECA regional average of 40% and there has been a slight decline in forest coverage of 0.4% annually during the past ten years, mainly due to fires, pest infestation, illegal logging, reduced afforestation and over harvesting. While the annual reduction is not very dramatic, forest quality degradation, as a result of illegal cutting and the lack of suitable forest management, is neglected. There is a general need for improved and more sustainable use of forest resources.

- **Preservation of biodiversity.** Approximately 2.7% of the total land area in Serbia is protected in terms of conservation, which is above the ECA average[76]. Serbia is planning on increasing the percentage of land under protection. However, there is still room for the improvement of the management of Serbia's biodiversity, which is of global importance.

7.2.2. Strategic options, measures and activities

Upgrading the water supply system

The household research shows that around 84% of the population of Serbia has access to water supply networks and sanitary utilities, as well as drinking water. There are observable differences between the coverage of urban and rural areas (97% and 68% accordingly). Despite almost full accessibility, this sector needs urgent repair. As a consequence of poor maintenance and insufficient investment in the past decade, the majority of water supply networks cannot provide regular water supply.

Water quality is unsatisfactory. According to the findings of the Public Health Institute of the Republic of Serbia, 29% of samples from water supply systems did not satisfy physical, chemical or bacteriological standards in 2001. The main problem in central Serbia is that more than 40% of samples were bacteriologically contaminated and did not satisfy quality criteria. Only Belgrade has adequate water quality, with more than 90% of samples satisfying standards.

The document "Water Supply Foundation of Serbia" presents a strategy for water supply in Serbia for the period 2002-2012. In order to satisfy increased demand and raise the coverage by water supply networks, the document proposes the continuation of development of water supply systems, which was initiated in the eighties, for those regions that overused the capacities of local sources. It is also suggested that initiated construction on all accumulative lakes should be finalised. Comprehensive work on the protection, amelioration and revitalization of resources of underground waters and artificial induction and usage of modern technologies and treatments where needed is also envisaged. There are detailed suggestions for the advancement of water supply systems of Novi Sad, Vojvodina, Pančevo, Belgrade, Niš.

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[76] IUCN categories I-IV

The Ministry of Agriculture and Water Utility, in charge of the construction of water supply systems in rural areas, has set the priorities regarding rural water supply. In southern Serbia, priority municipalities are Vranje, Bujanovac and Preševo, in eastern Serbia they are Bor, Doljevac and Bojnik. Most investments are small-scale and include repair or construction of new wells, expansion and repair of the pipeline network, as well as chlorifying systems. Most of these activities should be financed by municipalities, in cooperation with the Ministry.

Investment in the water supply sector should aim at achieving maximum efficiency of the existing system, with a special focus on reducing loses that often reach 30-50%.

The water resource sector is not financially independent. Nowadays the income from water resource services is insufficient to meet operational costs. It is necessary to introduce calculation of water consumption by metering, to implement price reform and to increase the collection rate in order to aim to resolve financial problems.

In the last two years international financial institutions have initiated projects for water supply and wastewater in medium sized towns as well as in rural areas that face the most serious problems.

Improvement of sewage system

The majority of the population (99.6%) lives in households with some sanitary utilities; 88.3% of the population is connected to sewage system or septic tanks. However, serious problems remain in rural areas. The connection level to sewage system in towns is 87.5% and villages only 22.2%. Villages rely on septic tanks which are in most cases illegally built and located.

Roma communities in Serbia most often have limited or no access to utility and public services, the most serious problem being lack of access to electrical power, water, sewage and garbage collection.

Construction of utility and industrial sewage systems over the last decade in Serbia was insufficient in terms of the development of water supply systems. There are significant regional differences in sanitary services, with 49% of the population of Vojvodina being connected to the public sewage network, compared to 66.9% in central Serbia, including Belgrade.

In Serbia there are 37 central plants for the treatment of wastewater. Seven of them are for primary treatment and 30 are for secondary and biological treatments. Seven plants are more than 30 years old and have considerably deteriorated, and three are not working at all. Belgrade does not have a plant for processing sewage water and relies on the self-purifying capacities of the Danube. Only 12% of wastewater is treated in Serbia.

This sector calls for reforms and fresh financing. The investments are most urgent in the poor urban quarters that are quickly expanding, especially those with large numbers of refugees and internally displaced persons. Regarding the disposal of faecal material, it is very important to identify places with unsatisfactory access to the sewage network. Regulations pertaining to septic tanks must be strictly implemented and the status of tanks must be monitored.

Cleaning black spots in Serbia

Bilateral donors have contributed to cleaning the environment in several black spots, above all in the places damaged by NATO bombing (Pančevo, Novi Sad, Bor, Kragujevac). UNEP-UNHCS Balcan working Group has identified 27 projects aimed at resolving the post conflict environmental problems and the humanitarian problems caused by them So far, donors have provided USD 12.5 million and 16 projects have been realized. In addition to this, projects of decontamination are under way in the South of Serbia where munitions with depleted uranium were used, as well as cleaning areas of cluster bombs.

Also, ecological black spots that are not the consequence of bombing have been registered (e.g. thermoelectric power stations) and significant funds and time for their repair are needed.

7.3. Necessary changes in the institutional and legislative spheres

Institutional and legal framework. The existing institutional and legal framework in Serbia is undergoing constant changes as a result of the recently finalized phased devolution of legislative and executive powers from the federal level to the republics, and the review of a set of laws, undertaken simultaneously with the economic transition.

In June 2002, the Government of the Republic of Serbia upgraded the agency for the protection of the environment from a directorate to a ministry level.

The new Law on the System of Environmental Protection is being considered by the Republic Parliament. The Law is comprehensive and ambitious: its objectives are to develop a consistent and modern legal and institutional system for environmental protection, which is harmonized with the EU's framework, and will improve horizontal and vertical cooperation and raise responsibility and efficiency.

Institutional/policy reforms need to be undertaken in the following areas: strengthening institutional capacities for environmental management, and addressing environmental liabilities and privatization issues.

Public information and participation. Civil society, the private business sector and non-governmental organizations are still not sufficiently involved in the protection of natural resources. Within the business community, environmental protection issues are not among the top priorities. Business associations and environmental committees are still at the stage of being established. Currently, the participation of the private sector in the protection of the environment is not adequate, especially in the areas of waste water management, water supply and sanitation in major towns, forestry and national park management. The participation of local non-governmental organizations is limited mostly to public awareness campaigns, environmental education and information.

7.4. Financing requirements and other necessary resources

Areas requiring urgent investment include:

- Development of hazardous waste storage facilities in Serbia

- Improvement of solid waste disposal facilities
- Development of waste water treatment plants
- Addressing major pollution issues in the environmental hot spots
- Improvement of water supply in rural and urban water supply services.

IV COSTINGS OF THE POVERTY REDUCTION STRATEGY

This chapter sets out an analysis of expenditure implications of the PRSP. As with other Government programmes, the activities described in the PRSP will be financed primarily through the budget process. These activities will be financed within the overall macro/fiscal resource framework set out by the Government; funding for these activities will result mainly from making budgetary savings and reallocating existing resources to higher priority activities.

The PRSP will be facilitated by recent changes in the budget system. For the first time, in the 2004 Budget Instructions from the Ministry of Finance, sector ministries were asked to identify in their budget submissions funding requirements for: (i) continuing existing level of activities; (ii) on-going activities which are not currently covered by budgetary allocations; (iii) planned capital expenditures; and (iv) new programmes. The costings set out in Table 1 represent the ministries' first attempts at identifying on-going or new priorities activities which are not yet funded but which they consider to be priorities under the PRSP.

This chapter begins by setting the costing analysis in context by discussing in more detail the medium-term resource framework within which PRSP activities will need to be financed. The discussion then moves on to describe the purpose of the costings and the future process of further strengthening the costing analysis before turning to a description of the costs themselves.

1. Medium-Term Resource Framework

The budget is the main (fiscal) tool through which activities in the PRSP will be prioritised and thereby funded. In the medium-term consolidated macro/fiscal resource framework, within which PRSP priorities will need to be financed, total expenditures are projected to increase by 19% between 2004 and 2006 to YUD 688 billion by the end of the period.[77] This represents a slight decrease in the share of expenditures in GDP from 46.1% expected in 2003 to 44.8% by the end of the three-year period. The overall resource framework includes resources of: (i) the Republican budget; (ii) local budgets; (iii) extra-budgetary funds; (iv) grants and (v) external budget support credits.

Sectoral Priorities and Budgetary Allocations

The budget should provide the link between policy activities and budgetary allocations. For example, the PRSP in the education sector indicates that budgetary allocations to the sector over the medium term will grow in relation to GDP.

The Ministry of Finance's Budget Memorandum includes for each sector the medium-term sectoral resource ceilings within the overall resource framework. In their 2004 budget submissions, ministries are expected to constrain their budget requests within their relevant ceiling whilst at the same time addressing PRSP policy priorities. Whilst some PRSP sectoral policy measures, e.g. passing legislation, can be undertaken with no

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[77] See 2004-2006 Budget Memorandum, Ministry of Finance, Government of Serbia, May 2003.

or limited budgetary allocations, many of the activities will require the allocation of sufficient budgetary resources. The public expenditure implications for policy measures are identified in the sectoral policy matrices attached to the Executive Summary.

The table below sets out for each sector the PRSP policy priorities and the relevant sectoral expenditure ceilings contained in the 2004-2006 Budget Memorandum. These are consistent with the overall fiscal framework for the period.

Table 1

Sector	PRSP Policy Priorities	Medium Term Consolidated Sectoral Budget Allocations[1]					
		2004		2005		2006	
		Bn YUD	% GDP	Bn YUD	% GDP	Bn YUD	% GDP
Macro/fiscal framework, public admin, judicial decentralisation, international integration	Maintain macro stability. Maintain sustainable fiscal policy. Contain fiscal deficit to at or below 2% in the long term.	46.7	3.7%	53.3	3.8%	63.0	4.1%
Support to economic activity	Improved skills of unemployed. Development of SME and entrepreneurship	58.1	4.6%	61.7	4.4%	64.5	4.2%
Social protection, pensions, elderly	Greater efficiency in pension provision. Better protection of socially vulnerable groups. Widening of the range and quality of social protection services.	247.5	19.6%	267.9	19.1%	287.2	18.7%
Health care	Develop special programmes for most vulnerable. Improve allocation of resources (emphasis on primary/preventive care).	64.4	5.1%	72.9	5.2%	80.0	5.2%
Education	Increase total budgetary expenditures on education as a share of GDP to 4% by 2006. Inclusion of vulnerable groups in formal education. Improve efficiency of vocational training.	45.5	3.6%	53.3	3.8%	61.4	4.0%
Housing, communal services	Ensure relevant institutional infrastructure for local community development.	30.3	2.4%	33.7	2.4%	36.9	2.4%
Environmental protection	Sustainable access to improved water sources/ improved sanitation. Improved waste management and condition of ecological black spots.	1.3	0.1%	2.8	0.2%	3.1	0.2%
TOTAL OF ABOVE		**493.8**	**39.1%**	**545.6**	**38.9%**	**596.1**	**38.8%**

1. Includes Central budget, local budgets, extra-budgetary funds, grants and external budgetary support. PRSP sectors have been matched as closely as possible to the functional classification of the budget.

Purpose of the Costing Analysis

The allocations are intended to reflect the costs of meeting the highest priority of the newly prioritised activities contained in the PRSP; they do not represent the full cost of all proposed PRSP policies. Rather, as indicated above, they focus on those new or restructured policies/activities which are affordable, are of the highest priority and are currently unfounded, rather than being comprehensive of the sector. They are intended to show sector ministries and local administrations the expenditure implications of meeting all PRSP objectives. In other words, the costing data attempt to show the extent of the trade-offs needed between "new" PRSP objectives and current existing national policy aims. Thus, in order to incorporate these new PRSP priorities in their spending plans, sector ministries and local administrations will need to reduce other, non-priority expenditures (i.e. make savings and reallocate existing resources between activities).

Since new PRSP activities will be financed largely within existing resource levels, including already committed or programmed external project financing, sector ministries and local administrations will need to restructure their existing budgets, reducing the costs of some services (efficiency savings) and making cuts in other, lower priority services. However, the way that the budget is currently structured (i.e. not by programmes or activities) means that it will be difficult for them to do so.

The total budgetary amount planned to be allocated to the highest priority PRSP activities is approximately YUD 27 billion per year, representing around 1.9% of GDP annually for the 2004-2006 period and less than 5% of the total consolidated budget for the period 2004-2006. This is consistent with the overall macro/fiscal resource framework set out in the 2004-2006 Budget Memorandum.

It is important to note that the process of decentralisation, which will be defined in the new Constitution to be adopted, with consequential changes to revenue and expenditure assignment between different levels of government is likely to have an impact on the relative share of PRSP budgetary financing undertaken by the different levels of government.

Table 2. Funding allocations for PRSP priority areas, 2004-06 % GDP annually

	Central and local budgets and external finance
TOTAL	1,91
Social protection	0,28
Education	0,58
Health care	0,30
Employment and SME development	0,42
Decentralisation, local and public governance	0,05
Regional development	0,05
Rural poverty	0,06
Urban poverty	0,12
Environment protection	0,01
Human rights	0,03
Monitoring and evaluation	0,00

Challenges to the Preparation of More Detailed Costings

The process of analysing the full cost implications of the long-term measures identified in the PRSP has just begun. At present, there is concern about the potential gap between the fiscal resources required to implement the whole PRSP programme of policy measures (long-term) and the funds available in the short- and medium-term. Indeed, the lack of comprehensive prioritisation and costing of policy measures can undermine the implementation of the PRSP. Given budget constraints and multiple goals, there is a need to prioritise among policy alternatives, making explicit the rationale underpinning choices, and acknowledging the trade-offs as well as spillover effects, particularly in terms of the most vulnerable categories of the population.

Thus, a number of challenges remain in the process of building more detailed cost analysis for the PRSP: (i) numerical targets have not yet been set out in sufficient detail to provide the basis for making very detailed costings; (ii) ministries have limited capacities to undertake such detailed costings; (iii) ministries have relatively limited information on existing actual expenditures by activity to determine their starting point; and (iv) the budget system, being based on input budgeting, does not facilitate the identification of priority activities and reallocation of resources towards priority activities. Ministries have made an initial start through classifying sectoral activities into four main groups, identifying priority measures not yet financed, and ensuring that they are consistent with the overall medium-term resource framework.

Experience from other countries in the region suggests that the development of detailed costings of the PRSP is likely to take some years and will have to be linked to procedures for reviewing and determining resource allocations, such as would be incorporated into an MTEF process. This is especially the case in situations where budgetary processes can provide only limited information on programme-level funding allocations and where there is a need for wide-ranging reform of sector and local expenditure programmes to ensure more effective and efficient use of public resources. Typically, in these countries the initial PRSP provides only a very limited costing of proposals, and has instead emphasised the importance of moving ahead with public expenditure management reform.

Over time, therefore, the Government will work towards developing a prioritised set of medium-term costed PRSP activities which is comprehensive and which fits within the overall macro/fiscal resource framework (i.e. that the activities can be financed) and which work towards core PRSP targets. This would be reflected in budget allocations being shown alongside activities in the policy matrices.

Thus, ministries and local administrations will aim to develop the tools and capacities to restructure their budgets in order to facilitate the achievement of PRSP objectives through the implementation of sectoral PRSP activities and making the relevant policy trade-offs. This will involve: (i) a strategic policy review/analysis for each sector and sub-sector, setting out the key policy objectives and priority policies for the sector/sub-sector; (ii) a detailed review of key expenditure programmes within sectors/sub-sectors, including a comprehensive analysis of the activities currently supported by budgetary resources; (iii) identification of measures to improve efficiency of resource use; and (iv) strengthening capacities for budget analysis and planning.

Sector ministries and local administrations will require assistance with this process, and it will take time. Detailed costings of sector PRSP policy measures should be undertaken in stages, in accordance with the implementation of wider public expenditure management reforms. As indicated above, the starting point for detailed sector expenditure work should be a review of current public expenditure patterns, followed by the identification of more efficient ways of undertaking current priority policy measures. As part of wider public expenditure management reforms, this process is also likely to require accompanying changes to the budget structure in order to be able to appropriately reflect the programmes and activities so that they can be planned, executed and reported against.

2. Costing Assessment of PRSP Priority Activities

As indicated above, the total amount to be allocated for PRSP priority sectors[78] is approximately 1.9% of GDP annually (YUD 26.6 billion on average) over the next three years. For comparison, the overall public expenditure for the period will amount to approximately 45% of GDP. The priority PRSP sectors include employment and SME development, education, health care, and social protection. Financing of these sectors for PRSP activities would take place through increases in planned allocation of budgetary resources in relation to GDP (e.g. education) and through cost savings made within the sector (e.g. savings on the wagebill through restructuring of ministry activities, reallocation of existing resources and reductions in overall employment).

The principles behind the allocation of resources shown in the costing section in the PRSP include:

- Emphasis is placed on budgetary savings and optimisation of the work of ministry, local and other government bodies.

- Allocations are defined in such a way as to enable gradual achievement of the set goals in line with the overall macro/fiscal framework.

- The share of domestic fiscal resources in the overall resources for PRSP implementation is rising, in accordance with the goal for Serbia to become able in the medium-term period (till the end of this decade) to solve the poverty problem on its own.

- The importance of maintaining balance between resources intended for mitigation of poverty consequences (social protection) and those earmarked for eradication of poverty causes (education, health, employment and SMEE development etc.).

[78] As indicated above, the activities in the attached costings concentrate on the *highest priority* PRSP actions, not all activities, some of which are longer-term in nature or require other higher-priority activities to take place first.

PRSP COSTING ASSESMENT				
	Central and local budgets and external finance % GDP			**Central and local budgets and external finance**
	Million dinars			**mil EUR**
	2004	**2005**	**2006**	**2004-06**
<u>TOTAL</u>	**24,179.3**	**28,247.9**	**27,510.5**	**1,087.3**
Social protection	3,923.7	4,343.1	3,242.8	157.2
Education-total	7,551.6	8,163.3	8,789.4	333.2
Health care	4,842.1	3,905.6	3,692.2	170.2
Employment and SME development	4,002.0	7,224.9	6,385.3	238.5
Decentralization, local and public administration	671.0	716.7	820.5	30.0
Regional development	587.3	715.0	862.7	29.3
Rural poverty	635.0	910.3	1,039.2	35.0
Urban and housing aspects of poverty	1,490.7	1,675.3	2,015.2	70.3
Environmental protection	134.8	141.6	146.3	5.8
Human rights	314.9	429.5	491.0	16.7
Monitoring and evaluation	26.2	22.7	25.8	1.0
Social protection	3,923.7	4,343.1	3,242.8	157.2
Assistance to poor families	2,000.0	2,026.3	1,994.7	82.0
for IDPs	585.0	526.5	460.7	21.5
for Roma	45.0	45.6	44.9	1.8
Extending the capacities of elderly homes and mental health institutions	175.8	73.8	0.0	3.5
Development of services for family support at the local level	262.5	283.5	297.7	11.5
Education for implementation of reforms in the area of family and social protection	70.3	73.8	0.0	2.0
Social Innovation Funds	281.3	221.3	114.5	8.5
Social innovation Fund (improvement of social protection services)	140.7	73.8	38.2	3.5
Social Innovation Fund (direct poverty reduction)	140.7	147.6	76.3	5.0
Specific needs of persons with disabilities	4.6	4.8	5.0	0.2
Development and networking of databases for persons with disabilities	2.5	2.6	2.7	0.1
Measuring the quality of living environment of persons with disabilities	2.1	2.2	2.3	0.1
Design of unified IT systems of pension funds (design, implementation training)	73.8	703.3	0.0	10.6
Equipping SWCs (IT technology, training and other)	70.3	36.9	0.0	1.5
Payment of farmers' pension arrears	600.0	629.5	651.0	25.6

Assistance to poor refugee families (**Commissariat for Refugees of the Republic of Serbia**)	385.0	290.0	180.0	11.8
Education - total	7,551.6	8,163.3	8,789.4	333.2
Reform of primary and secondary education	1,200.0	602.7	305.5	29.2
Preschool education	1,100.0	1,300.0	1,549.9	53.6
Adjusting secondary vocational schools to market requirements	600.0	609.7	623.1	25.0
Education of people with special needs	900.0	966.1	1,046.5	39.6
Adjustment of educational facilities for children with special needs	4.7	4.9	5.1	0.2
Education for Roma children and adults	1,000.0	1,139.2	1,309.4	46.8
Education of refugees	700.0	578.0	481.7	24.1
Adult vocational education	0.0	600.0	700.0	17.3
Pupils and students' standard	700.0	808.2	941.2	33.2
Reconstruction and equipment for schools	1,300.0	1,505.1	1,776.1	62.2
Educational development centres for excluded children	51.6	54.2	56.0	2.2
Two pilot projects for children from urban areas	15.6	16.4	16.9	0.7
Two pilot projects for Roma children	13.5	14.2	14.7	0.6
Two pilot projects for children in rural areas	22.5	23.6	24.4	1.0
Health care	4,842.1	3,905.6	3,692.2	170.2
Education of medical workers in transitional period	281.3	295.1	305.2	12.0
Raising work quality and strengthening health inspection	30.0	50.0	80.0	2.2
Introduction and development of IT system in primary health care	416.7	450.0	477.0	18.3
Programs of prevention of non-contagious diseases	1,000.0	600.0	648.0	30.8
Health care of refugees	410.0	700.0	350.0	19.9
Health care of IDPs from Kosovo and Metohia	90.0	351.5	298.0	9.9
Health care of uninsured individuals	800.0	864.0	915.8	35.1
Health care of farmers	464.0	108.0	114.5	9.6
Persons with disabilities -orthopedist aids	1,350.1	487.0	503.6	32.4
Employment and SME development	4,002.0	7,224.9	6,385.3	238.5
Training and retraining etc.	430.0	516.0	620.0	21.2
Training for active job seeking	25.0	30.0	36.0	1.2
Stimulation of entrepreneurship	353.0	423.0	506.0	17.4
New programmes (job clubs, virtual enterprises, public works)	7.0	8.4	10.0	0.3
Stimulating employment of vulnerable groups	400.0	180.0	210.0	10.9

Fund for launching of business	1,000.0	3,690.0	2,289.0	94.2
Information technology	50.0	60.0	72.0	2.5
Human resource development	1.0	1.1	1.2	0.0
Training of Ministry and Labour Market staff	5.0	5.5	6.1	0.2
Paying off unemployment benefit arrears	1,000.0	1,500.0	1,500.0	54.2
Employment of Roma	356.3	185.5	196.7	10.2
Elaboration of programmes	3.5	0.0	0.0	0.1
Training-education	17.6	0.0	0.0	0.3
Public construction works	300.0	147.6	156.4	5.4
Legalization of collecting secondary raw materials	35.2	38.0	40.3	1.5
Employing refugees	226.7	480.0	780.0	23.6
Granting favourable loans	141.7	300.0	600.0	16.2
Public construction works	85.0	180.0	180.0	7.4
Stimulating development of small and medium-sized enterprises	148.1	145.4	158.4	6.2
Supporting work intensive sectors	2.7	0.0	0.0	0.0
Strengthening the Republic and regional SME agencies	65.0	65.0	65.0	2.7
Removing legal obstacles to business	13.5	13.5	13.5	0.6
Raising SMEs' competitiveness	43.5	43.5	43.5	1.8
Promoting SMEs' development	6.4	6.4	6.4	0.3
Reform of public services	17.0	17.0	30.0	0.9
Decentralization, local and public administration	671.0	716.7	820.5	30.0
Decentralization and development of local government	93.3	125.5	160.3	5.1
Public administration reform and modernization of governance	200.0	216.0	229.0	8.8
Increasing accessibility of administrative services to the poor	200.0	216.0	229.0	8.8
Education of local government on stimulation of entrepreneurship	93.3	100.8	160.3	4.8
Regulating the status of refugees	84.4	58.4	42.1	2.5
Elaboration of survey, study and policy program	14.1	0.0	0.0	0.2
Programme implementation	70.3	58.4	42.1	2.3
Regional development	587.3	715.0	862.7	29.3
Stimulation of entrepreneurship	42.0	51.6	61.8	2.1
Construction of infrastructure	540.0	663.4	795.1	27.1
Poor areas	5.3	0.0	5.8	0.2
Designing a map of poor areas	2.0	0.0	2.2	0.1
Formulation of a national programme for poor areas	3.3	0.0	3.6	0.1
Rural poverty	635.0	910.3	1,039.2	35.0
Present status analysis and activity programme	35.0	25.8	29.4	1.2
Stimulation of entrepreneurship – business centres	300.0	442.3	504.9	16.9

Reform of the agrarian sector	300.0	442.3	504.9	16.9
Urban and housing aspects of poverty	1,490.7	1,675.3	2,015.2	70.3
Present status analysis and formulation of the social housing strategy	70.0	0.0	0.0	1.0
Formulation of laws and by-laws	10.0	10.0	10.0	0.4
Construction of affordable housing and state support to affordable housing	300.0	500.0	800.0	21.5
Slums – mostly Roma	1,110.7	1,165.3	1,205.2	47.4
Project documentation for 600 settlements	56.3	59.0	61.0	2.4
Regulating and equipping of slums	632.5	663.6	686.3	27.0
Resettling 20 most vulnerable settlements	422.0	442.7	457.8	18.0
Environment protection	134.8	141.6	146.3	5.8
Laws, regulatory mechanisms, education	29.3	30.9	31.8	1.3
Cleaning environmental "hot spots"	105.5	110.7	114.5	4.5
Human rights	314.9	429.5	491.0	16.7
Laws, institutions and education	105.5	147.6	190.8	6.0
Equality of women	139.1	193.4	198.5	7.2
Laws, education and legal help	52.7	73.0	76.3	2.7
Gender studies research	26.4	55.3	57.2	1.9
Programme for prevention of violence against women and children	60.0	65.0	65.0	2.6
Providing legal assistance to the poor	70.3	88.5	101.7	3.5
Monitoring and evaluation	26.2	22.7	25.8	1.0
Central and sectoral teams for M&E of the PRSP	11.8	15.6	18.3	0.6
Development of data sources, research, M&E trainings etc.	13.1	5.8	6.1	0.3
Evaluation	1.3	1.3	1.4	0.1

PRSP COSTING ASSESMENT

	Central and local budgets and external finance % GDP			Central and local budgets and external finance
	2004	**2005**	**2006**	**Average 2004-06**
TOTAL	1.86	1.91	1.67	1.81
Social protection	0.30	0.29	0.20	0.26
Education-total	0.58	0.55	0.53	0.56
Health care	0.37	0.26	0.22	0.29
Employment and SME development	0.31	0.49	0.39	0.39
Decentralization, local and public administration	0.05	0.05	0.05	0.05
Regional development	0.05	0.05	0.05	0.05
Rural poverty	0.05	0.06	0.06	0.06
Urban and housing aspects of poverty	0.11	0.11	0.12	0.12
Environmental protection	0.01	0.01	0.01	0.01
Human rights	0.02	0.03	0.03	0.03
Monitoring and evaluation	0.00	0.00	0.00	0.00
Social protection	0.30	0.29	0.20	
Assistance to poor families	0.15	0.14	0.12	
for IDPs	0.04	0.04	0.03	
for Roma	0.00	0.00	0.00	
Extending the capacities of elderly homes and mental health institutions	0.01	0.00	0.00	
Development of services for family support at the local level	0.02	0.02	0.02	
Education for implementation of reforms in the area of family and social protection	0.01	0.00	0.00	
Social Innovation Funds	0.02	0.01	0.01	
Social innovation Fund (improvement of social protection services)	0.01	0.00	0.00	
Social Innovation Fund (direct poverty reduction)	0.01	0.01	0.00	
Specific needs of persons with disabilities	0.00	0.00	0.00	
Development and networking of databases for persons with disabilities	0.00	0.00	0.00	
Measuring the quality of living environment of persons with disabilities	0.00	0.00	0.00	
Design of unified IT systems of pension funds (design, implementation training)	0.01	0.05	0.00	
Equipping SWCs (IT technology, training and other)	0.01	0.00	0.00	
Payment of farmers' pension arrears	0.05	0.04	0.04	

Assistance to poor refugee families (**Commissariat for Refugees of the Republic of Serbia**)	0.03	0.02	0.01
Education - total	0.58	0.55	0.53
Reform of primary and secondary education	0.09	0.04	0.02
Preschool education	0.08	0.09	0.09
Adjusting secondary vocational schools to market requirements	0.05	0.04	0.04
Education of people with special needs	0.07	0.07	0.06
Adjustment of educational facilities for children with special needs	0.00	0.00	0.00
Education for Roma children and adults	0.08	0.08	0.08
Education of refugees	0.05	0.04	0.03
Adult vocational education	0.00	0.04	0.04
Pupils' and students' standard	0.05	0.05	0.06
Reconstruction and equipment for schools	0.10	0.10	0.11
Educational development centres for excluded children	0.00	0.00	0.00
Two pilot projects for children from urban areas	0.00	0.00	0.00
Two pilot projects for Roma children	0.00	0.00	0.00
Two pilot projects for children in rural areas	0.00	0.00	0.00
Health care	0.37	0.26	0.22
Education of medical workers in transitional period	0.02	0.02	0.02
Raising work quality and strengthening health inspection	0.00	0.00	0.00
Introduction and development of IT system in primary health care	0.03	0.03	0.03
Programmes of prevention of non-contagious diseases	0.08	0.04	0.04
Health care of refugees	0.03	0.05	0.02
Health care of IDPs from Kosovo and Metohia	0.01	0.02	0.02
Health care of uninsured individuals	0.06	0.06	0.06
Health care of farmers	0.04	0.01	0.01
Persons with disabilities -orthopedist aids	0.10	0.03	0.03
Employment and SME development	0.31	0.49	0.39
Training and retraining etc.	0.03	0.03	0.04
Training for active job seeking	0.00	0.00	0.00
Stimulation of entrepreneurship	0.03	0.03	0.03
New programmes (job clubs, virtual enterprises, public works)	0.00	0.00	0.00
Stimulating employment of vulnerable groups	0.03	0.01	0.01
Fund for launching of business	0.08	0.25	0.14

Information technology	0.00	0.00	0.00
Human resource development	0.00	0.00	0.00
Training of Ministry and Labour Market staff	0.00	0.00	0.00
Paying off unemployment benefits arrears	0.08	0.10	0.09
Employment of Roma	0.03	0.01	0.01
Elaboration of programs	0.00	0.00	0.00
Training-education	0.00	0.00	0.00
Public construction works	0.02	0.01	0.01
Legalization of collecting secondary raw materials	0.00	0.00	0.00
Employing refugees	0.02	0.03	0.05
Granting favourable loans	0.01	0.02	0.04
Public construction works	0.01	0.01	0.01
Stimulating development of small and medium-sized enterprises	0.01	0.01	0.01
Supporting work intensive sectors	0.00	0.00	0.00
Strengthening the Republic and regional SME agencies	0.00	0.00	0.00
Removing legal obstacles to business	0.00	0.00	0.00
Raising SMEs competitiveness	0.00	0.00	0.00
Promoting SMEs development	0.00	0.00	0.00
Reform of public services	0.00	0.00	0.00
Decentralization, local and public administration	0.05	0.05	0.05
Decentralization and development of local government	0.01	0.01	0.01
Public administration reform and modernization of governance	0.02	0.01	0.01
Increasing accessibility of administrative services to the poor	0.02	0.01	0.01
Education of local government on stimulation of entrepreneurship	0.01	0.01	0.01
Regulating the status of refugees	0.01	0.00	0.00
Elaboration of survey, study and policy programme	0.00	0.00	0.00
Program implementation	0.01	0.00	0.00
Regional development	0.05	0.05	0.05
Stimulation of entrepreneurship	0.00	0.00	0.00
Construction of infrastructure	0.04	0.04	0.05
Poor areas	0.00	0.00	0.00
Designing a map of poor areas	0.00	0.00	0.00
Formulation of a national programme for poor areas	0.00	0.00	0.00
Rural poverty	0.05	0.06	0.06
Present status analysis and activity programme	0.00	0.00	0.00
Stimulation of entrepreneurship – business centres	0.02	0.03	0.03
Reform of the agrarian sector	0.02	0.03	0.03

Urban and housing aspects of poverty	0.11	0.11	0.12
Present status analysis and formulation of the social housing strategy	0.01	0.00	0.00
Formulation of laws and by-laws	0.00	0.00	0.00
Construction of affordable housing and state support to affordable housing	0.02	0.03	0.05
Slums – mostly Roma	0.09	0.08	0.07
Project documentation for 600 settlements	0.00	0.00	0.00
Regulating and equipping of slums	0.05	0.04	0.04
Resettling 20 most vulnerable settlements	0.03	0.03	0.03
Environment protection	0.01	0.01	0.01
Laws, regulatory mechanisms, education	0.00	0.00	0.00
Cleaning environmental "hot spots"	0.01	0.01	0.01
Human rights	0.02	0.03	0.03
Laws, institutions and education	0.01	0.01	0.01
Equality of women	0.01	0.01	0.01
Laws, education and legal help	0.00	0.00	0.00
Gender studies research	0.00	0.00	0.00
Programme for prevention of violence against women and children	0.00	0.00	0.00
Providing legal assistance to the poor	0.01	0.01	0.01
Monitoring and evaluation	0.00	0.00	0.00
Central and sectoral teams for M&E of the PRSP	0.00	0.00	0.00
Development of data sources, research, M&E trainings etc.	0.00	0.00	0.00
Evaluation	0.00	0.00	0.00

V IMPLEMENTATION AND MONITORING OF THE POVERTY REDUCTION STRATEGY

1. Implementation of PRSP programmes

The fight against poverty is a long struggle that will be facilitated by the implementation of the Poverty Reduction Strategy Paper (PRSP). To maximise the future impact of the strategy, it is important to ensure an effective integration with and linkages to the overall reform process in Serbia and the overarching European Integration agenda. It is also of central importance to align and link the implementation of the PRSP with the Budget process and the Reform Agenda of Serbia since these establish the framework for the allocation of budget and external resources. The EIp, the Budget Process, RAoS and the PRSP, due to their multisectoral and comprehensive focus, are all key pillars of the reform process in Serbia.

With the adoption of the Strategy, the focus shifts from planning to action - a critical and challenging phase for most strategy processes. In the case of the PRSP this challenge is strengthened since two slightly diverging main considerations need to be taken into consideration when designing the implementation modality:

- First, due to the overall poverty situation in Serbia it is critical to ensure that policies and actions laid out in the strategy move into implementation in an efficient and rapid manner, taking into consideration sequencing and prioritisation. This indicates the need to build a strong central capacity to oversee and steer the implementation process. In the past, the Government has often chosen a model with a partly external unit or agency to meet these requirements due to the limited flexibility and constraints of the regular public administration.

- Second, due to the long-term dimension and the complexity of the strategy, it is necessary to develop sustainable institutional arrangements which will promote long-term ownership of the strategy and its implementation within both the public administration and the wider political leadership. This highlights the importance of ensuring that the implementation of the strategy is fully integrated in regular structures within the administration. Experiences from Serbia and other transitional countries have shown that it is a long-term and difficult task to achieve this for multi-sectoral and complex processes like the PRSP and the EIp. The reason for this is the diversity of interests and stakeholders involved, changing global and sector priorities, weak horizontal information flows and co-ordination, limited central co-ordination mechanisms, etc.

The task at hand is to develop an effective implementation mechanism taking into consideration the somewhat conflicting interests laid out above. The Government of Serbia is committed to doing so, building on the following elements:

- The relevant line ministries, government institutions and agency will be responsible for the implementation of the policies, measures and activities laid out in the PRSP. Different types of action plans and programmes will be developed during the coming period to facilitate implementation, to promote accountability and to make it easier for external and internal stakeholders to follow the process. As indicated above it will be necessary to strengthen the internal links between staff in central and local level government bodies which are responsible for the Budget process, Development and Aid Co-ordination, the European Integration process and Public Administration reform. Specific steps which are being considered at ministry level are: the creation of a strategy/policy implementation team, strengthening the ability to use the budget process for planning and programming, the sharing of human resources, etc.

- A central function/unit will be established within the Cabinet of the PM / General Secretariat of the Government to oversee and facilitate the implementation of the PRSP. It is the aim of the Government to develop this function in conjunction with the recently initiated process of strengthening the central co-ordination mechanisms of the Government. Regular progress reports will be prepared and presented to the Government identifying progress, problems and challenges, changing priorities, recommended actions, etc. These reports will be based upon data from the "Central Team for Monitoring and Evaluation " as described in detail in the following chapter.

- The importance of involving the local level of the Government both in identification of problems and policies, planning and implementation has been emphasised throughout the strategy. Even though a number of initiatives are ongoing to strengthen the Local Self Government (LSG) much work is still needed. There is also need for closer co-ordination of ongoing initiatives to better exploit potential synergies and share lessons learned.

- As with the development of the PRSP, wider civil society will play a critical role both in implementation and in monitoring and evaluation. The Government welcomes the intentions of ACs to continue to develop and to play a pro-active role in the forthcoming implementation process. It is the Government's intention to strengthen links to activities that are already ongoing such as Development and Aid Co-ordination, Social Innovation Fund, etc.

Bearing in mind the importance of ensuring close links between the PRSP, EIp and the use of budget and external assistance it is important to look into the possibility of developing joint steering and implementation mechanisms. In this context it would be natural to investigate the possibility of linking some of the above mentioned processes closer together.

The linkage between the PRSP and the SAp criteria and the Millennium Development Goals has been explicitly highlighted in the policy / activity matrices. Through the PRSP process, Serbia has made significant progress in nationalising the MDGs. This process will continue and the Government is committed to using the MDGs as an integral part of the long-term development goals for Serbia.

The implementation of the PRSP will include a comprehensive Monitoring and Evaluation system. A draft system which comprises both input, output and process indicators is explained in the following sections.

2. Monitoring of Poverty Reduction Strategy Implementation

The monitoring and evaluation system should cover all the phases in the implementation of the Strategy and, therefore, its basic tasks are:

- Monitoring efficiency in the implementation of the activities defined within the Strategy (Input, Process and Output Monitoring),
- Assessing the efficiency in the achievement of the basic and sectoral goals set by the Strategy (Outcome and Impact Monitoring and Evaluation),
- Monitoring the level, trend and profile of poverty for the purpose of timely redefining of certain elements of the Strategy (if necessary),
- Monitoring the participation of the poor in the strategy implementation process,
- Promoting stakeholder accountability in strategy implementation.

2.1. Poverty-related surveys/parameters used so far

A principal source of data for monitoring the poverty level is the Household Budget Survey carried out by the Federal Statistics Office (FSO) and the Republic Statistics Office of Serbia (RSO). The Survey gives a detailed picture of household income and expenditures and general data on the demographic structure of households, with the possibility of quarterly monitoring.

The following definitions are usually used for the poverty line:

- Consumer basket for a four-member household (only food, published by FSO),
- Average consumer basket – RSO,
- Minimum consumer basket – RSO,
- Minimum subsistence basket of the World Food Program,
- Various USD amounts per capita (1, 2 and 4 USD), with or without PPP correction,
- Relative poverty measures (60% household income median).

The percentage and number of the poor, the degree of inequality in distribution, and the territorial distribution of the poor, were calculated on the basis of these parameters.

2.1.1. Participants engaged in collecting data required for poverty monitoring

The main participants in data collection are:

- Statistics Offices

- The Health Care System
- National Bank of Serbia
- Records of line ministries (social welfare system, education system, etc.)

A number of polling agencies and research institutes are engaged in carrying out regular or occasional surveys on poverty and the economic status of the population, i.e. particular groups of population, economic trends or other parameters relevant to poverty monitoring.

Besides the above-mentioned participants, a number of international humanitarian and development agencies are also engaged either in collecting data in the field or in hiring local research agencies for the purpose of monitoring the poverty level and the state of the population in Serbia, and more often the poverty level and state of particular vulnerable groups. For example:

- The World Food Program and the United Nations High Commissioner for Refugees carry out regular surveys of the economic status of the refugee population and regular annual evaluations of humanitarian needs in food;
- From time to time UNICEF and the World Health Organization carry out (at intervals of several years) multiple-indicator surveys on the state of health of the population and particularly on the under-nourishment of children (Multiple Indicator Cluster Survey, MICS);
- Local NVOs (Report on Status of Human Rights in SCG, Center for Human Rights in Belgrade, Serbia in the 1980-s, 1990-s and 2000, Institute for Social Sciencies, Service of personal assistants in Serbia, CIL).

2.1.2. Various poverty monitoring methodologies

There are two types of basic problem related to monitoring poverty. The first is the methodological openness of defining poverty, arbitrariness in setting poverty line standards, and the complexity of establishing a system that will efficiently and unmistakably show poverty trends. The other problem is the availability and quality of data.

Public opinion is especially sensitive to various definitions and poverty levels that have appeared in recent poverty surveys. Expert consultations are required when establishing general definitions of the poverty line in order to minimize the possibility of manipulation, and to ensure openness and transparency in monitoring the level of poverty. Out of several possible approaches and definitions it is necessary to select the one that is resistant to methodological manipulations and which can provide comparisons over time. It is desirable that the definition is not methodologically complex. A similar approach is also welcome in defining other key parameters for monitoring poverty and Strategy efficiency.

Special attention should be paid to the defining of poverty as a multi-dimensional phenomenon. Besides the economic approach, various aspects of poverty will also be included within the set of MDG indicators, as well as by specific participatory and sociological research.

2.1.3. Problems with the existing data sources

The official statistics with its regular surveys is the principal regular source of data for monitoring the effects of the Poverty Reduction Strategy. The existing statistics system has suffered for years because of isolation, the unfavourable budget situation, and staff drain. In addition, quite a number of surveys are carried out according to a methodology which does not reflect current economic relationships (due to the transition and reform process, and an inadequate covering of private sector growth).

The lack of regular qualitative research (on the attitudes and expectations of the population, causes of poverty, etc.) is also evident. There is a need for regular participatory research that would throw more light on the qualitative aspects of poverty, which would at the same time encourage the poor to take part and express their attitudes concerning poverty issues.

The issue of the revision of the system of statistical surveys has been addressed through the preparation of the new Master Plan for Statistical Surveys and the development of a concrete action plan for making a revision of surveys (proposed by FSO and RSO of both republics). This plan takes account of most of the criticisms made so far and envisages the revision of quite a number of surveys. In addition, the plan also envisages general personnel and technological improvement of the statistical system. In the situation analysis and preparation of the plan, much assistance was provided by international statistical organizations (including EUROSTAT, and renowned statistical agencies of other countries). International expert and financial assistance will continue through the ongoing reform of the system.

Another significant source of poverty-related data is the network of municipal social welfare centres. A weak point is the lack of a uniform information system which would enable regular and prompt data processing and the preparation of specific reports on the current status of poor families and persons. There is also a need for better interconnection of the local centres and other local participants that collect or have relevant data required for monitoring the poverty level.

There is a noticeable absence of regular and comparative surveys focused on monitoring the status of particular vulnerable groups (refugees and IDPs, Roma, social transfer beneficiaries, etc.). In addition, official surveys and data sources are usually not representative of this population.

2.2. Defining the system for monitoring PRSP implementation and outcomes

2.1. Defining the basic set of poverty indicators

The basic set of outcome indicators should enable an insight into the effects of Strategy implementation, the poverty level and trends in various dimensions (economic status, education, health and others). The basic set of poverty indicators will be based on those set by the **Millennium Development Goals**. The Millennium Development Goals were globally defined by a UN General Assembly declaration and accepted by most countries of the world. Some of the indicators will require minor changes due to local characteristics (for example, yellow fever morbidity and mortality rates are not included). Poverty rates will be calculated according to several basic poverty lines (the national poverty line defined by the consumer basket, and the poverty line set at the 60% household per capita income median).

Millenium Development Goals and the recommended set of indicators enable insight into and monitoring of poverty as a multi-dimensional phenomenon, since they include, in addition to the basic indicator of the number of the poor, various aspects of poverty (including those relating to education, health care, gender equity, and a healthy living environment) At the same time, MDG indicators affirm the human rights aspect. In drawing up the basic set of indicators, recommendations from the document "A Human Rights Approach to Poverty Reduction Strategies", Office of the United Nations High Commissioner for Human Rights, were also used.

One of the basic indicators of Strategy success will be the number of persons below the national poverty line. This definition starts from the minimum food consumer basket, estimating other necessary articles and services by means of the Engel's method, also used in the Survey on the Living Standard of the Population[79] (SLSP, Ministry of Social Affairs of the Republic of Serbia). For the sake of comparability with EU countries, the poverty line set at the 60% household per capita income median is also proposed.

Besides the basic indicators suggested by the Millennium Declaration, there is a set of important additional indicators that should be included. It is also very important to consider basic parameters grouping levels/types (by particular features, such as: sex, household type, and region). It is especially important to group the parameters and monitor them by particular especially vulnerable groups (including MOP beneficiaries, displaced persons and refugees, Roma, and persons with disabilities).

Defining sectoral indicators (process and outcome)

In addition to basic outcome indicators suggested by the Millenium Declaration, specific outcome benchmarks for monitoring progress in achieving strategic and operational objectives in certain sectors also need to be defined.

Sectoral process indicators that would enable monitoring of strategy implementation should be defined. Process indicators and monitoring dynamics are derived from sectoral policy/activity matrices and include the monitoring of PRSP implementation phases.

Process indicators include monitoring of strategy implementation from the initiation of a certain activity (level of investment in certain sectors that have a poverty reduction impact), to the monitoring of concrete reform trends (legislative changes...) and monitoring of implementation of concrete projects and activities within the PRSP, to the achievement of immediate activity results (e.g. «number of persons who attended training for professions that are in high demand») .

Outcome indicators are linked to the achievement of the declared Strategy objectives and to particular sectors (e.g.lower poverty rate among Roma population or lower unemployment rate of the population)

[79] What is estimated is the average total consumption of households which consume food on the level of the previously defined subsistence food basket. In this way the unknown share of non-food stuff consumption and the total poverty line level are calculated on the basis of concrete data of the Household Budget Survey.

Based on the numerous criteria that a set of indicators should generally fulfil, as well as many suggestions from relevant state institutions, civil society, international development partners, and other actors in the development of the PRSP, a preliminary set of indicators was proposed (see Annex). It is very extensive, with more than 100 outcome and more than 160 process indicators. The extensive scope of the set resulted from the need for multi-dimensional poverty monitoring and, particularly, from the complexity of monitoring that will include numerous sectors and institutions. It is estimated that some 60% of outcome indicators and around 80% of process indicators can be provided from existing data sources, with small modifications (for example, in a number of cases process indicators boil down to the needed changes and implementation of new regulations, which are easy to monitor). The list of indicators is not final. Following systematic analysis of data availability[80] (regularity, quality, relevance), the list will be updated.

2.2.2 Data sources and requirements from the statistical system, alternative sources

Revision of the existing Household Budget Survey, enabling the implementation of standard poverty monitoring methodologies

Experiences of progressive methods of poverty analysis[81] should be incorporated into regular poverty monitoring mechanisms. The most efficient way would probably be a partial modification of the existing Household Budget Survey (HBS)[82]. In this way the necessary regular periodic calculation of the poverty level according to the defined poverty line would be provided, as well as poverty distribution by specific features (region, household type, demographic and socio-economic characteristics of persons, gender, and vulnerable groups). It is also necessary to provide distribution and inequality analyses (decile analyses, Gini coefficient by different groups). In order to meet these requirements, a team of experts in statistics has been established. The purpose of this team is to carry out intensive research and present concrete suggestions and changes to be integrated into the regular statistical surveys (new HBS).

Analysis and revision of the present Master Plan of Statistical Surveys in accordance with demands for monitoring the achievement of the PRSP and Millennium Development Goals

Since the basic set of output indicators mostly relies on recommendations and definitions from the set of the Millennium Development Goals, one of the important activities will be to consider the availability of data sources and capacities for the revision of current data sources, as well as the introduction of new ones. The above-mentioned team of statistics experts will also be in charge of designing a study on the availability of data sources for the purposes mentioned. The study should offer a concrete action plan for the revision of current statistical surveys for the purpose of quality monitoring of MDG and PRSP goals.

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[80] The analysis of the proposed set of indicators and the existence of data sources, as well as alternative options, is being carried out.

[81] Survey on the Living Standard of the Population in Serbia (conducted by the Ministry of Social Affairs of the Republic of Serbia, with expert and financial support from the World Bank) demonstrated a very strong set of methods in poverty analysis.

[82] Household Budget Survey (HBS), a regular survey conducted by the Serbian Office of Statistics

Encouraging development of alternative data collection networks

The need for the development and use of alternative data sources has been confirmed through numerous discussions with representatives of the professional public. The statistical system has difficulties in monitoring those population groups who have not been integrated into society, with no permanent residence, as they are not easily covered by regular records and surveys. It is necessary to support local initiatives for establishing records of the poor, especially in municipalities with expected high poverty rates. Emphasis should be put on connecting the locally available data sources (local labour markets, social welfare centres, records of large companies that are being restructured, local governments, NVOs) and on creating a unique data base on poor families and persons in municipalities. The development of a uniform information system for the network of local Social Welfare Centres and more active field work by social workers should be encouraged.

It should be mentioned that the Institute of Public Health, together with UNICEF, is trying to organize a system for monitoring the growth and development of children, which would provide a uniform data source. A repeated UNICEF-organized MICS survey would be very useful for providing specific health care and educational information on the population of children and mothers in Serbia.

The monitoring of particularly vulnerable population groups (beneficiaries of social assistance, IDPs and refugees, Roma, persons with disabilities, etc.) is not possible without expert and financial support from international development partners and more active participation of non-governmental organizations with proven experience in such research and established contacts with these population groups. The NGO sector has the capacity to develop alternative data sources, and to organise a wide network for monitoring and the application of specific procedures such as participatory monitoring and specific forms of socio-monitoring, as well as monitoring of qualitative aspects of PRSP activities in the local community.

The NGO network "Serbia Free of Poverty", established in 2001, includes 20 local non-governmental organizations from 14 towns across Serbia. One of the activities that they are engaged in is collecting data on poverty and vulnerable groups.

Professional research agencies, capable of carrying out field research and implementing expert evaluations may also be engaged in certain cases.

Enabling participation of interested stakeholders, civil society and especially vulnerable groups in monitoring strategy implementation and outcomes.

The success of the PRSP to a large extent depends on the efficient and active involvement of civil society, local communities and vulnerable groups (Roma, MOP beneficiaries, refugees and IDPs) in the PRSP implementation and monitoring process. There are several channels for the inclusion of these groups.

The first channel is the **local** organization of groups for monitoring Strategy implementation and outcomes within municipal socio-economic councils. The mandatory requirement regarding these groups would be the inclusion of representatives of civil society and vulnerable groups. Apart from this form of organization, local NGOs can significantly strengthen the capacities for monitoring PRSP implementation and outcomes by organizing special thematic monitoring groups (sociological aspects, budgetary/financial monitoring, participation of the poor, etc).

The other channel for the inclusion of civil society and vulnerable groups is **at the national level**, and includes their direct participation in the national non-governmental and civil society working group, as well as their direct participation in the Central PRSP monitoring and implementation team.

Support would also be provided for the organization of regular participatory research that would enable the collection and systematization of opinions of the representatives of poor population categories on PRSP implementation and outcomes. This research would point to innovative directions for Strategy development and implementation based on the participation and opinions of the poor.

Role of civil society and the NGO sector in monitoring Strategy implementation and outcomes

In the preceding passages reference was made to the capacities of the NGO sector that can be mobilized for the organization of a research network to be used in certain forms of PRSP monitoring. In order to achieve better coverage, better quality and comparability of data provided by different actors, it would be useful to standardize and unify data collection procedures and report forms. This would result in greater transparency of PRSP activities and greater interest from the local community in taking an active part in Strategy implementation. Support is needed for the development of specific data collection and processing procedures and their adjustment to local actors.

With a view to defining acceptable and efficient methods of inclusion of vulnerable groups and local communities in Strategy monitoring, four local NGO projects in the field of PRSP monitoring were supported (ARDI Belgrade, Resource Center Niš, Open University and Open Perspectives, Subotica). In addition, UNICEF is currently carrying out participatory research on children's poverty in Serbia. These efforts, building on previous experience, will provide a solid basis for the proposal of a set of participatory research and questionnaires on vulnerable groups in Serbia. The key role in the implementation of this research should belong to NGOs.

Civil society and the NGO sector are interested in the process of monitoring budgetary prioritization and the spending of budgetary resources at the local level. The new Law on the Budget System provides for the standardization of the nomenclature and enables good quality reporting. It is necessary to advocate and enable a presentation of local budget spending by project principle, so that spending and investing of funds in concrete planned and executed activities in the local community could be monitored. Particular importance should be attached to Public Expenditure Tracking Surveys, in which the NGO network could take an active role.

Public Expenditure Tracking Surveys (PETS) are research based on the monitoring of the financial flow of public expenditures to the end beneficiary of goods and services, ascertaining potential inadequacies or inefficiencies in the use of budgetary resources.

2.2.3. Evaluation of the implementation and success of the PRS

A regular annual evaluation of PRSP implementation and outcomes is envisaged in all the previously defined sectors. Above all, Strategy implementation in terms of economic indicators, i.e. resources allocated and spent in certain segments/projects of the Strategy, should be monitored. The next step is the evaluation of the implementation of planned activities according to previously defined basic process indicators. In a considerable number of cases it is necessary to establish the level of institutional and legislative changes carried out (at the same time qualifying the implementation of adoped laws).

It is necessary to make a selection of areas and activities of special interest to be specially evaluated during or at the end of the Strategy implementation cycle. Bearing in mind the need for significant resources for each particular evaluation, it is necessary to prioritize and schedule the areas that will be evaluated on the basis of defined criteria (high significance for poverty reduction, considerable investment in a specific activity, etc..).

Expert assistance from the World Bank is expected in the performance of quite a number of evaluations (Multi-dimensional quality of poverty in Serbia, Effects of the change in the electrical power tariff system on poverty, Evaluation of the social system reform, Map of poverty in Serbia). The assistance and participation of local experts in these evaluations is also anticipated.

It is very important to introduce testing practice, to simulate the effects of the implementation of new measures and policies that have an impact on poverty-stricken groups. The examples are the analysis of the impact of an increase in the price of electricity on the poverty level, and the analysis of changes in the number of MOP beneficiaries depending on the eligibility criteria.

An integrated plan for data collection and the performance of evaluations will be drawn up bearing in mind all the available data sources and needs for particular evaluations.

2.2.4. Organization of the monitoring system

It is planned that teams for strategy monitoring be organized by sector. The key line ministries (of social affairs, health care, education, etc.) would nominate individuals (or small teams if possible) in charge of monitoring strategy implementation and outcomes. This does not necessarily imply hiring new staff; the ministries are supposed already to have experts responsible for planning and analysis who would be the most appropriate members of a working group for strategy monitoring. The working group should also include experts from the official statistics system. In many countries, official statistics is the main body responsible for monitoring Millennium Goal indicators.

Experts from civil society would constitute a separate working group. The network of non-governmental organizations should be strengthened in order to cover local budget monitoring, participatory monitoring and questionnaires focused on sociological and psychological aspects of the strategy. The NGO working group would delegate one representative to the Central team for monitoring PRSP implementation and outcomes.

The establishment of local level working groups for Strategy monitoring, within socio-economic municipal councils, should be encouraged. It is desirable that working groups should comprise experts, together with representatives of civil society, vulnerable groups and relevant local institutions (employment bureaux, health care institutions. etc.).

One way of organizing a working group for monitoring strategy implementation and outcomes has been suggested by the project «Active inclusion of the local community of Zvezdara in the process of monitoring PRSP implementation and outcomes». The project was carried out by a local NGO, ARDI, Belgrade, within the PRSP Local Initiatives project. The suggestion on the modus of local organization resulted from a series of consultative meetings with the representatives of relevant local institutions as well as of vulnerable groups.

Local monitoring working groups would have their representative in the Local Government Advisory Committee, who would be, at the same time, a member of the Central team for monitoring strategy implemenation and outcomes. In addition, the Central team would also include representatives of the main vulnerable groups.

The central team for monitoring strategy implementation and outcomes would have a special function. The basic structure of the team would include several members in charge of the coordination of sectoral monitoring and evaluation teams, collection of sectoral reports from working groups and the preparation of a synthesized report on strategy implementation and outcomes, covering specific segments of strategy monitoring and media communication, as well as communication with the PRSP implementation management unit. The wider composition of the team would include representatives of Advisory Committees, i.e. working groups (representative of the local government working group, civil society/vulnerable groups and several representatives of certain relevant stakeholder groups/institutions). The wider Central team would meet bi-monthly (if necessary, more frequently).

Regular quarterly reports on PRSP implementation should be submitted to the Parliament of the Republic of Serbia, together with an annual report on Strategy implementation and outcomes.