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INTERNATIONAL FINANCE CORPORATION

MULTILATERAL INVESTMENT GUARANTEE AGENCY

COUNTRY PARTNERSHIP FRAMEWORK

FOR

MONTENEGRO

FOR THE PERIOD FY16-FY20

May 24, 2016

South East Europe Country Management Unit
Europe and Central Asia

The International Finance Corporation
Europe and Central Asia

The Multilateral Investment Guarantee Agency

The date of the last Country Partnership Strategy Progress Report was May 29, 2014.

CURRENCY EQUIVALENTS
Exchange Rate Effective May 5, 2016
Currency Unit – Euro
EUR 1.00 = US$ 1.14
SDR 1.00 = US$ 1.42

FISCAL YEAR
January 1 – December 31

ABBREVIATIONS AND ACRONYMS

ASA	Advisory Services and Analytics	NPL	Non-performing Loan
B40	Bottom 40 percent of the population	PEFA	Public Expenditures and Financial Accountability
CPF	Country Partnership Framework	PLR	Performance and Learning Review
CPS	Country Partnership Strategy	PPP	Public-Private Partnership
DPL	Development Policy Loan	SCD	Systematic Country Diagnostic
DPO	Development Policy Operation	SORT	Systematic Operations Risk-rating Tool
EC	European Commission	SFRY	Socialist Federal Republic of Yugoslavia
ECA	Europe and Central Asia	SOE	State-Owned Enterprise
EU	European Union	WB	The World Bank
EUR	Euro	WBG	The World Bank Group
FDI	Foreign Direct Investment		
FSAP	Financial Sector Assessment Program		
FY	Fiscal Year		
GDP	Gross Domestic Product		
GEF	Global Environment Facility		
IBRD	International Bank for Reconstruction and Development		
ICT	Information and Communication Technology		
IEG	Independent Evaluation Group		
IFC	International Finance Corporation		
IFI	International Financial Institution		
IMF	International Monetary Fund		
IPA	Instrument for Pre-Accession		
IPARD	Instrument for Pre-Accession in Rural Development		
MIGA	Multilateral Investment Guarantee Agency		
LGBT	Lesbian, Gay, Bisexual, and Transgender		
MSME	Micro, Small, and Medium Enterprises		

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MONTENEGRO COUNTRY PARTNERSHIP FRAMEWORK

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FY16-20 COUNTRY PARTNERSHIP FRAMEWORK FOR MONTENEGRO

I. INTRODUCTION

1. **The Country Partnership Framework (CPF) for Montenegro covers the period from July 1, 2015 to June 30, 2020 (fiscal years 2016-2020)**. The CPF builds on the results and lessons of the previous World Bank Group (WBG) Country Partnership Strategy (CPS), which originally covered the period July 1, 2011 to June 30, 2014, and was subsequently extended to June 30, 2015. The one-year CPS extension[1] was intended to provide greater clarity on the country's medium-term macro-fiscal framework as a basis for the new CPF, and to give additional time to make progress on improving environmental management, a key pillar of the CPS. The new CPF seeks to address the top priorities identified by the recently completed Systematic Country Diagnostic (SCD)[2] as those that Montenegro needs to most urgently tackle to advance in its path towards shared prosperity and sustainable development.

2. **The CPF will selectively support Montenegro's development agenda outlined in the Montenegro Development Directions (MDD) 2015-2018, Economic Reform program 2015-2017 (ERP) and the Montenegro EU Accession Program 2014-17.** The MDD, which was adopted in July 2015, identifies three main policy objectives, namely, Smart Growth, Sustainable Growth and Inclusive Growth, each encompassing key strategic sectors for investment. The MDD identifies tourism, energy, agriculture and rural development, and manufacturing industry as the main priority sectors, and recognizes the need to increase productivity and enable job creation. The CPF will complement and support the areas outlined in the MDD that will most effectively contribute to eradicating poverty and improving shared prosperity.

3. **The WBG strategy will continue to support, and be aligned with, Montenegro's EU accession and integration process.** The country is a frontrunner among its neighbors in terms of accession to the European Union, but substantial efforts are still needed if it is not only to become a member country, but also to be able to compete and take full advantage of the benefits of the Union. The CPF will support these efforts to strengthen the foundations of Montenegro's long term growth and development, as well as continue to provide targeted support, where appropriate, for meeting specific accession benchmarks.

4. **The formulation of the new CPF benefitted from extensive consultations** held in October 2015 and in January and March 2016, and involving several line ministries, municipalities, civil society, academia, and private sector across various regions of the country, as well as representatives of the international development community. The resulting proposal for engagement under the FY16-20 CPF reflects a broad consensus of a wide range of stakeholders and a shared understanding of development priorities and challenges facing the country.

[1] See Progress Report, May 29, 2014.
[2] Report No. 105019-ME.

II. COUNTRY CONTEXT AND DEVELOPMENT AGENDA

2.1 Social and Political Context

5. Montenegro is a small[3] young state that gained sovereignty only in 2006, after a referendum that resulted in the separation from the State Union of Serbia and Montenegro. Prior to that, Montenegro was one of the republics of the Socialist Federal Republic of Yugoslavia (SFRY). Independence followed a decade of political debate as well as a complex transition from a command-and-control to a market economy. The political spectrum has been dominated by the Democratic Party of Socialists (DPS), which has been in power since independence. The next parliamentary elections are planned for October 2016.

6. Montenegro is still undergoing transition to a sovereign state and to a market economy. Transition to a sovereign nation required an expansion of government capacities. National institutions had to be created to assume these functions. EU-compatible regulatory bodies and capacity to absorb EU funds and harmonize the legal framework with that of the EU required new capacity to be built. Because Montenegro is a small state, the already high costs of developing and running national institutions and a central government are compounded by a limited capacity to exploit economies of scale in the provision of public goods and services. At the same time, the economic transition to a market economy has required a reduction of the footprint of the state in the economy**.** Legacies of the SFRY were large public employment, including in State Owned Enterprises (SOEs), and large government spending. Moving away from this model to create a favorable environment for private sector development requires a reduction of public sector employment, restructuring of SOEs, and rationalization of public spending. Governance has improved but continues to lag behind EU member states, particularly in areas such as regulatory quality, control of corruption, and rule of law (see paragraph 30 for more detail).

7. The opening of EU accession negotiations in June 2012 represents an important milestone in Montenegro's international integration. Montenegro started negotiations with the European Union in June 2012 and strives to join by 2020 ahead of the other countries in the Western Balkans. Of the 35 negotiations chapters, two have been provisionally closed and twenty two have been opened. In the latest European Commission (EC) Progress Report on Montenegro, issued in November 2015, the EC notes that Montenegro has made good progress towards meeting opening benchmarks for chapters such as agriculture and rural development, energy, employment and social policy, and regional policy and preparation for structural instruments. The report notes that particular attention needs to be paid to fulfilling the opening benchmarks in chapters like competition policy and environment and climate change. The EC also emphasizes that progress in the accession process overall will depend on progress on the rule of law.

[3] With a population of 624,000.

2.2 Recent Economic Developments

8. As a small open economy without its own currency,[4] Montenegro is vulnerable to external shocks. Before the 2008 global financial crisis, Montenegro benefitted from high growth spurred by high capital inflows and government spending, reaching over 46 and 51 percent of GDP in 2008, respectively. This boosted consumption, imports and investments, and led Montenegro to incur a large external debt to GDP ratio of 106 percent and an alarming current account deficit. Between 2000 and 2008 real GDP increased at an average of nearly 5 percent a year, peaking at 10.7 percent in 2007. Commercial banks supported private sector activities with an expansion of credit of an average of 77 percent per annum in 2003-08, bringing the credit to GDP ratio to 90.7 percent by 2008 and the loan-to-deposit ratio to 167 percent at its peak in April 2009.

9. The 2008 global financial crisis interrupted capital inflows and private investment, and growth plummeted. GDP contracted by 5.7 percent in 2009 and remained at 1.7 percent on average until 2014. The subsequent tightening of external financing caused a contraction of domestic consumption and a collapse in investment and decelerated imports. GDP growth contracted abruptly, from 6.9 percent in 2008 to –5.7 percent in 2009. The aftermath of the credit expansion was reflected in high levels of non-performing loans, followed by a credit crunch that has kept credit to GDP ratios below pre-crisis levels. The Government implemented a fiscal stimulus to support recovery, including a large public investment package and increased social transfers. These efforts paid off and growth rebounded, recovering the output lost since 2008, supported by investments in real estate, energy, and tourism.

Figure 1: Changes in Economic Growth and Poverty

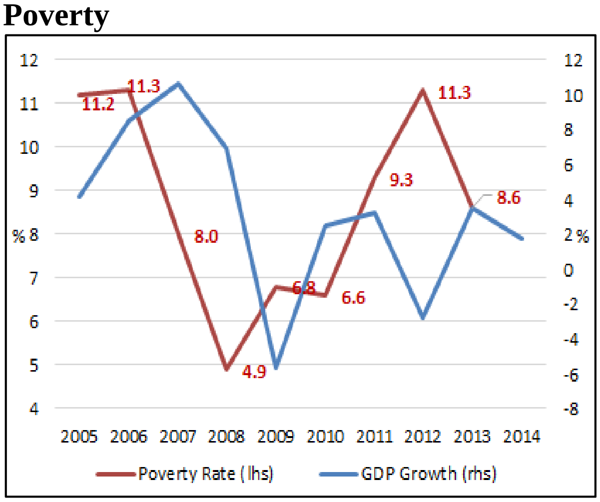


Table 1. Composition of Montenegro's Growth

Percent	Average contribution to growth (2002-2008)	Average share in GDP (2002-2008)	Average contribution to growth (2009-2014)	Average share in GDP (2009-2014)
Agriculture	0.2	9.1	0.2	8.0
Industry	0.2	14.8	-0.2	10.9
Services	2.9	59.8	0.8	64.4
- Tourism	0.23	3.0	0.16	5.9
- Construction	0.36	3.8	-0.23	4.7
- Retail trade	1.55	12.1	-0.03	11.8
- Financial sector	-0.01	2.5	0.04	4.2

Source: MONSTAT, World Bank staff calculations using Household Budget Survey (HBS)

[4] The Deutsche mark has been used since the 1990s and formally adopted in 1999, to be replaced by the euro in 2002.

10. During the boom years (2000-2008), growth led to poverty reduction as a result of, among other things, increasing demand for unskilled labor, while in the bust and stagnation period (2009-2012) growth became less pro-poor as demand shifted towards higher skilled labor (see Figure 1). Poverty followed a U-shaped pattern up to 2013: it fell from about 11 percent in the mid-2000s to its lowest point of 4.9 percent in 2008, and then bounced back to 8.6 in 2013, with an increasing fraction of vulnerable households near the poverty line. During the boom years, increased demand for labor came from sectors such as construction, mining, and retail trade, which were heavily reliant on unskilled labor. It was the same sectors, along with tourism, that drove growth until 2008 (Table 1). This led to a fall in the unemployment rate (although unemployment levels remained high even at the peak of economic growth), a steady decline in poverty, and an increase of the income of households in the bottom 40 percent of income distribution (Bottom 40). During the economic contraction that followed the 2008 crisis, growth slowed down and demand for labor shifted towards higher skills as construction and mining industries contracted. Employment of tertiary educated labor increased by over 40 percent from 2008, while the employment of workers with at most primary education fell by over 40 percent during the same period, thus limiting poverty reduction effects.

Table 2: Key Macroeconomic Indicators and Projections*

Indicators	*Outturn*			*Preliminary*	*Projections*			
	2012	*2013*	*2014*	*2015*	*2016*	*2017*	*2018*	*2019*
National Accounts								
Real GDP growth	-2.7%	3.5%	1.8%	3.2%	3.7%	3.1%	3.0%	0.5%
Total Investment	20.6	19.6	20.2	20.6	25.0	26.5	27.6	22.1
Gross National Savings	2.1	5.1	5.0	7.2	10.8	11.6	12.4	7.4
Foreign Savings	18.5	14.5	15.2	13.4	14.2	14.9	15.2	14.7
Public Sector								
Primary Balance	-4.0	-2.4	-0.8	-4.7	-4.1	-3.8	-3.1	1.8
Interest payments	1.9	2.1	2.3	2.3	2.1	2.5	2.4	2.4
Fiscal Balance (w/o privatization revenues)	-5.8	-4.6	-3.1	-7.0	-6.2	-6.4	-5.6	-0.6
Balance of Payments								
Trade Balance	-43.7	-39.5	-39.8	-40.7	-40.7	-40.7	-40.6	-40.6
Current Account Balance	-18.5	-14.5	-15.2	-13.4	-14.2	-14.9	-15.2	-14.7
FDI	14.5	9.6	10.2	17.2	11.0	11.2	10.8	11.0
Debt								
Foreign Debt	144.8	142.3	145.2	147.9	149.2	149.6	150.3	149.9
Public Debt (w/o guarantees)	53.4	57.5	59.9	68.1	72.3	76.4	78.6	79.0
Public and publicly guaranteed debt	65.4	66.8	68.8	78.9	82.6	86.3	88.1	88.3
Gross Internat. Res. (in months of Imports)	1.9	2.5	3.1	3.6	4.1	4.4	4.7	5.0
Memo items:								
GDP (EUR millions)	3,181	3,362	3,458	3,595	3,778	3,951	4,134	4,175
Inflation (p.a., %)	4.1	2.2	-0.7	1.5	1.9	2.0	2.2	2.2
Debt service to export ratio	26.7	43.9	48.2	43.4	37.8	34.3	33.9	33.5
Exchange rate EUR:US$ (p.a.)	0.78	0.75	0.75	0.90	0.90	0.90	0.90	0.90

* Official fiscal projections of the Government of Montenegro
Source: MoF, CBCG, MONSTAT, WB staff calculations

11. Driven by an excessive boost in public investment, the economy rebounded in 2015 and is expected to continue to expand in the medium term. GDP increased by 3.2 percent in 2015 and growth is expected to be sustained at around 3 percent in 2016 and 2017. The unemployment rate continued to decline in 2015 and is expected to decline below 17 percent by 2018 as a result of new large infrastructure investments, namely new power generation plants and highway construction. Household welfare remains highly exposed to macroeconomic risks, given that most of disposable income comes either from employment or social transfers.

12. Fiscal consolidation gains reaped by 2014 were followed by a sharp rise in fiscal imbalances in 2015, which are expected to persist in the medium term. The fiscal deficit was reduced from an average of 5.1 percent of GDP in 2009-13, to 3.1 percent of GDP in 2014, underpinned by improved revenue collection and containment of expenditures. These interventions did not result in an overall reduction of the public debt, which instead doubled since 2008, reaching 60 percent of GDP in 2014. At the end of 2014, public debt stood at EUR2.1 billion, of which 80 percent was held externally. Driven by a surge of capital investments for the Bar-Boljare highway, for which Montenegro took a US$944 million loan (23 percent of the 2014 GDP), the fiscal deficit grew to a preliminary 7 percent of GDP in 2015. Public debt grew further to 68 percent of GDP in 2015 and is expected to increase to over 70 percent in 2016 and further in 2017-18.

13. Strong pressures have emerged on the expenditure side of the budget, threatening fiscal sustainability. Fiscal deficits for the next three years are swollen by capital spending on the large highway project. While the Government's original medium-term fiscal plans suggest public debt containment once the highway disbursements are over (in 2019), more recent measures, such as the introduction of lifetime benefits for mothers of three and more children, the rise in minimum pensions and wages, and the potential new financing of large infrastructure projects, raise concerns about the ability to sustain fiscal discipline in the medium term. Fiscal plans are also vulnerable to potential cost overruns related to the highway construction. A reduction in current expenditures equivalent to around 2 percent of GDP is already anticipated by 2019 – albeit undefined – in the Government's original fiscal framework. This is likely to be an underestimate of the actual adjustment needed, for several reasons.

14. Medium-term pressures on public finances stem from the following: First, Montenegro's financing needs are high, at 18 percent of GDP in 2016, with public debt projected to approach 80 percent of GDP and external debt to reach 150 percent of GDP by 2019. Montenegro's elevated (public and external) debt levels are highly sensitive to shocks (related to real GDP growth, financing costs, contingent liabilities, primary balance, exchange rate and most notably to an overrun in financing costs associated with the highway).[5] Second, debt exposure to the US dollar-denominated highway loan (US$944 million signed in 2014) present risks to public finances at the time of loan repayment. Third, the recent social (pension and new lifetime benefit for mothers of three and more children) and public wage (an increase in the coefficients of professional and managerial staff to allow for wage decompression) policy measures are estimated to contribute another 2 percentage points or more of GDP in additional spending on top of Government's original medium-term fiscal framework (as reported in Table 2). Fourth, historical performance suggests that government deficit targets are typically missed by a large margin (2-3 percentage points of GDP on average per year since 2008) due to over- commitments and contingent liabilities (like guarantees repayment or lawsuits). Fifth, public arrears estimated at close to 11 percent of

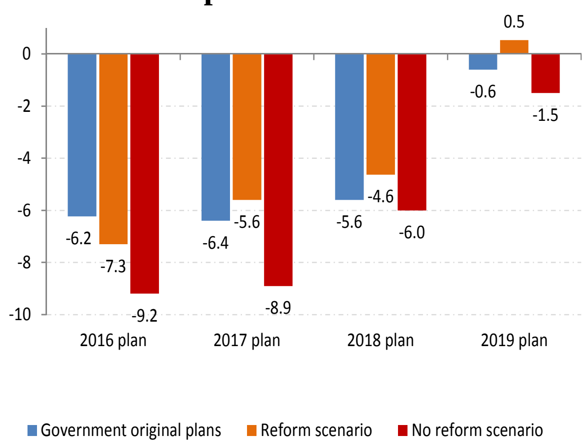
[5] See details in the public debt and external debt sustainability analyses presented in IMF. 2016. Montenegro: Article IV Consultation.

GDP[6] are another liability which would need to be recognized and eliminated over the medium-to long-term.

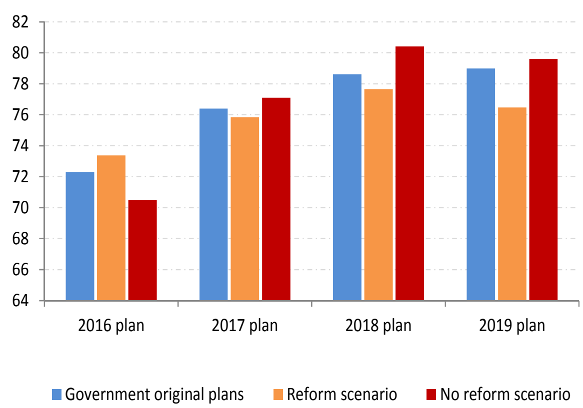
15. To restore fiscal sustainability and place public debt firmly on a downward trajectory, the country will need to undertake ambitious fiscal consolidation. In the absence of fiscal consolidation measures, the deficit will swell to 9 percent of GDP in 2016-17 (not including arrears) before highway construction ends, while public debt will continue rising to around 80 percent of GDP in 2019 (Figure 2). To put public finances on a sustainable footing, an overall fiscal surplus of 0.5 percent of GDP (based on a primary surplus of about 3 percent of GDP to accommodate rising interest payments and amortization) is needed in 2019 to reverse the rising public debt dynamics. A fiscal adjustment of 2-2.5 percent of GDP each year, along with investment contraction after the end of the highway project, would reduce public debt in 2019 to a still high 76 percent of GDP. The country's vulnerability to shocks, the lack of independent monetary policy, and the structural rigidities of the economy further support the case for immediate and sustained fiscal consolidation.

Figure 2. Reversing the Fiscal Path

Fiscal deficit as percent of GDP



Public debt as percent of GDP



Source: World Bank staff calculations, MOF. The "no reform" scenario is based on estimates in the 2016 Article IV IMF Staff Report.

16. To maintain market access and limit the risks to public finances, policies on the expenditure and revenue side can be pursued. A reversal of recent policy measures related to a rise of social transfers and public sector wage bill, as well as savings on other operational costs, prioritization of public investment decisions, further revenue mobilization and reducing tax expenditures are among the efforts that could have a sustained positive impact on fiscal balances in the medium term and help reverse the growing public debt dynamics (see Figure 2). Such measures, if well designed, could bring an adjustment of 2-2.5 percent of GDP annually by 2019. Strong political will is needed to implement such an ambitious program of fiscal consolidation, aimed at creating the long-term macro-fiscal conditions for higher levels of growth and

[6] Source: Ministry of Finance data, combining local government and central government arrears.

employment creation. The long-term poverty and inclusion effect of these measures is expected to be positive: stable macroeconomic environment and reduced sovereign risk premium would reduce the cost of capital for the private sector, and thus free up resources for stimulating private sector investments and increasing employment. It will be nonetheless important to design fiscal consolidated measures in a way that protects vulnerable groups. The Bank will also work with Government to reduce the potential adverse welfare impact of fiscal consolidation measures in the short- to medium-term by supporting projects focused on job creation in key sectors, as well as on eliminating barriers to employment.

17. In addition to restoring fiscal balance to support growth, weaknesses in the financial sector need to be addressed. The financial sector's support to economic growth has been constrained by high costs of intermediation, high – albeit declining – levels of non-performing loans, and the presence of too many banks in a small market. The 2015 IMF/World Bank Financial Sector Assessment Program (FSAP) revealed that while the legal, regulatory, and supervisory frameworks for the banking and financial sector have markedly improved since the 2006 assessment, further progress is needed. The increasing competition and slow economic recovery are weighing on banking sector profitability. Growing risks in domestic banks and weaknesses in bank regulation and oversight pose fiscal and financial stability risks that could potentially reverse economic recovery. Decisive action to deal with weak banks is critical for preserving financial stability. Moreover, a number of key shortcomings should be remedied to complement improvements in the framework for non-performing loans (NPL) resolution. In addition, recently strengthened supervisory requirements should be complemented by reversing the loosening of regulatory standards over the last several years. In the absence of independent monetary policy and to complement sound fiscal management, a macro prudential framework - which would include instruments such as loan-to-value, debt-service-to-income, debt-to-income ratios, and capital buffers - should be established and, over time, made fully operational.

18. Growth in the next three years is positive, but likely unsustainable once large capital expenditures are completed. Maintaining high growth after the highway construction ends would require reorienting the economy towards a more sustainable and inclusive growth model. In the absence of structural changes, the rate of economic growth is projected to fall below 1 percent by 2019 as Montenegro runs out of fiscal space and borrowing capacity to stimulate growth directly through public investment. Even this outlook comes with large downside risks. On the external side, slowing down or stagnation of global growth and of the Euro area, as well as volatility of the financial market, threatens Montenegro's growth prospects. Risks on the domestic side include delays in the needed structural reforms to stabilize public finances and increase competitiveness of the economy, persistently high levels of government arrears and NPLs (12.7 percent as reported in February 2016) and high unemployment.

19. Montenegro's future growth needs to rely on the private sector, with a focus on productive investments and improved competitiveness that would allow Montenegrin firms to export and access much broader markets and economies of scale. Such a growth model will require increasing labor productivity and labor market flexibility. Specifically, demand is likely to focus on higher skilled, better educated, and innovation-oriented labor, as Montenegrin firms try to grow, innovate, and eventually compete in the EU and beyond. At the same time, it will be important to attract investments and foster job creation in key sectors requiring labor-intensive and lower-skill labor (such as tourism services and agriculture), which will have a significant impact on poverty reduction and inclusion.

20. Montenegro's strategy needs to focus on restoring macro-fiscal sustainability and facilitating private sector job creation through increasing productivity and competitiveness. This is also underlined in the Government's Economic Reform Program 2016-2018. Going forward, economic growth will largely, though not exclusively, depend on factor productivity enhancements rather than on labor and capital accumulation. With the growing volatility of foreign capital inflows and a large external and public debt, it is unlikely that capital accumulation (including large investments in infrastructure) will be a dominant factor of growth in the future. Moreover, an aging population calls for mobilizing the existing labor force and moving people from inactivity to the labor market by addressing incentives for work and labor demand. However, job creation alone may not be sufficient to eliminate poverty and increase shared prosperity, as Montenegro is faced with high unemployment among youth but also middle aged workers who have difficulties finding jobs or face disincentives for engaging in formal job search.

2.3 Poverty Profile

21. At 8.6 percent[7], Montenegro has one of the lowest poverty rates in the Western Balkans, but a large number of households are considered vulnerable and could quickly fall into or out of poverty as a result of small changes in income. Vulnerability increased even more than poverty since 2008 (see Figure 3), with the percentage of vulnerable households[8] increasing from 18.9 percent in 2007 to 26 percent in 2013. Most of this increase happened in urban areas, where the percentage more than doubled from 10 percent in 2009 to 22 percent in 2013. In 2013, almost 30 percent of the population in urban areas was either poor or vulnerable[9], largely a result of the downsizing of the ailing metal industry.

22. The probability of being among the bottom 40 percent of the income distribution is strongly associated with poor labor market attachment, being female, and having limited access to economic opportunities. The Bottom 40 count on relatively few working-age members to provide for larger households, making them highly vulnerable to job loss, illness or other shocks affecting income earners. The poverty rate in 2013 was the largest (around 19 percent) in households with an unemployed head, followed by those with an inactive household head. Minority populations, including Roma, Ashkaelia, and Egyptians (RAE)[10] are particularly vulnerable and lack economic opportunities. A 2009 UNDP report found that among RAE groups, more than 14 percent were "excluded",[11] much higher than the national rate of 3.5 percent. The same report details that some 25 percent of the RAE population had unresolved status in

[7] In 2013, using the national absolute poverty line of EUR186.5

[8] Those with a consumption per adult equivalent below 1.50 times the poverty line.

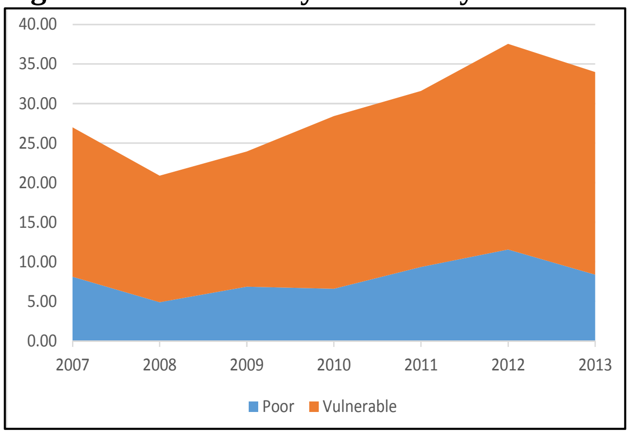
[9] Households whose consumption per adult equivalent is below 1.50 times the poverty line.

[10] Representing about 3 percent of the total population in Montenegro.

[11] Households are considered vulnerable/excluded if their incomes are low, they have difficulty in paying utility, mortgage or any other bills and are in arrears, and if they have insufficient access to health services. Individuals are considered as vulnerable/socially excluded if they are unemployed or are employed but social contributions are not paid, if they have less than 8 years of schooling and are no longer in education, and if they have insufficient access to health services.

Montenegro and lacked identity documents. Many therefore had limited access to public services, and only 18.4 percent of RAE families received allowances or other social benefits. About 38 percent of RAE owned their houses in 2009, while 50 percent lived in illegally-built structures mainly in city suburbs, and only around 20 percent were employed. The vast majority of unemployment in Montenegro is long-term, with 80 percent of the unemployed looking for a job for over one year. Finding a job when entering the labor market is proving increasingly difficult and the number of individuals chronically unemployed has been rising over time. Over 70 percent of the unemployed in 2013 were new market entrants (compared to 55 percent in 2011). Among individuals with primary or vocational education, the percentage of those unemployed for more than 24 months rose to over 85 percent in 2013.

Figure 3. Vulnerability vs. Poverty Increase

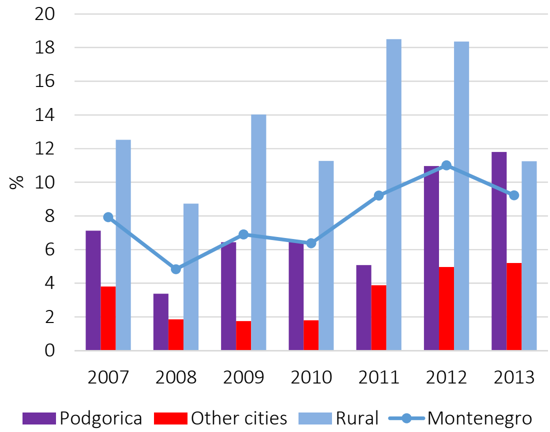


Source: World Bank staff calculations using HBS 2007-13.

23. The gap in educational attainment between the poor, the vulnerable and the rest is substantial. Two-thirds (67.5 percent) of the heads of households in poverty have achieved primary education or less, compared to 41 percent of the vulnerable and 11.7 percent of the rest. Only 4.6 percent of the poor heads of households have tertiary education compared to 26 percent of the non-vulnerable. Among RAE, 36 percent had no education and 72 percent were illiterate in 2009. This suggests that the poor are less likely to benefit from the increased opportunities offered by demand for labor in the expanding, higher-skilled sectors, which are likely to become even more significant if Montenegro embarks on a growth model that is private sector-driven, requiring firms to become more competitive.

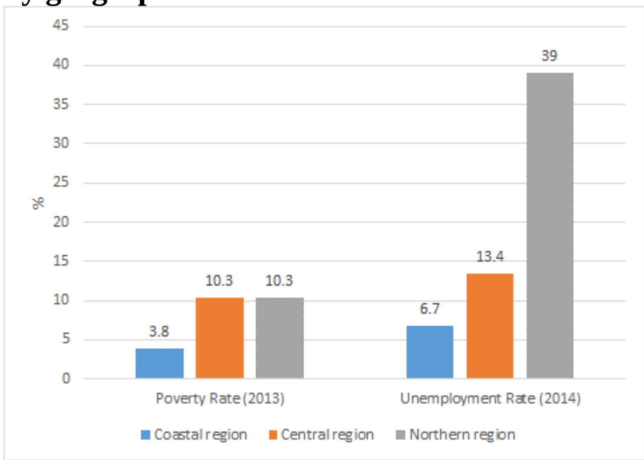
24. Vulnerability and poverty incidence varies across regions of the country and the urban-rural divide is significant (see Figure 4). The poverty rate has consistently been higher in rural than in urban areas, but the majority of households below the poverty line as well as in the Bottom 40 reside in urban areas, and reached 59 percent in 2013. The share of the poor and Bottom 40 living in urban areas has been increasing partly due to labor shedding in metal industries and subsequent decrease in labor income. There are also differences between the relatively more vibrant coastal zone and the poorer northern regions, where poverty and unemployment are significantly higher (see Figure 5).

Figure 4: Poverty rate by urban/rural location, 2007-13



Source: HBS 2007-13. World Bank staff calculation.

Figure 5: Poverty and Unemployment rates by geographic location



Source: MONSTAT

2.4 Drivers of Poverty and Development Challenges

25. The SCD shows that the composition of economic growth and employment are the main determinants of poverty changes in Montenegro. Growth composition, led by increasing demand for unskilled labor during the boom years, and by a shift in demand towards higher skilled labor during the bust period, resulted in corresponding decreases and increases in poverty, respectively. Unemployment remains high and labor force participation low – especially among the poor and Bottom 40, youth, women, and middle-aged men – indicating that a large share of the population does not benefit from labor market opportunities or that adequate incentives are not in place. Unemployment remained stubbornly high even at the peak of the economic cycle in 2008 (at above 17 percent). The rate of unemployment among youth is twice as high as the average, with about 36 percent of youth unemployed in 2014. In addition to high unemployment, Montenegro has one of the lowest levels of labor force participation in Europe, with 53 percent of individuals aged 15+ in the labor force in 2014 (46 percent in the case of women).

26. Incomplete economic transition, skill mismatches, disincentives for work, high reservation wage, and reliance on seasonal migrant workers all contribute to Montenegro's high unemployment and low participation rates. The economic transition, which resulted in shedding of workers from the restructuring and closing of traditional firms and the declining importance of agriculture and public sector as sources of employment has resulted in an increase in unemployment for workers in their mid-forties and older, as well as increases in early retirement. Mid-career and older workers find it harder to retrain to be employed in a different sector. The sectoral composition of employment growth indicates that more jobs are being created in higher skills sectors, and that there is an excess of people with primary education and vocational training compared to labor market demand. Although most secondary students attend vocational schools, their curriculum is poorly aligned with the labor market. Finally, a high reservation wage below which individuals are not willing to accept a particular type of job, and the practice of hiring undeclared seasonal migrant workers to avoid compulsory social contributions explain why Montenegro imports low skilled seasonal workers while locals remain unemployed.

27. Increased employment and inclusive access to economic opportunities is key to reducing poverty in Montenegro, but this will require a re-thinking of the growth model and addressing supply-side and demand-side barriers to jobs. The large and continuous poverty reduction before the crisis was the result of an economic boom that generated increased demand for unskilled labor. However, looking ahead there are important factors that may hinder Montenegro's ability to benefit from future growth opportunities, in a way that also improves welfare and reduces vulnerability for the poor and the less well-off. Inequitable access to education, skills mismatches, and disincentives for work hold back potential gains in the labor market, particularly for disadvantaged groups. The changing growth composition may result in increased demand for different types of skills that are not adequately supplied in the labor force (tourism, financial sector and real estate have seen the highest employment growth between 2009 and 2014, while mining and manufacturing the lowest). In addition, the design of social protection, labor and tax legislation, and potential barriers related to information or perception create certain disincentives for employment, including for the poor and vulnerable.

28. Montenegro has a large public sector, which remains a source of distortions to the functioning of the labor market and of delays in improving productivity. Part of the legacy of the SFRY, in 2015 public sector spent 49 percent of GDP and employed 32 percent of the labor force.[12] While there is no reliable information on whether public sector wages exceed those in the private sector, public sector jobs are seen as more secure, and thus much more desirable.

29. Montenegrin firms are relatively poorly integrated into the global economy, with their competitiveness limited by Montenegro's small size and lack of economic diversification. Only 7 percent of firms export their goods compared with 18 percent in the Balkans, and they are less likely to have purchased a technology license from a foreign-owned company. There is also a limited usage of ICT among private firms, and firms are less likely to innovate. Barely 80 percent of firms use email to communicate with suppliers and clients, just over 70 percent have high speed internet, and fewer than 30 percent have a website. The overall R&D investment in the country amounts to only 0.45 percent of GDP, of which 75 percent comes from the government. Montenegro can benefit from opening up the economy, attracting FDI, developing niche markets, and creating linkages between industrial clusters such as between tourism, agribusiness value chain, environmental and infrastructure needs. One of the main factors behind private sector development in successful small states is institutional quality and good governance. Firm level data from the 2013 Enterprise Surveys (BEEPS) suggest that, although Montenegro's regulatory environment significantly improved, more progress is needed on implementation of reforms and transparency of procedures. In addition to its critical role for economic growth and jobs creation, the private sector can also play a key complementary role in increasing access to and quality of infrastructure services, including energy security, education, and health. In this context, viable Public-Private Partnerships (PPPs) could play an important role in increasing efficiency and sustainability of public services.

[12] Employment figures include SOEs.

30. Montenegro has been improving on various dimensions of governance and rule of law, but continues to lag behind EU member states. The gap remains largest when it comes to government effectiveness, regulatory quality, control of corruption, and justice sector performance. Despite reforms to align legal frameworks with the EU Acquis, the gap between laws on the books and laws in practice remains wide. In the justice sector, the enforcement of contracts is weak and the processing of cases is slow and inefficient, which undermines business confidence. Across the country, tolerance of corruption is high: few citizens report corruption to authorities and many are willing to pay bribes to obtain services.[13] However, some progress is being made, and in the 2015 Corruption Perception Index, Montenegro ranked 61st out of 168 countries, above the other Western Balkans countries. It also performs better than the EU11 countries in terms of transparency of government policy making: only two countries, Estonia and Lithuania, are rated better on this indicator. Although the public sector is large and more could be done to professionalize the public administration, there are pockets of efficiency[14] that provide an opportunity for scaling up to better serve citizens and the private sector. For instance, compared to EU11 countries, Montenegro emerges as the least wasteful, with only Estonia and Czech Republic performing better. As Montenegro moves towards EU accession, there is a need to focus more strategically on strengthening its governance institutions to improve service delivery and public trust in the state.

31. Montenegro has made strides in promoting equality between men and women, but gender disparities still exist. [15] The Government of Montenegro is bringing attention to gender issues through measures such as creating the Department of Gender Equality and Gender Equality Offices and the creation of the Action Plan for Achieving Gender Equality. Remaining gender gaps include access to economic opportunities and educational attainment. Gender gaps in labor force participation are large, particularly in rural areas. Forty six percent of women aged 15+ participate in the labor force in Montenegro (2014), compared to 60 percent of men. Economic inactivity is especially high among women with primary schooling or less, ethnic minorities, and older women. Overall, women spend more time than men caring for their families and children, which reduces their opportunities to participate in the labor market in the absence of alternative childcare options.

32. Public participation in government decision-making has been modest. This is not surprising given that citizen engagement does not have a strong tradition in Montenegro. Existing NGOs operate in areas such as human rights, anti-corruption, gender, rights of disabled people, LGBT issues, civil society development, education, social protection, and environmental issues. However, their influence on formal decision-making is often modest. Some NGOs provide essential services to vulnerable groups, and increasing their involvement in policy design and implementation would significantly improve outcomes. The EC Progress Report (November 2015) notes the importance for Montenegro of providing opportunities for the development of an empowered civil society, including the necessary legal space and material means for this to occur.

[13] UNODC (2013).
[14] Source: Global Competitiveness Report 2015-16
[15] World Bank (2013) "Montenegro Gender Diagnostic: Gaps in Endowments, Access To Economic Opportunities and Agency" (2013). Report 78678 – ME.

Box 1. Gender Equality in Montenegro: Diagnostics of Key Gender Gaps

Montenegro has made strides in promoting equality between men and women, but gender disparities still exist. As in neighboring countries, some of the most notable gaps are found in women's access to economic opportunities, although some concerns also exist in other dimensions, and gaps remain for some specific population groups defined by age, ethnicity or other. Specifically, findings in the World Bank Gender Diagnostic for Montenegro (Omar and Vick, 2013), show that:

- **Access to economic opportunities.** Male and female labor force participation is low in Montenegro compared to other countries in the region. A gender gap of around 14 percentage points exist in activity rates which, although large, is smaller than in neighboring countries in South Eastern Europe. Much of the inactivity gap is explained by large gender disparities experienced by rural people. Economic inactivity is especially high among women with primary schooling or less, ethnic minorities, and older women. There is little difference between male and female unemployment rates. Among those who work, a clear wage gap exists, with women earning 16 percent less than men with similar observed characteristics.
- **Education.** On average, Montenegro has achieved gender equality in school enrollment. Going beyond averages, gender disparities exist for some population subgroups, particularly: the inactive (suggesting that the lack of education might represent a barrier to jobs), certain ethnic groups and people in rural areas. Tertiary enrollment, in turn, has grown rapidly in the past decade, with higher enrollment among women. There is evidence, however, of gender segregation in fields of study – with potential impact on labor market outcomes.
- **Health.** Maternal mortality is very low compared to the region, and nearly all pregnant women receive prenatal care. As in other countries, there is a gap in favor of women in life expectancy, although life expectancy remains below that of OECD countries for both men and women. Some evidence suggests that certain health related issues remain a source of concern for women – such as preventative care, psychological distress, and domestic violence – and for men - higher rates of alcohol abuse, higher smoking rates, and risky sexual behavior.
- **Agency.** Evidence suggests that domestic violence is a pervasive problem that goes widely unreported in Montenegro. Furthermore, women are poorly represented at all levels of government and. have lower rates of firm ownership and management. Men also hold more leadership positions in the media and there are perceptions that the media reinforces gender stereotypes.

Source: Omar, Yumna and Brandon Vick (2013) "Montenegro. Gender Diagnostic: Gaps In Endowments, Access To Economic Opportunities And Agency". World Bank Report 78678 - ME

III. WORLD BANK GROUP PARTNERSHIP STRATEGY

A. Government Program and Medium-term Strategy

33. Montenegro's overarching development goal is to achieve smart, sustainable and inclusive growth. Montenegro's development plan is outlined in three separate but complementary strategies: the EU Accession Program 2014-2018, the Montenegro Development Directions (MDD) 2015-2018, and the Montenegro Economic Reform Program 2015-2017 (ERP). Montenegro's EU Accession Program was adopted in December, 2013 and represents the main strategic document in the area of European integration. It focuses on measures required for completing alignment with the *acquis communautaire*. The MDD, aligned with the Europe 2020 strategy, was adopted by the Government in July 2015. Under the overarching objective of achieving "smart, sustainable and inclusive growth", the MDD identifies four driving sectors, namely tourism, energy, agriculture and rural development, and manufacturing industry. The concept of smart growth, with tourism as a key driver, envisions a reduction in import dependence and an increase in foreign direct investment (FDI) and productivity. Sustainable growth is envisioned through further development and effective use of the country's natural resources, and through an inclusive labor force participation model, which includes strengthening active and passive labor market measures, such as unemployment benefits, as well as lifelong learning, education and vocational training. Montenegro's ERP outlines economic policy to achieve higher and sustainable economic growth, along with job creation. The focus of the policy includes fiscal sustainability, reduction of informal employment, and creating the conditions for increased access to finance aimed at small and medium enterprises' growth and development.

B. Proposed WBG Country Partnership Framework

3.B.1 Lessons from CPS Completion Report, IEG Evaluation, and Stakeholder Consultations

34. World Bank Group engagement in Montenegro so far has yielded many positive results and can be a basis for deeper, more strategic cooperation in the future. Experience of the last Country Partnership Strategy (CPS) summarized in the Completion and Learning Review (see Annex 3) shows that the WBG program is by and large achieving intended development results. Key successes are associated with areas where the Bank was able to build local capacity and improve policy and institutional frameworks, such as in the case of land administration, health, education and agriculture sectors. Of particular note has been the work on preparing Montenegro for EU accession, where the Bank was able to play a useful complementary role to the European Commission, an experience that could be replicated in other countries. With respect to program design, the CLR notes that focusing on two thematic areas has been appropriate in the small portfolio, while the scope of development objectives could be refined to better reflect the impact of Bank operations.

35. The CLR also notes that future engagement should strike a balance between (i) flexibility in adapting to changing circumstances, and (ii) persistence in implementing difficult but necessary reforms, and points to the need to maintain high-level political dialogue in an environment where difficult reforms might cause significant delays in program implementation. Although in principle the client has been committed to the implementation of the Bank program, client ownership has not been consistent across the portfolio. Ensuring full commitment to difficult reforms at the political level will be crucial in maintaining program efficacy in the next CPF.

36. Improved public expenditure management remains a crucial goal for Montenegro's fiscal sustainability and economic development. It was dropped from the WBG program during midterm review of the CPS in 2014. The Development Policy Operation underpinning this objective did not materialize due to large scale external borrowing that undermined Montenegro's medium term macro-fiscal framework. As a result, this issue is even more important today, and should be addressed in the new strategy.

37. IEG project evaluations underline the importance of close coordination on policy dialogue and technical assistance with other partners, project ownership at both central and local level, and balancing timely project design with quality at entry. More specifically, IEG findings point to the importance of: (i) effectively relying on Government commitment and public participation, and developing a strong engagement strategy at the local level, particularly in instances involving potentially sensitive investments; (ii) balancing rapid project preparation with quality of a project at entry, so as not to jeopardize implementation, especially during the initial years; (iii) timely project restructuring, so as to make adequate and appropriate mid-course adjustments; (iv) sequencing long-term and complex reforms by building on necessary prerequisites; (v) close coordination of policy dialogue and technical assistance with other partners, such as the IMF, EU, and EBRD, given the complementarities in partners' expertise and areas of interest. At the sector level, IEG notes the importance, for a sustainable recovery of the banking sector, to put in place a clearer strategy for NPL resolution.

38. Citizen engagement proved to be a factor in the success of the CPS and has been mainstreamed in the new country strategy cycle through an extensive set of consultations, both at the SCD and CPF stage. Consultations were attended by various levels of government, private sector, academia and civil society, and the international development community. These consultations confirmed a broad consensus with respect to the key development priorities and focus areas identified in the CPF. In particular, there was a broad agreement on the need to address fiscal sustainability and job creation as the main priorities. Representatives of civil society provided feedback on job creation, good governance, efficiency of social protection and specific issues related to implementation of ongoing projects. Stakeholders agreed on the need for a growth model driven by the private sector, and focused on key economic sectors, namely sustainable tourism and agriculture, as vehicles for inclusive job creation that could benefit communities across the country, including vulnerable groups such as the Roma, the disabled and women. Private sector stakeholders stressed the importance of supporting competitive sub-sectors, such as tourism and agriculture/agribusiness as top priorities, as well as infrastructure development, with a special focus on the PPP model. Both government and private sector stakeholders also stressed the need to improve the quality of education and training in the country and to reduce the gap between the skills produced by the education system and those demanded by the labor market.

39. The CPF was also informed by the FY16 Country Opinion Survey. The results of the survey indicate that the WBG is seen as a valuable and respected long-term development partner. Survey respondents found governance to be the top development priority, followed by jobs and global integration. The survey also found that WBG can add greater value to its work in Montenegro by reaching out more to groups outside of Central Government, specifically local governments, civil society, private sector and academia as key interest groups.

3.B.2 Overview of World Bank Group Strategy

40. The overarching objective of the new CPF is to support Montenegro on a path of more sustainable and inclusive growth. The CPF is consistent both with SCD recommendations and Government priorities. Given the limited size of the program, the CPF will focus on priority areas where the country's ownership is strong, and the potential impact on the WBG Twin Goals and the country's development aspirations is substantial. The volatile regional and global environment calls for reforms and institutional changes that will make the economy more resilient to external shocks. The need to move to a model of development where the private sector leads growth must be supported and complemented by putting in place sustainable public finances under an effective and transparent government.

41. **The SCD identifies eleven priority actions to achieve the Twin Goals of eliminating extreme poverty and bolstering shared prosperity** (see Table 3). One set of priority actions supports the objective of strengthening Montenegro's resilience to shocks, and focuses primarily on ensuring a sound fiscal policy, strengthening financial stability, strengthening the social protection system and social service delivery, and safeguarding against environmental risks. The second set of priorities supports the objective of reducing unemployment and inactivity, with a focus on strengthening human capital and improving inclusive access to economic opportunities. A final set of priority actions supports the objective of facilitating private sector development, and focuses on improving commercial, institutional and infrastructure integration, maintaining a supporting environment for private investment and job creation, and strengthening governance, public service delivery, and the rule of law.

42. **The CPF applies four selectivity filters,** namely: (i) alignment with the SCD; (ii) alignment with Government priorities and ownership; (iii) WBG comparative advantage and track record in Montenegro; and (iv) complementarity with other development partners (see Annex 7), to maximize the impact of WBG assistance in light of the limited program size. The CPF will focus on six of the eleven priority actions identified in the SCD (see Figure 6).

Table 3: Summary of SCD Priorities

Increase resilience to shocks and volatility	Reduce unemployment and inactivity	Facilitate private sector development
Ensure sound fiscal policy	Increase access to economic opportunities, including for vulnerable groups (youth, rural population)	Improve commercial and institutional integration with the EU
Ensure financial stability	Increase quality of human capital, including through strengthened education and skill acquisition	Improve connectivity and infrastructure integration
Strengthen the social protection system to safeguard against shocks	Facilitate activation and strengthen incentives for work	Level the product and labor market playing field to foster private sector development
Safeguard against environmental risks and protect natural resources		Strengthen governance, public service delivery and the rule of law

43. **CPF objectives and results are grouped into two focus areas:**

- ***Focus Area 1: Enhance macroeconomic and financial resilience.*** The primary objectives under this focus area will be to: (i) improve the sustainability and efficiency of public finances, with an emphasis on helping Montenegro get back on a path of fiscal sustainability; and (ii) increase the stability and efficiency of the financial sector, by addressing weaknesses in the banking sector and the still high levels of non-performing loans (NPLs). The Bank program envisages a series of Development Policy Operations (DPOs) or Policy-Based Guarantees

(PBGs) as the main instrument to support key measures under these two objectives. IFC envisages supporting the first objective through a selected number of PPPs.

Focus Area 2: Expand access to economic opportunities and jobs. The main objectives under this area will be to: (i) increase the alignment between skills and labor market demand; (ii) strengthen incentives for work by addressing disincentives in the social protection system, other barriers to activation, information, perception, and labor and tax legislation, particularly for vulnerable groups and women; (iii) enhance private sector investments and job creation in high-potential sectors; and (iv) enhance environmental sustainability. WBG support under the first objective would focus on building the right skills and supporting school-to-work transition for graduates of the education system, in particular of higher education and technical and vocational education students. Support under the second objective would focus on addressing disincentives in the social protection system and expanding access to employment services through the Jobs and Competitiveness Project, complemented by substantive analytical work. Under the third objective, the WBG will use the comparative advantage of all its arms (IBRD, IFC, and MIGA) to foster tourism-based local economy and sustainable development, support MSMEs development (including expanded access to finance, particularly for the more socially vulnerable parts of the population, provision of business support services to improve firms' capabilities, technology upgrading), facilitate access to ICT, and develop critical tourism-related infrastructure. Support under the fourth objective would be provided through selected investments focused on industrial waste disposal, transboundary water resource management, and investments in energy efficiency, but also through selected interventions as part of the Tourism-based Local Development Project. These investments would also contribute to strengthening the sustainability of the tourism and agriculture sectors and thus building the basis for sustained job creation in the long run.

Figure 6: Selected SCD priority actions, CPF Focus Areas, and CPF Objectives

SCD PRIORITIES

- **Ensure sound fiscal policy**
- **Ensure financial stability**

SCD PRIORITIES

- **Increase quality of human capital**
- **Increase access to economic opportunities**
- **Level the product and labor market playing field to foster private sector development**
- **Safeguard against environmental risks and protect natural resources**

CPF Focus Area 1: **Enhance Macroeconomic and Financial Resilience**	***CPF Focus Area 2:*** **Expand Access to Economic Opportunities and Jobs**
CPF Objectives: **1a: Improved sustainability and efficiency of public finances** **1b: Increased stability and efficiency of financial sector**	**CPF Objectives:** **2a: Increased alignment between skills and labor market demand** **2b: Facilitation and strengthened incentives for work** **2c: Enhanced private investments and job creation in high-potential sectors** **2d: Enhanced environmental sustainability**

44. The CPF will not include substantive engagement in sectors where political championship is unclear, or where other partners are taking the lead. Notably, governance and the rule of law emerges as a key priority under the SCD, and the European Union will continue taking the leading role here through its Instrument for Pre-Accession Assistance (IPA) II 2014-2020. The WBG will complement these efforts mostly through public finance and financial sector engagement. Specifically, the proposed series of Development Policy Operations (DPO) would support the authorities in consolidating public finances and strengthening the stability of the financial sector. Fostering transparency and accountability of public finance management, strengthening commitment control and ensuing mandatory costing of new policy proposals before their adoption, as well as supporting measures to strengthen banking oversight and financial sector regulatory standards are among areas for possible supportive policy actions. The DPO series would be underpinned by the recent findings of the FSAP and by a Public Finance Review, which will make recommendations to increase efficiency, effectiveness and equity of public spending. In addition, the ongoing EU-financed Road to Europe Program of Accounting Reform and Institutional Strengthening (REPARIS), implemented by the World Bank Center for Financial Reporting, supports the implementation of corporate financial reporting frameworks in line with the EU *acquis communautaire* in the countries of Southeast Europe, including Montenegro, with a view to promoting enhanced availability, transparency and reliability of financial information. Analytic work in the judicial sector further complements the EC's efforts in the area of governance. Similarly, although the WBG will be engaged in supporting environmental sustainability in the areas of industrial waste management, transboundary integrated water resources management, and energy efficiency, the CPF does not envisage a large program in the area of disaster risk management, where partners such as the EU have an active engagement as part of IPA II. On large scale infrastructure investments in SCD priority areas, such as transport and energy, EU, EIB and EBRD will continue playing the leading role. However, building on its ongoing engagement in infrastructure in the Western Balkans, IFC will look for new opportunities in Montenegro to support private sector investments in renewable energy, transport, and municipal infrastructure projects through direct investments as well as design and implementation of viable PPPs. IFC program in this area is subject to market demand and clear Government commitment to implementation.

45. The main shift since the last strategy is a renewed focus on support for macroeconomic reforms, specifically in the areas of fiscal sustainability and financial sector stability and efficiency. The WBG will support public financial management and debt sustainability through the proposed Development Policy Operation series as well as through Investment Project Finance operations to improve the efficiency of public spending in health and revenue collection. The new strategy will also focus more explicitly on jobs and economic opportunities to improve inclusion and living standards of the Bottom 40 (see Focus Area 2).

46. At the same time, the new strategy will provide continuity with the ongoing program. Both strategic objectives of the previous strategy – support for EU integration and prudent environmental management – remain relevant for Montenegro and will be incorporated in the implementation of the existing portfolio as well as in the design of future operations. For example, planned lending and Advisory Services and Analytics (ASA), such as the Health System Efficiency and Quality Improvement Project and the Revenue Administration Project, will integrate compliance with EU requirements into their design, while preservation and management of natural resources will be addressed in the current portfolio as well as new operations such as the planned Tourism-based Local Development Project.

47. The new CPF also draws on a recent gender diagnostic for Montenegro. The proposed program includes actions to promote women's access to economic opportunities, where the most notable gender gaps exist. First, the proposed ASA agenda on barriers to job creation and labor force participation will be fully gender informed, to ensure that potential barriers that are more severe or particular to women, such as access to formal child care services, are identified. Second, as gender gaps in labor force participation and employment start early on for youth, ensuring that men and women are equipped with relevant skills to find a job (CPF Objective 2a) can improve job prospects for women, and thus decrease the severity of associated barriers that women may face such as those related to social norms and affordability of formal care. Lessons and evidence from ongoing ASA in a neighboring country on females entering non-traditional fields of study will be considered, as these findings are more relevant to this context than existing analysis in advanced economies. Third, given that disincentives for formal work are significant and are highest for low-income earners or those in part-time work - the latter more likely to be women, given their need to often balance work and household responsibilities - removing those disincentives to work will contribute to increasing women's access to jobs. Finally, increased private sector investment in key sectors like agriculture and tourism is expected to benefit employment opportunities for women.

48. In addition to an increased focus on inclusion in the program, the World Bank Group will continue its contribution to building a more inclusive public discourse. While the EU generally takes the lead in promoting citizen engagement in Montenegro as part of the EU accession agenda, the WBG will engage with key partners to strengthen coordinated work in this area. Experience gained under the FY11-15 Country Partnership Strategy has demonstrated the value of including beneficiary feedback in project preparation, implementation, and evaluation (see Box in Annex 3). These good practices have not only significantly improved project quality and outcomes, but also resulted in much broader benefits for local communities. The Strategic Framework for Mainstreaming Citizen Engagement in WBG Operations will continue to guide project design to include features that enable citizen participation. The strategic approach to citizen engagement in Montenegro has been operationalized through the development of a Country Roadmap (see Annex 2), which identifies agriculture, tourism, health, and the environment as key sectors where participatory mechanisms are necessary for project success. It envisages extensive use of consultations, participatory planning, beneficiary feedback, and implementation monitoring.

Focus Area 1: Enhance macroeconomic and financial resilience

49. As a small open economy without its own currency, strengthening macroeconomic and financial resilience is essential to Montenegro's strategy of poverty reduction and inclusive growth. Large infrastructure investments are expected to generate growth in the near and medium-term, but come at the expense of exacerbating already pronounced public debt-related vulnerabilities. Large general government financing needs are also an important source of macroeconomic risk. Addressing these issues requires a credible medium-term fiscal plan underpinned by sound sectoral policies to reduce deficit and eventually debt. The financial system is also hampered by a number of inefficiencies, including high costs of intermediation and high level of non-performing loans (NPL). The latter, although in decline from a peak of 25.3 percent in June 2011 to 12.7 percent in February 2016, still remain a challenge. Growing risks and weaknesses in bank regulation and oversight pose fiscal and financial stability risks.

<u>CPF Objective 1a: Improved sustainability and efficiency of public finances</u>

Results indicators for Objective 1a
Indicator 1: Stabilization of public debt

50. Montenegro remains highly susceptible to external shocks owing to its levels of public debt. With the construction of the highway the Government has committed to a debt financing of that investment which would determine the rising debt trajectory between 2015 and 2018. Managing the rapid public debt growth, from 68 percent of GDP in 2015 to an estimated 80 percent in 2019, and the long period of large fiscal deficits, require a credible medium-term fiscal consolidation underpinned by sound sectoral policies to reduce deficit and eventually debt. Sustainable fiscal consolidation is needed both as a measure to mitigate Montenegro's vulnerability to external shocks and to meet its refinancing needs, however it must be designed with due regard to protecting the most vulnerable groups of population. The size of non-discretionary spending (like public administration wage bill, increasing health and pension expenditures, and disconnect between the current health/pension insurance benefit package and available resources) and tax revenue collection does not provide much fiscal space for an expansion of government expenditures. The Government has also accumulated sizable payment arrears, estimated at close to 11 percent of GDP at end-2014. Of these, around 80 percent are arrears of municipalities, most of which have a fragile financial condition and are hindered by unsustainable expenditures and debt. In 2015, the Bank conducted analysis to address fiscal sustainability and operational restructuring of the more distressed local government units in Montenegro, which may pave the way for further engagement in this area.

51. Increased efficiency and quality of health expenditure is needed to address the growing burden of non-communicable diseases and an aging population. Montenegro's per capita expenditure in health is lower than the EU average but higher than the ECA average. The total health expenditure in 2013 GDP was relatively high (at 6.5 percent) compared to countries in the region, and although public spending is below the EU28 average (3.7 percent of GDP), per capita health expenditure is high for Montenegro's income level. However, out-of-pocket spending accounted for only about 33 percent of total health expenditure between 2000 and 2013, which is lower compared to similar countries in the region. The efficiency and equity of health spending should be improved to cope with the growing burden of non-communicable diseases and an aging population. Montenegro made important progress in moving toward capitation financing of primary health care; these reforms were undercut, however, by negotiated salary increases for all health personnel. Hospitals are still financed through line-item budgets rather than based on outputs or quality, and the hospital network has yet to be rationalized, contributing to inefficient spending and hospital deficits. Pharmaceutical spending is relatively high, as are drug prices. The health insurance benefits package has continued to expand, including high cost procedures and medicines, without sufficient attention to financial sustainability, which results in growing waiting times for procedures and budget pressures that may compromise quality or provision of primary health care.

52. In the justice sector, expenditure remains high, yet court performance lags behind EU standards and corruption risks remain. Court expenditure is more than double the EU average, both on per capita basis and as a share of GDP.[16] Yet courts remain inefficient, with large backlogs and long case processing times, which create obstacles for citizens and business, especially for MSMEs. Average disposition times for civil cases are approximately two years,[17] which is more than double the average among Council of Europe states, triple the median, and significantly behind comparator states such as FYR Macedonia and Slovenia. Corruption and undue influence remain a concern, and cause unpredictable decision-making. Despite the relatively large network of courts across the country, low income and vulnerable groups face barriers in access to justice. Significant progress has been made to align legislative frameworks with EU standards, however,

[16] This is largely because Montenegro has more than double the number of judges per capita than the EU average, and nearly triple the number of court staff per capita

[17] The European Commission for the Efficiency of Justice (CEPEJ) Evaluation Report, 2014.

implementation has lagged behind the legal reforms. ASA support will focus on fiscally sustainable ways to strengthen efficiency and quality of service delivery in courts in line with EU standards.

53. On the revenue side, collection has improved consistently since 2010, supported by tax policy changes, but Montenegro's tax administration system needs to boost efficiency. Montenegro has taken important steps in recent years to reform and modernize its tax administration. The legal framework has been recently amended to clarify the role of tax and customs administration in revenue collection, simplify tax procedures, strengthen internal control of tax administration and the integrity of tax officials, and improve enforced tax collection. Enhancements were also initiated in the organizational structure of the tax administration, its strategic management, and IT resources. Notwithstanding this important progress, longer-term sustainable improvements in the ability to collect taxes and social contributions require enhancement of tax administration systems, processes, and skills. WBG support will focus on the operational efficiency of Montenegro Tax Administration (MTA) to put it on track to becoming a modern revenue administration on par with best practice in the EU, and on reducing the tax compliance burden to taxpayers by supporting the modernization of taxpayer services.

54. The WBG will support authorities in their efforts to achieve fiscal sustainability. Measures for achieving this will be outlined in the planned Fiscal and Financial Sector Resilience DPO or PBG series.[18] Preparation of the DPO/PBG series will be subject to a satisfactory medium-term macroeconomic framework, which adequately addresses the high deficits and public debt. This would include prior evidence of fiscal consolidation and increased efficiencies in the areas of public sector wage bill, targeting of social benefits, health and pension insurance benefit packages, as well as financial sector reform measures. In the absence of such evidence, the extent and nature of WBG engagement will be re-assessed mid-course, as part of annual monitoring and the medium-term CPF Performance and Learning Review. The planned Health System Efficiency Project and Revenue Administration Project, as well as the ongoing Energy Efficiency Project will complement and further support this agenda by focusing on increasing the efficiency of health and energy spending and of the tax administration system. In addition, Public-Private Partnerships (PPPs), through IFC's support, could be considered as an alternative instrument to address infrastructure financing gaps, and to reduce the cost and improve the quality of services. At the same time, the fiscal impact and viability of new PPP projects would need to be carefully assessed, particularly within Montenegro's context of increasing public debt and an overall weak PPP regulatory framework. Administrative, regulatory, and market constraints could also limit IFC's engagement to a small number of PPPs.

[18] The content of the DPO/PBG series has not as yet been agreed and will be discussed with the government and the Central Bank.

CPF Objective 1b: Increased stability and efficiency of financial sector

Results indicators for Objective 1b
Indicator 2: Reduction in the incidence of NPLs in total loan portfolio ***Indicator 3:*** Strengthened prudential norms for identification, classification, and re-classification of nonperforming assets

55. The financial sector is an essential building block for maintaining Montenegro's macro stability and increasing efficiency in intermediating financial resources. Montenegro's financial sector is not yet equipped to play this role, due to several inefficiencies identified under the 2015 IMF/World Bank FSAP. These include high costs of intermediation and high level of non-performing loans (NPL), which remain a challenge, notwithstanding a notable decline over the past few years. Growing risks in domestic banks and weaknesses in bank regulation and oversight also pose fiscal and financial stability risks. Sound fiscal management and a macro prudential framework are needed.

56. WBG interventions to support Government reforms in these areas, and especially in addressing weaknesses in the banking sector and reducing the still high level of NPLs are critical to maintaining financial stability and enhancing efficiency of the financial sector. Measures for achieving this will be outlined in the planned Fiscal and Financial Sector Resilience DPO/PBG series. In the areas of financial sector stability and efficiency the DPOs would focus on key priorities identified in the 2015 Financial Sector Assessment Program, including addressing weaknesses in the banking sector (in particular related to identification and classification of nonperforming assets as well as the framework for credit and liquidity risks), reducing the high level of NPLs, strengthening the financial safety net and bank oversight, as well as establishing a macro-prudential framework to complement sound fiscal management. In the absence of a satisfactory macroeconomic framework, the extent and modalities of WBG engagement will be re-assessed in mid-course, as part of the CPF Performance and Learning Review. The planned FinSAC Deposit Protection Fund Strengthening TA Program will complement and further support this agenda, by focusing on strengthening the financial safety net. IFC will continue supporting NPL resolution in the Western Balkans, including Montenegro, and will offer credit lines to local banks and microfinance institutions to support MSMEs, housing finance, renewable energy and agribusiness projects. In addition to financing, IFC will offer advisory services to the banks and microfinance institutions to enhance their risk management and governance practices.

Focus Area 2: Expand Access to Economic Opportunities and Jobs.

57. In order to reduce poverty and increase shared prosperity, Montenegro needs to invest in an inclusive growth model where the private sector serves as the engine of growth. Persistently high unemployment and low labor force participation, especially among the poor, Bottom 40, youth, middle-aged men, and women, indicate that a large share of the population does not benefit from labor market opportunities or that adequate incentives are not in place. Montenegro has one of the lowest levels of labor force participation in Europe and persistently high unemployment, especially among the young. Minority populations, including Roma, Ashkaelia, and Egyptians are particularly vulnerable and lack economic opportunities. There are also persistent differences between the relatively more vibrant coastal zone and the poorer northern regions with higher unemployment. The low activity rate of the working-age population and the high unemployment rate are often the result of mismatches between supply and demand for skilled labor, as well as of disincentives for active labor force participation.

58. Montenegro is facing a twin challenge of providing better opportunities to the low skilled sections of the labor force and of raising the overall skill level if it wants to be a competitive investment destination within the EU. In particular, the country needs to attract investments and foster job creation in key sectors requiring labor-intensive and unskilled labor (such as tourism agriculture), which will have a great impact on poverty reduction and shared prosperity, while also unlocking the potential for micro, small and medium enterprises (MSMEs) to grow and become more competitive. Montenegro has seen a constant improvement in the overall ease of Doing Business. Its current ranking of 46th out of 189 countries signals an increasingly favorable business environment, backed by continued significant inflows of foreign direct investment. Staying the course of reform to improve the business climate and improve private sector competitiveness and integration with global markets is essential. Montenegro has one of the lowest goods export-to-GDP ratios in the world, and while access to the EU offers Montenegro a remarkable opportunity to connect to the EU and other markets beyond its borders, its firms and products are not competitive and often do not meet the necessary regulatory standards. They are also less likely to adopt new technologies and to innovate. Supporting MSMEs, whose value added is estimated to account for about two thirds of GDP, is equally critical for Montenegro's growth and competitiveness. While Montenegro's coastline, proximity to EU markets, and relatively educated workforce present great potential for MSMEs to overcome the country's size limitations, Montenegrin firms are relatively poorly integrated into the global economy, still struggle with accessing finance and developing bankable projects, and are characterized by a low use of ICT. The more dynamic and innovative firms, those holding greatest potential to lead future growth, are also those most likely to cite lack of labor with relevant skills as a constraint.

59. Tackling these issues requires addressing labor market rigidities, improving the quality and relevance of education and training, minimizing disincentives to work, improving facilitation services for the unemployed, and fostering private sector-led job creation in high-potential sectors. WBG support will contribute to this agenda by addressing skills gaps and mismatches (objective 2a) both through continued implementation of the Higher Education Research for Innovation and Competitiveness project, and through proposed additional engagement in vocational/post-secondary education reform that would link the output of tertiary education system more closely to private sector needs. Strengthening incentives and facilitation for work (objective 2b) will be supported by addressing disincentives in the social protection system and expanding access to employment services as well as creating conditions for more productive employment through a Jobs and Competitiveness Project. In addition, a solid ASA agenda will strengthen the evidence base for understanding barriers to job creation and labor force participation. Finally, the WBG will support increased private sector investments and job creation (objective 2c), with a focus on Montenegro's key economic sectors of sustainable tourism and agriculture, through the proposed Tourism-based Local Development project, ongoing MIDAS project, and IFC and MIGA operations.

CPF Objective 2a: Increased alignment between skills and labor market demand

Results indicators for Objective 2a
Indicator 4: Share of updated TVET curricula in line with occupational standards.
Indicator 5: Increase in the perception of relevance of higher education programs and degrees

60. Improving Montenegro's labor market performance and economic competitiveness will require a more skilled and better educated labor force, as well as increased knowledge and innovation. Montenegro faces a long-term issue of quality of education reflected in relatively low performance of students. While access to education has improved, there is a challenging disconnect between the products of the education system and the private sector needs. At 4.5 percent of GDP, Montenegro spends as much on public education as other countries in the Western Balkan region and very close to the OECD recommended 5 percent of GDP, but these spending levels have not yet resulted in comparable education outcomes. Montenegrin students underperform on the Programme for International Student Assessment (PISA) showing inadequate levels in reading, mathematics, and science among 15-year-olds, though scores have improved in recent years. In the medium term, the challenge is to ensure that tertiary and vocational education students transition from school to work, but also that long-term unemployed are retrained and can re-enter the labor market.

61. WBG support under this objective will focus on building the right skills and supporting school-to-work transition for graduates of the education system (in particular, of higher education and technical and vocational education and training (TVET) students), by ensuring labor market relevance of education and further fostering academic/industry collaboration. In parallel, the ongoing Higher Education Research for Innovation and Competitiveness (HERIC) project continues to support reforms to improve higher education monitoring and service delivery, including in terms of financing and quality assurance, and to increase cooperation with the private sector through the establishment of a Center of Excellence that resulted in several international R&D partnerships and business start-ups. These complementary activities will allow TVET and higher education to further improve their relationship with the labor market and improve the transition from both TVET and tertiary education to employment.

CPF Objective 2b: Facilitation and strengthened incentives for work

Results indicators for Objective 2b
Indicator 6: Decrease in the average effective tax rate (AETR) of a low-income one earner couple (equivalent to half-time job at minimum wage) with two children on social assistance that moves from unemployment into a formal job.
Indicator 7: Percentage of unemployed registered with Public Employment Services finding formal employment.

62. Disincentives for formal work are significant—and in the case of recipients of social assistance prohibitively high. Work disincentives are highest for low-income earners or those in part-time work (the latter more likely to be women), and are very high for those receiving social assistance. It hardly makes sense to have a low-paying, part-time job within the formal sector. The main disincentives for formal work apply to single parents or single-earner couples with children who receive social assistance and family benefits (the child allowance). For these families, any part-time low-paying job would actually decrease net income. A full-time job at minimum wage would pay about as much as social assistance and family benefits when not working at all. A one-earner couple with two children is entitled to about EUR 1,750 a year[19] in social assistance and family benefits. A full-time job at minimum wage would pay about EUR 1,650. Any part-time job at minimum wage would considerably decrease net income of the family. For example, a half-time job at minimum wage would decrease the family's income to only about EUR 1,000 a year.

63. At the same time, employers are able to hire people informally, in particular for seasonal jobs, for example in the tourism industry, and thus prefer to rely on migrant workers from other countries, paying no taxes or social contributions, and sometimes observing no labor standards. This effectively creates a disincentive to employ the available local labor force, as well as having adverse implications for budget and pension funds revenues, in addition to putting informal workers into a vulnerable position. It is important to address the disincentives on the employee and employer side in parallel to achieve the maximum effect.

64. WBG will support strengthening incentives for work, including for poor and vulnerable groups, by focusing on disincentives in the social protection system, other barriers to activation, such as those related to information, perception, or labor and tax legislation, and strengthened regulation of the 'grey' economy to promote formalization of informal jobs, as well as improved facilitation services for job seekers. The WBG will support addressing disincentives in the social protection system and expanding access to employment services through a Jobs and Competitiveness Project. The aim would be to improve effectiveness and expand inclusive access to employment services, keeping in mind deficits faced by specific groups, by linking employment services with last-resort social assistance so that the poor would access these services, and addressing information barriers to accessing productive employment faced by vulnerable groups. In parallel, the project would support measures to reduce disincentives to employ people in the formal sector by encouraging registration, enforcing labor standards, and levelling the playing field between local and migrant workers. An employment and pension TA will also aim to reduce workers' disincentives for work in the design of social assistance and pensions, the latter focusing on addressing early retirement. In addition, the World Bank will build a solid ASA foundation to strengthen the evidence base for understanding barriers to job creation and labor force participation, particularly in the formal economy.

<u>CPF Objective 2c: Enhanced private investments and job creation in high-potential sectors</u>

Results indicators for Objective 2c
Indicator 8: Private sector investments generated through IFC interventions and WB investments in tourism. ***Indicator 9:*** Increased share of jobs in Travel & Tourism sector in non-coastal urban centers. ***Indicator 10***: Increased investments in agriculture and rural development in line with IPARD measures.

[19] Net (income tax and social contributions are already deducted).

65. Agriculture and Tourism are Montenegro's main economic sectors, with great potential to create income and jobs. Tourism, the fastest growing sector in Montenegro, is a major source of employment and economic growth. Over 18 percent of total employment in the country was generated by the tourism industry in 2014, while foreign receipts from tourism service exports corresponded to 20 percent of GDP in the same year. The Government recognizes tourism and tourism-based local economy as priorities for the country, as reflected in the *Montenegro Tourism Development Strategy to 2020.* The vision of the strategy is to create a tourism product based on an integrated approach that includes coastal areas and the hinterland, as a way to extend the tourism season and give impetus to the poorer northern and central regions of the country. Supporting the tourism value chain will generate jobs and growth of local suppliers and MSMEs linked to the tourism industry, including those in agriculture, which itself accounts for around 8 percent of GDP and is by far the largest activity of the rural population, with almost 50,000 families obtaining their income partly or entirely from agriculture. Labor force survey data indicate that around 8 percent of employment in 2015 was in agriculture. According to the Household Budget Survey (HBS) the share of the Bottom 40 working in subsistence agriculture and self-employment is approximately twice that of the top 60.[20]

66. Increased private sector investments and job creation in the areas of agriculture and sustainable tourism would substantially benefit rural communities and vulnerable groups, including women and youth. Agriculture is by far the largest source of income in rural areas where 41 percent of the poor live, and where the inactivity rate for women reaches 67 percent, 27 percentage points higher than for men. Private sector investments in sustainable tourism will offer new opportunities for youth and new entrants in the labor market, who find it particularly difficult to transition to work.

67. Supporting the growth of innovation-driven and productivity-led MSMEs is critical to enhancing Montenegro's competitiveness in key economic sectors. MSMEs often face significant post-entry barriers rooted in market and institutional failures which hinder firm productivity and growth. In Montenegro, MSMEs produce an estimated 65 percent of GDP, but are relatively poorly integrated into the global economy, still struggle with accessing finance, and have limited business skills and capacity for innovation and absorption of new technologies. Programs targeting MSME policies and strengthening the overall entrepreneurial ecosystem and strategies to support firms through the venture life cycle (from start-up and early-stage businesses to high-growth enterprises) would facilitate entrepreneurship, improve the innovative capacity of firms and foster a dynamic and competitive private sector.

68. Improving the business environment, particularly for MSMEs, will also be essential to creating long-term conditions for private sector growth and job creation. The Government has enacted extensive business climate reforms as reflected by the country being in the top 50 countries in the world per the ease of doing business, however, there is still room for improvement. Ensuring effectiveness of regulatory reforms (M&E of implementation of government's regulatory reforms, strengthening accountability and incentives for regulators, and strengthening awareness of reforms) and further cutting the regulatory burden on firms (in areas such as construction

[20] The share estimated in the HBS is likely an underestimation, because the HBS doesn't allow for capturing those "employed" in agribusinesses.

permits, inspections, IP rights, and so on) could help improve firm competitiveness and foster growth and job creation.

69. The WBG will use the comparative advantage of all its arms (IBRD, IFC, and MIGA) to foster employment in these areas. More specifically, the WBG support would include: (i) fostering tourism-based local economy and sustainable development through better mobilization of environmental and cultural assets; (ii) supporting sustainable agriculture and rural development in line with the EU's pre-accession requirements; (iii) supporting development of MSMEs through the firm lifecycle (increasing MSMEs' access to finance, business support services to improve internal capabilities of firms, and technology upgrading) and addressing business environment constraints to competitiveness of firms. In addition, IFC will finance sustainable microfinance institutions to support economic opportunities and employment, in particular for the more socially vulnerable parts of the population, including women and people living in less developed regions; (iv) facilitating access to ICT as a means to grow market access; (v) supporting increased cooperation with the private sector in several international R&D partnerships and business start-ups; and (vi) promoting development of critical tourism infrastructure.

CPF Objective 2d: Enhanced environmental sustainability

Results indicators for Objective 2d
Indicator 11: Contaminated land managed or dump sites closed ***Indicator 12:*** Energy savings in targeted public buildings

70. Improving environmental sustainability is essential for attracting and retaining sustainable tourism and other private sector investment. Although industrial production is stagnant, industrial waste is constantly increasing and poses a threat to the environment. The existing main industrial waste disposal sites containing materials such as coal ash, lead, other heavy metals and hazardous waste pose risks not just to the immediate environment, but also to the public health of surrounding communities due to groundwater contamination and other pathways. These risks are amplified for some of the sites located in zones of seismic risk. Other areas, such as the surroundings of Skadar Lake, where the Aluminum Plant KAP is located, have experienced serious flooding, which could become more frequent and severe under predicted climate change-related shifts. Some of the polluted sites are located not far from the country's most valuable natural resources, important from both environmental and economic point of view. These include national parks, the most important watershed in Montenegro and the largest and trans-boundary lake in the Balkans, tourist centers, and a UNESCO protected site. The ongoing Industrial Waste Management and Clean-up project will help address the issue of remediation of such crucial sites.

71. Recent studies also indicate that Balkan countries are particularly sensitive to climate and precipitation change, with weather related events becoming more frequent and intense. The Drina River Basin has been assessed as the part of the Danube River Basin that is most sensitive to climate variability. The Western Balkans Drina River Basin Management GEF project[21] will complement ongoing activities financed by the Bank, the EU and other international institutions which aim at improving integrated planning and cooperation for water in the region. The GEF will help deal with climate change-related disasters, notably floods and droughts, by improving mechanisms and capacity to plan and manage the basin, incorporating climate change adaptation plans. Building up on its previous work with the Municipality of Podgorica, IFC will look for opportunities to support financially sustainable municipalities in waste management projects. Where appropriate and fiscally viable, IFC would consider pursuing PPPs in this area.

72. The Montenegrin economy has high energy intensity measured as energy used per unit of gross domestic product. This is primarily due to significant consumption in the aluminum smelting process, which uses outdated technology. But energy consumption is also inefficient among households, many public buildings, and in the services sectors, especially with regard to heating. As a result, a very high share of electric energy is used for space heating, aided by low electricity prices. Overall household energy expenditures in Montenegro are estimated to represent about 15.3 percent of average household income, the highest level among the neighboring countries; annual electricity expenditure alone is estimated to average over EUR 600 per household. The relative share of these expenditures in poorer households is likely to be even higher. Reducing energy intensity and increasing renewable energy production are essential for enabling sustainable growth as well as reducing public expenditures. Public sector action on improving energy efficiency also serves to increase awareness of energy efficiency among the population and to demonstrate the benefits of energy saving, including reduction of expenditures. The ongoing Energy Efficiency project as well as possible IFC investments in renewable energy generation will contribute to this agenda.

C. Implementing the FY16-20 Country Partnership Framework

73. IBRD financing during the CPF period is estimated at approximately US$250-US$300 million, but the level and modalities of engagement will depend on the implementation of specific measures aimed at putting Montenegro back on a fiscally sustainable path. [22] The indicative lending program for the first three years of the new CPF (FY16 through FY18) is US$163 million[23] with a greater emphasis on Focus Area 1 objectives of fiscal consolidation, efficiency of public spending and financial sector stability (see Table 4). Under Focus Area 2, the program will combine work on skills and removing disincentives to employment with investment in the creation of new jobs in the private sector, through the Tourism-based Local Development project, including support to MSMEs through the firm life cycle as part of the project, as well as through facilitating private sector investments by IFC and MIGA. The lending program for the last two years of the CPF period is indicative and could include for example building on successful experiences in the agriculture sector (MIDAS 2), land administration (LAMP 2) or Energy Efficiency as these projects exit the portfolio, or new areas of engagement in support of

[21] GEF amounts to US$8.7 million for the three countries.

[22] The FY16-20 program is indicative and actual lending amounts will depend on country demand, overall performance, global economic developments affecting IBRD's financial capacity, as well as demand from other IBRD borrowers.

[23] Excluding the Drina River project, which is GEF and Special Climate Change-funded and whose amount is shared by three countries.

environment for private sector growth, such as a Digital Economy project. The lending program in years 4 and 5 of the CPF will be firmly defined in the mid-term Performance and Learning Review (PLR). Advisory Services and Analytics (ASA) will complement the lending program and help fill key knowledge gaps. For example, a Public Finance Review will help identify fiscal consolidation measures to be supported under the planned DPO/PBG series, an analytic and advisory engagement would clarify the nature of the skills gap in the labor market and help inform the design of the TVET Reform project, while the Pension System review will identify the key measures to be supported under the Jobs and Competitiveness project.

Table 4: IBRD FY16-20 Indicative Lending

Project Name	**Instrument**	**Planned Amount (US$ million, DPO and IPF)**
FY16		**9**
1. Western Balkans Drina River Basin Management	GEF/SCCF[24]	9
FY17		**63**
2. MIDAS Additional Financing	IPF	3
3. Revenue Administration Project	IPF	10
4. Fiscal and Financial Sector Resilience DPO I	DPL/PBG	50
FY18		**100**
5. Health System Efficiency and Quality Improvement Project	IPF	10
6. Fiscal and Financial Sector Resilience DPO II	DPL/PBG	40
7. Tourism-based Local Development	IPF	50
FY19		
8. Training and Education for Improved Skills	IPF	TBD
9. Jobs and Competitiveness	IPF	TBD
10.Energy Efficiency 2	IPF	TBD
FY20		
11. Digital Economy Project	IPF	TBD
12. MIDAS 2	IPF	TBD
TOTAL		**250-300**

[24] Global Environment Facility and Special Climate Change Fund-financed regional project, covering Bosnia and Herzegovina, Montenegro, and Serbia. Project amount refers to the entire regional project, not only Montenegro.

Table 5: ASA and TF FY16-20 Indicative Program[25]

ASA Name	Type
FY16	
1. Western Balkans Pensions	TA
2. Policy Note on Broadband	TA
FY17	
3. Public Finance Review	TA
4. Justice Functional Review	TA
5. Strengthening of the financial safety net (FinSAC)	TA
6. Demand and supply-side barriers to employment	TA
FY18-20	
	TBD

74. IFC and MIGA will support and complement the Bank's efforts to enhance private sector investments, particularly in the areas of sustainable tourism, tourism related infrastructure and agribusiness projects, as well as to improve access to finance for MSMEs. IFC proposes a range of investments of US$40 to US$60 million during the CPF period, depending on market conditions and government openness and capacity to attract private sector in infrastructure projects through PPPs in a fiscally and regulatory viable framework. IFC will continue supporting improved access to finance for MSMEs and generation of productive employment opportunities through microenterprises. IFC will build on its ongoing engagements in infrastructure in the Western Balkans and will look for new opportunities to support private sector investments in Montenegro in renewable energy, transport, and municipal infrastructure through direct investments and PPP advisory services. IFC will also stand ready to support sustainable projects in tourism, as a contributor to employment, as well as tourism-related sectors. IFC will continue supporting investment climate reforms and help create an efficient and modernized customs management systems aligned with WTO standards. In parallel, potential MIGA political risk insurance will be explored within the scope of fostering private investments and job creation in high-potential sectors.

75. Use of country systems in Montenegro remains limited, but with prospects for improvements during the CPF period. A number of reforms have resulted in strengthening Montenegro's financial management system, including budget execution and cash management. However, substantial improvements are needed to set up a credible medium-term budgetary framework and, more generally, to put in place a more strategic approach to budgeting and management of public funds. Montenegro's public procurement system is regulated by the Public Procurement Law, which became effective on January 1, 2012 and was amended in 2015. The Law was adopted in close collaboration with the European Union to create a framework for the further streaming of public expenditures and improvements in public procurement system. Implementation revealed several bottlenecks, and a rapid effort to improve the legislation took place. Transparency has increased with publication of many public procurement documents, such as government procurement plans, bidding opportunities, contract awards and data resolution of

[25] Outer years will be determined in the course of the CPF implementation.

procurement complaints, all of which are now easily accessible to the public via the internet. An independent administrative procurement complaints system is also in place. Notwithstanding the significant improvements, Montenegro's public procurement system continues to face challenges, such as the need to increase efficiency, for example through the development of an e-procurement platform, as well as in governance and transparency. A new Public Procurement Strategy will be prepared in 2016 and is expected to address some of these issues.

IV. MANAGING RISKS TO THE CPF PROGRAM

76. The overall risk to the CPF Program is assessed as High (see Table 6). Although the country risk is deemed to be modest, the risk to the achievement of the CPF objectives is high. The highest risk is associated with Montenegro's ability to return to a sustainable macro-fiscal path, supported under Focus Area 1, a task that would require difficult political decisions, including reversal of recent policy measures. Should this risk materialize, the Bank would be unable to proceed with the proposed DPO/PBG series and the results under the first focus area would be substantially more modest. In this scenario, the content of the CPF program and the related results matrix will be reassessed at mid-term, as part of the PLR. The program would be scaled down and adjusted through reallocation of some of the DPO resources towards investment operations that could support Montenegro in strengthening its resilience to shocks and advance towards a private-sector driven, inclusive growth model.

77. Political and governance risk is rated Substantial, based on the fact that the Government often changes its priorities for WBG engagement, and that we can expect further changes after the 2016 elections regardless of their outcome. WBG engagement will remain flexible and the program will adapt as needed. Any needed changes will be reflected at the time of the PLR. With respect to governance more specifically, the ongoing EU accession agenda features this as a prominent area under IPA II, and it is thus likely that both the incentives embedded in the negotiations process, and the EU leadership, will provide a solid platform for continued progress in this area, notwithstanding any possible changes at the political level.

78. Macroeconomic risk is rated High. This stems from the risks associated with fiscal sustainability and stability of the financial sector, which could hinder the achievement of the CPF objectives under Focus Area 1. Public finances remain strained, with public debt set to further increase through 2018 and recent measures raising questions about the ability to maintain fiscal sustainability. Similarly, growing risks in domestic banks and weaknesses in bank regulation and oversight pose fiscal and financial stability risks that could potentially reverse economic recovery. The Bank would mitigate these risks, and help the Government in reversing these trends, through the envisaged DPO/PBG series. As noted earlier, should the operations not materialize, support would likely continue to focus on strengthening Montenegro's resilience to shocks through investment financing. In such a scenario, the program scope, results matrix, and associated risks would be revised accordingly at the time of the PLR.

79. Institutional capacity risk is rated Substantial, reflecting uneven implementation capacity as well as project experience in the previous program, which indicates that project preparation and implementation often takes longer than expected, delaying the achievement of intended development results. The Bank will continue providing hands-on preparation and implementation support, as well as technical assistance in order to mitigate this risk.

80. Finally, Environmental and Social risk is also rated Substantial. As discussed elsewhere in the document, Montenegro is vulnerable to the risks of natural disasters and climate change. Should a serious event occur during strategy implementation, it is likely to derail the program and the achievement of intended development results, particularly under Focus Area 1, but possibly also under Focus Area 2, where emphasis is on the development of sustainable tourism. These risks would be mitigated as part of the program, and particularly through supporting more effective industrial waste disposal, addressing climate change challenges as part of transboundary integrated water resources management and climate change adaptation in national planning, and supporting sustainable tourism, with a view to support investments that enhance and preserve Montenegro's natural resources. Like in other countries, if these risks materialize we would work with the Government to restructure the program to respond to new challenges.

Table 6: Systematic Operations Risk-rating Tool (SORT) Matrix

Risk Categories	**Rating**
Political and Governance	S
Macroeconomic	H
Sector strategies and policies	M
Technical design of project or program	M
Institutional Capacity for implementation and sustainability	S
Fiduciary	M
Environment and Social	S
Stakeholders	M
Overall	H

Annex 1. CPF Results Matrix

FOCUS AREA 1: ENHANCE MACROECONOMIC AND FINANCIAL RESILIENCE		
As a small open economy without its own currency, strengthening macroeconomic and financial resilience is essential to Montenegro's strategy of poverty reduction and inclusive growth. Large infrastructure investments are expected to generate growth in the near and medium-term, but come at the expense of exacerbating already pronounced public debt-related vulnerabilities. Large general government financing needs are also an important source of macroeconomic risk. Addressing these issues requires a credible medium-term fiscal plan underpinned by sound sectoral policies to reduce deficit and eventually debt. The financial system is also hampered by number of inefficiencies, including high costs of intermediation and still high level of non-performing loans (NPL). Growing risks and weaknesses in bank regulation and oversight pose fiscal and financial stability risks.		
CPF OBJECTIVE 1A: Improved sustainability and efficiency of public finances		
Intervention logic: Montenegro remains highly susceptible to external shocks, in particular due to its levels of public debt. Reversing the rapid public debt growth and persistent large fiscal deficits requires a credible medium-term fiscal consolidation underpinned by sound sectoral policies to reduce deficit and eventually debt. This is needed both to mitigate Montenegro's vulnerability to external shocks as well as to meet its refinancing needs. The size of non-discretionary spending (like public administration wage bill, increasing health and pension expenditures, and disconnect between the current health/pension insurance benefit package and available resources) and tax revenue collection does not provide much fiscal space for a large expansion of government expenditures. The Government has also accumulated sizable payment arrears, estimated at close to 11 percent of GDP at end-2014. Of these, around 80 percent are municipalities' accumulated arrears which adversely affect private sector liquidity and payments discipline and have also impacted banks' abilities to reduce their NPLs. The WBG will support the authorities in their efforts to achieve fiscal sustainability through the planned series of Fiscal and Financial Sector Resilience DPOs or PBGs. Preparation of the DPO/PBG series will be subject to a satisfactory macroeconomic framework, including prior evidence of fiscal consolidation measures. In the absence of such evidence, the extent and nature of WBG engagement will be re-assessed in mid-course, as part of the CPF Performance and Learning Review. The planned Health System Efficiency Project and Revenue Administration Project as well as the ongoing Energy Efficiency Project will complement and further support this agenda, by focusing on increasing the efficiency of health and energy spending and of the tax administration system. In addition, viable Public-Private Partnerships (PPPs) could play an important role in increasing efficiency and sustainability of public services.		
CPF Objective Indicators	**Supplementary Progress Indicators**	**WBG Program**
Indicator 1: Stabilization of public debt	***SPI1***: Wage bill to decline by one percentage point of GDP.	**IBRD Lending**:

Baseline: Public debt at 68 percent of GDP (2015) **Target**: After reaching its projected peak in 2018 (at 78 percent of GDP) public debt is reduced in 2019	**Baseline**: 12.2 percent (2015) **Target**: 11.2 percent (2019) ***SPI2***: Arrears of general government to GDP ratio declined. **Baseline**: 10.9% (2014), **Target**: Below 5% (2019) ***SPI3:*** Tax gap for VAT (VAT to consumption ratio is being used as proxy) **Baseline**: 12.3 (2010-14 average) **Target**: 13.4 (2020) ***SPI4:*** Percentage decrease in total cost of 50 most frequently dispensed prescription outpatient medicines **Baseline**: EUR7.8 million (2014) **Target**: 10 percent reduction in real terms (2019) ***SPI15*** Additional savings in heating costs due to energy efficiency improvements in public buildings Baseline: 0 (2015) Target: EUR950,000 (2020)	• Fiscal and Financial Sector Resilience DPO I and II (pipeline –FY17-18) • Health System Efficiency and Quality Improvement Project (pipeline – FY18) • Revenue Administration Project (pipeline – FY17) • Energy Efficiency in Public Buildings (ongoing) plus Additional Financing (pipeline – FY19) **ASA**: • Western Balkans Pensions TA (FY16) • Justice Functional Review TA (FY17) • Public Finance Review TA (FY17) **IFC**: • Support for PPPs in infrastructure and municipal services
CPF OBJECTIVE 1B: Increased stability and efficiency of financial sector		
Intervention logic: The financial sector is an essential building block for maintaining Montenegro's macro stability and increasing efficiency in intermediating financial resources. However, Montenegro's financial sector is currently not fully equipped to play this role, on account of several inefficiencies identified under the 2015 IMF/World Bank FSAP. These include high costs of intermediation and high level of non-performing loans (NPLs). Growing risks and weaknesses in bank regulation and oversight also pose fiscal and financial stability risks. WBG interventions will be outlined in the planned series of Fiscal and Financial Sector Resilience DPOs or PBGs. The planned FinSAC Deposit Protection Fund Strengthening TA Program will complement and further support this agenda, by focusing on strengthening the financial safety net. IFC will continue supporting NPL resolution in the Western Balkans including in Montenegro. Also, IFC will offer credit lines to local banks and microfinance institutions to support MSMEs, housing finance, renewable energy and agribusiness projects In addition to financing IFC will offer advisory services to the banks and microfinance institutions to enhance their risk management and governance practices.		
CPF Objective Indicators	**Supplementary Progress Indicators**	**WBG Program**

Indicator 2: Reduction in the incidence of NPLs in total loan portfolio **Baseline**: NPL value of 14.7 % (Q3, 2015) **Target**: NPL value of 10% (2019) ***Indicator 3:*** Strengthened prudential norms for identification, classification, and re-classification of nonperforming assets. **Baseline**: No amendment to CBM Decision on the minimum standards for management of credit risk (2015) **Target**: Amendments adopted (2018)	***SPI6:*** Adoption of a methodology for risk-based contributions from member banks for the Deposit Protection Fund (DPF) and shortening of pay out period to seven working days. **Baseline**: Methodology not adopted and pay out period of 15 working days (2015) **Target**: Methodology adopted and pay out period of seven working days (2018) ***SPI7:*** Number of out-of-court restructurings completed under the recently enacted Law on Voluntary Restructuring of Debts **Baseline**: 0 (2015) **Target**: 10 (2020) ***SPI8:*** Strengthened bank resolution framework via transposition of the EU Bank Recovery and Resolution Directive (BRRD). **Baseline**: No amendment to CBM and Banking Laws (2015) **Target**: Amendments adopted (2019)	**IBRD Lending:** • Fiscal and Financial Sector Resilience DPO I and II (pipeline – FY17 and FY18) **ASA:** • TA on strengthening of the financial safety net (FinSAC) (FY17) • 2015 WB/IMF FSAP (completed) **IFC**: • Debt Resolution Program advisory work

FOCUS AREA 2: EXPAND ACCESS TO ECONOMIC OPPORTUNITIES AND JOBS

Persistently high unemployment and low labor force participation, especially among the poor, Bottom 40, youth, middle-aged men, and women, indicate that a large share of the population does not benefit from labor market opportunities or that adequate incentives are not in place. The low activity rate of the working-age population and the high unemployment rate are often the result of mismatches between supply and demand for skilled labor, as well as of disincentives for active labor participation. Additionally, the lack of competitiveness of Montenegrin firms limits the private sector's ability to serve as the engine of growth and job creation.

Tackling these issues requires addressing labor market rigidities, investing in equitable access to quality education and training, minimizing disincentives to work, and fostering private sector-led job creation in high-potential sectors.

CPF OBJECTIVE 2A: Increased alignment between skills and labor market demand

Intervention logic: Improving Montenegro's labor market performance and economic competitiveness will require a more skilled and better educated labor force, as well as increased knowledge and innovation. Montenegro faces a long-term issue of quality of education, reflected in poor performance of students. While access to education has improved, there is a challenging disconnect between the products of the education system and the private sector needs. On the medium-term, the challenge is to ensure that tertiary education students transition from school to work, but also that long-term unemployed are retrained and can thus re-enter the labor market.

WBG support under this objective will focus on building the right skills and supporting school-to-work transition for graduates of the education system (in particular, of higher education and technical and vocational education (TVET) students). In parallel, the ongoing Higher Education Research for Innovation and Competitiveness (HERIC) project continues to support reforms to improve higher education monitoring and service delivery, including in terms of financing and quality assurance, and to increase cooperation with the private sector through the establishment of a Center of Excellence that resulted in several international R&D partnerships and business start-ups. These complementary activities will allow TVET and higher education to further improve its relationship with the labor market and improve the transition from both VET and tertiary education to employment for graduates.

CPF Objective Indicators	Supplementary Progress Indicators	WBG Program
Indicator 4: Share of updated TVET curricula in line with occupational standards. **Baseline:** 0 (2015) **Target:** All TVET curricula updated (2020) ***Indicator 5:*** Increase in the perception of relevance of higher education programs and degrees (gender disaggregated) **Baseline:** 86% (2015) **Target:** 95% (2017)	***SPI9:*** % of secondary TVET students benefitting from practical training in MSMEs and large sized firms (geographically and gender disaggregated) **Baseline:** 54% (2015) **Target:** 20% increase on baseline (2020)	**IBRD Lending:** • Higher Education Research for Innovation and Competitiveness Project (ongoing) • Training and Education for Improved Skills (pipeline - FY19) **TA:** • Demand and supply-side barriers to employment TA (FY17)

CPF OBJECTIVE 2B: Facilitation and strengthened incentives for work

Intervention Logic: Disincentives for formal work are significant—and in the case of recipients of social assistance prohibitively high. Work disincentives are highest for low-income earners or those in part-time work (the latter more likely to be women), and are very high for those receiving social assistance. At the moment, in Montenegro it hardly pays off to have such a low-paying, part-time job within the formal sector. The main disincentives for formal work applies to single parents or single-earner couples with children who receive social assistance and family benefits (the child allowance). For these families, any part-time low-paying job would actually decrease net income. At the same time, employers are able to employ people informally, in particular for seasonal jobs, for example in the tourism industry, and thus prefer to rely on migrant workers from other countries, paying no taxes or social contributions, and sometimes observing no labor standards. This effectively creates a disincentive to employ the available local labor force, as well as having adverse implications for budget and pension funds revenues, in addition to putting these informal workers into a vulnerable position.

WBG will support strengthening incentives for work, including for poor and vulnerable groups, by focusing on disincentives in the social protection system, other barriers to activation, barriers related to information, perception, or labor and tax legislation, and strengthened regulation of the 'grey' economy to promote formalization of informal jobs. The WBG will support addressing disincentives in the social protection system and expanding access to employment services through a Jobs and Competitiveness Project. An employment and pension TA will also aim to reduce workers' disincentives for work in the design of social assistance and pensions, the latter focusing on addressing early retirement. In addition, the World Bank will build a solid ASA agenda to strengthen the evidence base for understanding barriers to job creation and labor force participation, particularly in the formal economy.		
Indicator 6: Decrease in the average effective tax rate (AETR) of a low-income one earner couple (equivalent to half-time job at minimum wage) with two children on social assistance that moves from unemployment into a formal job. **Baseline:** 93.3% (2011) **Target:** 80% (2019) ***Indicator 7:*** Percentage of unemployed registered with Public Employment Services finding formal employment. **Baseline**: 12.2% (2015) **Target**: 20% (2019)	***SPI10:*** Public employment services implement strengthened methodology for job profiling of the unemployed **Baseline:** Methodology not implemented (2015) **Target:** Methodology implemented (2018)	**IBRD Lending:** • Jobs and Competitiveness Project (pipeline – FY19) **ASA:** • Western Balkans Pension TA (FY16) • Demand and supply-side barriers to employment TA (FY17)
CPF OBJECTIVE 2C: Enhanced private investments and job creation in high-potential sectors		
Intervention Logic: Agriculture and Tourism are Montenegro's main economic sectors, with great potential to create income and jobs. Tourism, the fastest growing economic sector in Montenegro, is a major source of employment and economic growth. Over 18 percent of total employment in Montenegro was generated by the tourism industry in 2014, while foreign receipts from tourism service exports corresponded to 20 percent of GDP in the same year. The Government recognizes tourism and tourism-based local economy as priorities for the country, as reflected in the *Montenegro Tourism Development Strategy to 2020.* Supporting the tourism value chain will generate jobs and growth of local suppliers and MSMEs supporting the tourism industry, including those in the agriculture sector, which itself accounts for around 8 percent of GDP. Increased private sector investments and job creation in the areas of agriculture and sustainable tourism would substantially benefit rural communities and vulnerable groups, including women and youth. Agriculture is, by far, the largest source of income for the rural population, where 41 percent of the poor leave, and where inactivity rate for women reaches 67 percent, 27 percentage points higher than for men. Montenegro needs to invest in an inclusive growth model where the private sector serves as the engine of growth and provides employment opportunities for the country's labor force. However, Montenegrin firms lack competitiveness: they are relatively poorly integrated into the global		

economy and are also less likely to adopt new technologies and to innovate. Unlocking the potential for Micro, Small and Medium Enterprises (MSMEs) (whose value added is estimated to account for about two thirds of GDP) to grow and become more competitive, is critical for Montenegro. The WBG will support the growth of innovation-driven and productivity-led MSMEs, to foster a dynamic and competitive private sector better positioned to generate growth and employment, through a Jobs and Competitiveness Project.

The WBG will use the comparative advantage of all its arms (IBRD, IFC, and MIGA) to foster employment in these areas. More specifically, the WBG support would include: (i) fostering tourism-based local economy and sustainable development; (ii) supporting sustainable agriculture and rural development in line with the EU's pre-accession requirements; (iii) supporting development of MSMEs through the firm lifecycle (increasing MSMEs' access to finance, business support services to improve internal capabilities of firms, and technology upgrading) and addressing the business environment constraints that they face, starting with those engaged in the sustainable tourism agenda; (iv) facilitating access to ICT as a means to grow market access; (v) supporting increased cooperation with the private sector in several international R&D partnerships and business start-ups; and (vi) promoting development of critical tourism-related infrastructure. IFC will also finance sustainable microfinance institutions to support economic opportunities and employment.

CPF Objective Indicators	Supplementary Progress Indicators	WBG Program
Indicator 8: Private sector investments generated through IFC interventions and WB investments in tourism. **Baseline**: 0 (2015) **Target**: US$30 million (2019) ***Indicator 9**:* Increased share of jobs in Travel & Tourism (T&T) sector in non-coastal urban centers. **Baseline***:* 9.7% (2014) **Target***:* 12% (2019) ***Indicator 10:*** Increased investments in agricultural and rural development in line with IPARD measures **Baseline:** 0 commercially-oriented agro-holdings (2009) **Target:** 400 commercially-oriented agro-holdings (2016)	***SPI11:*** Increased percentage of tourism overnight stays in non-coastal cities **Baseline**: 3% (2014) **Target**: 5% (2019) ***SPI12:*** Incremental number of microfinance and SME loans **Baseline***:* 0 (2015) **Target***:* 8,000 loans to microfinance companies, of which 3,000 owned by women (owners/stakeholders) (2020); 500 loans to SMEs (2020)	**IBRD Lending:** • Tourism-based Local Development project (pipeline – FY18) • Montenegro institutional development and agriculture strengthening Project (MIDAS) TF (ongoing) plus MIDAS Additional Financing /2 (pipeline - FY17-20) • Jobs and Competitiveness Project (pipeline – 2019) • Digital Economy project (pipeline – FY20) **ASA**: • Montenegro: Policy Note on Broadband TA (FY16) • Demand and supply-side barriers to employment TA (FY17) **IFC:** • IFC investments in tourism and tourism related sectors, including in infrastructure and in agribusiness sectors • Trade Facilitation Support Project (pipeline)

		Possible PPP advisory support to support private sector investments in infrastructure • Investments in local financial intermediaries (banks and microfinance institutions) aimed at enhancing access to finance for MSMEs

CPF OBJECTIVE 2D: Enhanced Environmental Sustainability

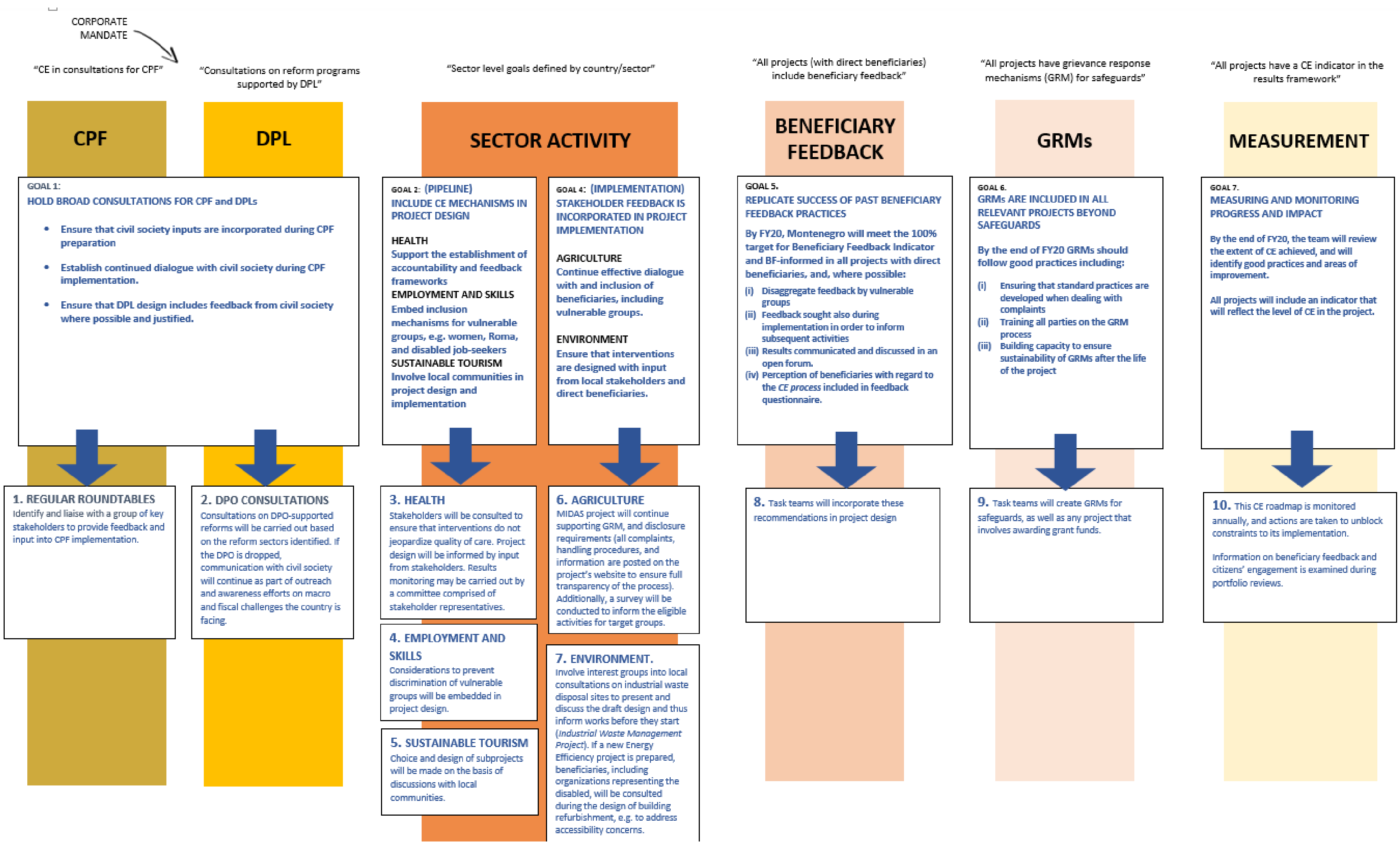
Improving environmental sustainability will be essential in mitigating Montenegro's vulnerability to natural disasters, but also an essential feature for attracting and retaining private investment and jobs, in particular in sustainable tourism. Although industrial production is stagnant, industrial waste is constantly increasing and poses a constant threat to the environment. The existing main industrial waste disposal sites pose risks not just to the immediate environment, but also to the public health of surrounding communities. Recent studies also indicate that Balkan countries are particularly sensitive to future climate and precipitation change in Europe with weather related events to become more frequent and intense. The Drina River Basin, a transboundary Basin of around 20,000 km2, about equally divided among Bosnia and Herzegovina, Montenegro and Serbia, is particularly sensitive to climate variability. Modelling done with support from the World Bank suggests possibility of floods that could cause severe economic and environmental impacts, resulting in damages around 4-5 percent of GDP. The Montenegrin economy also has high energy intensity. This is primarily due to significant consumption in the aluminum smelting process, which is using outdated and far from energy-efficient technology. But energy consumption is also inefficient among households, many public buildings, and in the services sectors, especially with regard to heating. As a result, a very high share of electric energy is used for space heating, aided by low electricity prices.

The ongoing Industrial Waste Management and Cleanup project will help address the issue of remediation of industrial pollution sites, while the Drina River Basin Management Project aims to improve mechanisms and capacity of the affected countries, including Montenegro, to plan and manage the transboundary Drina River Basin, incorporating climate change adaptation. IFC will look for opportunities to support financially sustainable municipalities to invest in waste management projects. Where appropriate, IFC will pursue PPPs as another efficient private sector solutions. The ongoing Energy Efficiency project as well as a possible Additional Financing will contribute to this agenda by promoting energy savings in public buildings, and facilitating the addition of renewable energy capacity.

CPF Objective Indicators	Supplementary Progress Indicators	WBG Program
Indicator 11: Contaminated land managed or dump sites closed **Baseline:** 0 (2013) **Target:** 110 (2019) ***Indicator 12:*** Energy savings in targeted public buildings **Baseline**: 0% (2009) **Target**: 25% (2017)	***SPI13****:* Number of building retrofitted with energy efficiency improvement schemes **Baseline**: 0 buildings (2009) **Target** 27 buildings (2017) ***SPI14****:*Additional Renewable Energy capacity facilitated **Baseline:** 0 (2015) **Target**: 20 MW (2020)	**IBRD Lending:** • Industrial Waste Management and Cleanup Project (ongoing) • Energy Efficiency in Public Buildings (ongoing) plus Additional Financing (pipeline – FY19) • Tourism-based Local Development Project (pipeline – FY18) • Western Balkans Drina River Basin Management GEF (FY16)

	SPI15: Percentage of Drina River Basin Strategic Action Plan activities addressing climate change issues related to droughts and floods. **Baseline:** 0 (2015) **Target**: 30 percent (2019)	**IFC:** BREP - ongoing advisory support with the BREP program and inclusion of Montenegro in the new ECA renewables program (to be launched in FY17)

Annex 2. Montenegro Citizen Engagement Roadmap FY16-20



Annex 3. Montenegro FY11-14 CPS Completion and Learning Review

Date of CPS (FY11-FY14): December 28, 2010 (Report No. 57149-ME)
Date of CPS Progress Report: May 29, 2014 (Report No. 87830-ME)
Period Covered by the Completion and Learning Review: July 1, 2010 to June 30, 2015

I. SUMMARY OF KEY FINDINGS

1. **The Montenegro CPS was prepared at a time when Montenegro was recovering from the sharp economic contraction caused by the combined effects of a boom-bust cycle and the effects of the global financial crisis, amid signs of a gradual recovery in mid/late 2010.** The objectives of the CPS were to: (i) Strengthen institutions and align them with European Union (EU) requirements in areas critical for longer term competitiveness in global markets; and (ii) Improve environmental management. The CPS was anchored in the Government's development plans. The Government's National Program for Integration (NPI) approved in 2007 outlined the reform agenda required for eventual EU membership and defined Montenegro's overarching policy objectives. Another government program, the 2009-2012 Economic and Fiscal Program (EFP), called for prudent fiscal policies and an efficient state administration, including reforming the business climate and promoting MSME growth. To encourage long-term competitiveness, the EFP called for further modernization of the education system, including through alignment with EU standards. The CPS was aligned with NPI's and EFP's proposed structural reforms to, *inter alia*, promote a market economy, strengthen public financial management, upgrade commercial laws, enhance environmental and agricultural standards, and improve the performance of the energy, transport, and infrastructure sectors.

2. **The CPS Progress Report was postponed until May 2014 in order to extend the dialogue with the Government and gain clarity on priorities for the remainder of the CPS period, especially under Pillar II.** In FY13 and FY14 Additional Financing for Energy Efficiency Project and Industrial Waste Management and Clean-up Project, the largest investment operation in the portfolio, experienced delays. Both were delivered in FY14 and FY15. PR extended the CPS period by one year, to FY15. Original objectives of the CPS remained relevant, but two outcomes were dropped from the CPS results framework at the PR stage.

Development Outcome

3. **The overall performance of the CPS program in contributing to the achievement of the selected set of country goals is rated as *Moderately Satisfactory*.** Measurable improvements in institution strengthening, business climate, agricultural productivity, reliability and security of the energy sector, strengthening environmental management and increased quality of health services have been achieved as a result of the Bank Group's contributions. As summarized in the discussion below and detailed in the results framework (Attachment 1), 15 (89 percent) of the 17 revised CPS outcomes are rated Achieved or Mostly Achieved (Table 1). There has been good subsequent progress in many areas even when related outcomes were not fully achieved during the CPS period. No major shortcomings were identified.

Table 1. Summary of outcome ratings

Pillar	Number of outcomes	Achieved	Mostly Achieved	Partially Achieved	Not Achieved	Dropped
Support EU accession through strengthening institutions and competitiveness	14	4	9	0	0	1
Improving Environmental Management	5	1	1	1	1	1
OVERALL CPS: Outcomes as designed at start of CPS	**19 (100%)**	**5 (26%)**	**10 (52%)**	**1 (5%)**	**1 (5%)**	**2 (11%)**
OVERALL CPS Outcomes as adjusted at CPSPR	**17 (100%)**	**5 (29%)**	**10 (59%)**	**1 (6)%**	**1 (6%)**	**--**

4. **During the CPS period, the World Bank Group delivered a program of support to Montenegro's development strategy through financing of US$262m** (financing from IBRD amounting to US$261.4m, and the Institutional Development Fund [IDF] amounting to US$0.5m), and two grants from the Global Environment Facility (GEF, US$6.56 million), which falls between US$216m (originally planned in the CPS) and US$311m (planned at the time of CPS Progress Report). Additionally, the Bank is administering two EU-supported Trust Funds, one under the Montenegro EU/IPA Agriculture and Rural Development Institution Building Project, and the other under the Additional Financing of Institutional Development and Agriculture Strengthening Project. IFC committed two long-term finance projects totaling US$26.5 million in the infrastructure sector.

5. **The CPS was prepared before the adoption of the new WBG Twin Goals strategy that aims to end extreme poverty and boost shared prosperity, nevertheless the CPS had envisaged interventions targeting sustainable and inclusive growth**, including employment policies addressing chronic unemployment and low activation rates, boosting agricultural employment and access to healthcare for vulnerable groups, as well as measures to support financial sector and protect deposits.

WBG's Performance

6. **The overall performance of the WBG in designing and implementing the CPS is assessed as *Good***. This assessment is based on: (i) alignment with the Government's own NPI and EFP development programs; (ii) utilization of appropriate and fit-for-purpose lending instruments and ASA program; (iii) flexibility of the Bank's response to client needs in the aftermath of the global crisis and during the CPS Progress Review; and (iv) effective implementation of the program that has created a sound portfolio and a momentum for the next CPF period.

II. HIGHLIGHTS OF ASSESSMENT

7. The self-assessment of the performance of the CPS program is based on the results framework as updated and revised in the CPSPR. The cutoff date for the assessment period is 30 June 2015, the end date of the CPS under review. Details of the status of outcomes, indicators, and milestones at the end of the CPS period are provided in Attachment 1. The following sections discuss key highlights using the outcomes as units of accounting and refer to major WBG activities which contributed to the results. They assess WBG performance and present major lessons.

8. The CPS Development Outcome is rated as Moderately Satisfactory: the Bank Group's program was anchored around two strategic pillars and originally 19, and after CPSPR 17, outcomes, the majority of which were rated as Achieved or Mostly Achieved. Both strategic pillars are assessed as having been Mostly Achieved.

Pillar 1: Support EU Accession through Strengthening Institutions and Competitiveness

9. Bank Group activities supporting this pillar were carried out in the context of Montenegro striving to recover from deep recession following the global financial crisis. Fittingly, activities to strengthen institutions and competitiveness were aimed towards addressing issues related to restoring macro balances, as well as putting in place stronger EU-aligned institutions and sharpening Montenegro's competitive advantages in the integrated EU market. In the aftermath of the financial crisis, the strengthening of the banking system was considered critical for resumption of bank lending and economic growth. To this end, the authorities, with Bank support provided through a Development Policy Loan (DPL) and a Policy-based Guarantee (PBG), took a number of steps targeted at boosting market confidence and strengthening the regulatory framework for the banking sector. IFC provided long-term financing in 2010 in the form of an SME line to NLB Montenegro for EUR10 million, thus supporting access to finance for local SMEs and contributing to the liquidity of the banking sector.

(i) CPS Outcome: Strengthen the Central Bank's capacity to provide liquidity as a Lender of Last Resort (LOLR), Mostly Achieved. The liquidity ratio in the banking sector had fallen sharply in 2008 to 21 percent, commensurate with the withdrawal of deposits. By the end of 2014, the liquidity ratio was 35.7 percent, a figure compliant with and well above the Central Bank's prudential norms. The Central Bank (CBCG) adopted several regulations to enhance its ability to provide banks with emergency liquidity assistance, including a new Policy for Reserve Requirements, and a new Law on Financial Collateral.

(ii) CPS Outcome: Enhance public confidence in the health of the banking sector, Mostly Achieved. The Government enacted the Law on Protection of Deposits, which introduced fiscally sustainable arrangements for deposit insurance. Additionally, it negotiated a stand-by credit line from the EBRD to the Deposit Protection Fund that materially expanded the capacity of the Fund to make insurance payouts. These confidence-building measures contributed to positive annual growth in the private sector's bank deposits on average by 8 percent in 2011-2015.

(iii) CPS Outcome: Improve capitalization of Montenegrin banks and their resilience to shocks, Mostly Achieved. The banking sector's capitalization, a common proxy for market confidence, has improved. The average Capital Adequacy Ratio (CAR) of the banking system remains well above the prudential norm of 10 percent mandated by CBCG. At the end of 2013, banks' overall CAR was reported to be 14.4 percent, by September 2015 it reached 16 percent. The Bank provided technical assistance through FINSAC to the authorities in drafting the regulatory framework for the resolution of NPLs which declined from 20.7 percent at the end of 2010 to 12.5 percent at the end of 2015. That support eventually led to the enactment of the Law on Voluntary Restructuring of Loans (the so-called "Podgorica approach") that provides tax relief for voluntary debt restructuring between creditors and debtors.

(iv) CPS Outcome: Strengthen Montenegro's capacity to resolve problem banks and financial institutions, Mostly Achieved. CBCG has somewhat increased its capacity to assess and address banking sector vulnerabilities. Since 2009, CBCG has undertaken a series of full-scope on-site inspections in all medium- and large-sized banks. Stress tests have been conducted to evaluate the likely impact of economic downturns. Based on these assessments Supervisory Action Plans (SAPs) were prepared for systemically important banks. SAPs identified weaknesses and risks, and established targets and deadlines for addressing any non-compliance with regulations with a focus on capital needs. CBCG monitored on a monthly basis progress with implementation of SAPs, including bank recapitalization, and found it generally to be satisfactory. Moreover, amendments to the Law on Banks were enacted to enhance the CBCGs enforcement powers, and strengthen the interim administration process for problem banks. Other key deficiencies addressed in these amendments included inter alia: (i) limiting the powers of the courts to suspend or revoke CBCG decisions; and (ii) establishing legal protection for the CBCG personnel as supervisory authority.

While WBG operations achieved all the outcome indicators defined for the objective of strengthening the banking system, there remain inefficiencies and vulnerabilities in the financial sector highlighted by the 2015 FSAP that hamper private sector growth and pose fiscal and financial stability risks; this is why this group of four strategy outcomes is assessed as Mostly Achieved. While the legal, regulatory, and supervisory frameworks for the banking sector have markedly improved since the 2006 FSAP, and some weak banks are not systemically important, further progress in this area is required. A number of key shortcomings should be remedied to complement improvements in the framework for NPL resolution. In addition, recently strengthened supervisory requirements should be complemented by reversing the loosening of regulatory standards over the last several years. In the absence of independent monetary policy and to complement sound fiscal management a macro prudential framework should be established and, over time, made fully operational. In preparation for Basel III, sound liquidity risk management standards as the first line of defense against liquidity pressures should be prioritized.

***(v) CPS Outcome: Improve public expenditure management, Dropped* at CPSPR stage** as not achievable after the Government's decision to execute foreign borrowing amounting to 23 percent of GDP for the construction of a highway led to a deterioration of the medium-term macroeconomic and fiscal framework. Originally the Bank considered countercyclical stimulus through a public expenditure and competitiveness DPO after the double dip recession of 2012. However, the DPO did not materialize in FY13-14 although most of the structural policy measures were undertaken and fiscal results improved by 2014. The Bank provided support for strengthening capacity for debt management strategy preparation as well as assessing fiscal risks related to municipal finance. Both the work accomplished by the Bank in the area of improving public expenditure management and the dropping of this outcome at CPSPR point to the continued need to engage with the Government on this issue and keep public finances in focus in the next CPF.

(vi) CPS Outcome: Streamline property registration and business permitting, Achieved. The Bank supported this outcome through the Land Administration and Management Project, and also through analytical work, namely, the Country Economic Memorandum: Growth and Competitiveness, and the preparation work of the dropped DPO. Property registration and granting of business permits have been streamlined and CPS targets were met.

(vii) CPS Outcome: Strengthen the transparency of corporate financial reporting in line with EU standards, Mostly Achieved. CBCG successfully implemented IFRS and IAS 39 standards in bank reporting during 2013 with an aim to increase the transparency of banks' financial status and improve market discipline. An IDF grant, the objectives of which are to assist in establishing an oversight authority and to strengthen transparency of corporate financial reporting, will be active until August 2016. Montenegro also participated in REPARIS and EU-REPARIS programs of accounting reform and institutional strengthening aimed at assisting countries of Southeast Europe to adopt and implement effective corporate financial reporting systems, aligned with the EU *acquis communautaire,* that contributed to an improved regulatory framework for innovative and high-potential enterprises in Southeast Europe in general, and specifically helped stimulate the build-up of a supportive venture capital ecosystem for high-potential SMEs.

Climate for business investment was further enhanced by IFC's Western Balkans Trade Logistics project implemented in six Western Balkan countries including Montenegro from 2012 to 2015. It was instrumental in reducing regulatory and administrative bottlenecks in cross-border trade, including reducing controls on excise goods from 100 percent to 23 percent after Montenegro Customs applied risk management methodologies and best practices, expediting processing times of customs declarations by up to 50 percent and bringing full transparency to the customs declarations process, and reducing documentation required from traders by Customs. IFC also worked with the Ministry of Justice to support the opening of the Mediation Center which has 80 trained mediators in in all cities in Montenegro and which apart from the central office in Podgorica also has branch offices in Bjelo Polje and Kotor. The center resolved 650 cases releasing €52million through commercial mediation.

(viii, ix) CPS Outcomes: Strengthen government capacity to deliver agricultural assistance and upgrade agricultural practices to EU standards, Achieved; Strengthen land and natural resource management focusing on Montenegro's northern regions, Achieved. The Bank's program supported the Government's efforts toward IPARD accreditation through the Montenegro Institutional Development and Agriculture Strengthening (MIDAS) project. MIDAS supported the Ministry of Agriculture and Rural Development (MARD) in the establishment and capacity building of the institutional bodies required to implement the IPARD program (Directorate for IPARD Payments/Paying Agency), and provided support to the Department for Rural Development/Managing Authority in the design and preparation of the Montenegro IPARD II Program submitted to the EU for final approval. The Project provided grants to eligible agricultural holdings, gradually introducing IPARD requirements through a learning-by-doing approach. This approach favored the gradual capacity building of MARD departments involved in the design, preparation, and implementation of the IPARD-like grants, and also the farmers' learning process in applying for IPARD-like grants and fulfilling the demanding requirements. Since the beginning of the project, in five rounds of grants, 1,465 applications have been received, 747 approved, and all funds available for grants amounting to around EUR7 million have been contracted, overachieving the target of €5m. As of April 2015, about EUR5.7 million of grant funds have been transferred to beneficiaries, in reimbursement for investments that had been completed. Smooth implementation of the remaining ongoing IPARD-like MIDAS grants is continuing without significant obstacles. As part of Bank support for increasing sustainable land management practices via the GEF-funded component of MIDAS, land area where sustainable land management practices have been adopted reached 2142 ha in April 2015 against a target of 2000 ha.

Over a medium term horizon, the Bank-supported program is bringing food safety, veterinary, and phyto-sanitary agencies, as well as required laboratories, to European standards. The Veterinary Diagnostic Lab has been equipped and 16 analysis methods have been ISO17025-accredited. The Bank activity on screening and classification of Food Establishments provided crucial analysis covering legal/institutional, administrative, and technical aspects of the food safety system and addressed some of the gaps identified under the EU Chapter 12 screening.

The partnership established within the MIDAS project among the Bank, MARD, and EU has allowed a constructive tripartite dialogue and coordination of activities. The broad cooperation that ensued due to the MIDAS grants' success has resulted in the establishment of an EU-supported Trust Fund administered by the Bank to provide further IPARD-like grants to Montenegro. At the end of 2015 additional EU funding to the TF was processed to support increasing capacities in the agro-processing sector.

(x, xi) CPS Outcomes: Assess the quality and strengthen financing mechanisms of higher education in Montenegro in line with EU developments and Bologna agreements, Mostly Achieved; and Improve the research capacity of the Montenegrin higher education and research communities, Mostly Achieved. Higher education quality has been strengthened and made more cost effective, and capacity for R&D and innovation in cooperation with the private sector has been established in a few niche areas relevant for Montenegro's growth. The Bank provides support in this area through the Higher Education Research for Innovation and Competitiveness (HERIC) project that produced higher education financing model recommendations adopted by the Government. Two task teams are working on implementing the new funding model with the focus on the University of Montenegro. Bank engagement directly supported two government initiatives prior to the 2012 launch of the HERIC project: (i) the 2011 Strategy for the Development and Financing of Higher Education in Montenegro for the period 2011-2020; and (ii) the 2010 Law on Scientific Research Activity. Since then the most substantial contribution of Bank support in this area has been to identify gaps between education and research, and business and the economy. In particular, Bank support helped translate the increase in capacity in infrastructure and human resources into improved research and innovation, through the establishment of a Center for Excellence and the provision of large grants to consortia of research partners including faculties, local private sector enterprises, and foreign institutions. An external evaluation and reaccreditation of all high education institutions utilizing new quality assurance measures developed in accordance with EU norms and practices was completed. A sectoral review of the entire tertiary education system was conducted by international experts, thus promoting further reforms at the institutional and sector levels.

(xii) CPS Outcome: Improve the quality and coverage of PHC services in and outside Podgorica, Mostly Achieved. Thirty public health centers were equipped, and some of them also renovated under Health Systems Improvement Additional Financing project. Utilization of primary health care services and patient satisfaction targets have been met or exceeded. Forty four percent of the overall population used the service of their chosen doctor against a target of 40 percent. The percentage of the Roma population reporting the use of PHC using the services of a doctor of their choice increased from 21 percent in 2004 to 82 percent in 2012. 70 percent of the total population reported satisfaction with the services rendered, meeting the established target, and 82.1 percent of the Roma population reported being satisfied with the services they received.

***(xiii)* CPS Outcome: Improve the financial sustainability of the health sector, Mostly Achieved.** Health Systems Improvement Additional Financing project was instrumental in supporting key reforms at all levels of the health care system, including health financing in primary and secondary levels of care, efficiency, quality of services, and strengthening institutional capacity. The Health Insurance Fund (HIF) annual deficit decreased from EUR2.2 million in 2004 to zero in 2012, technically meeting the target stated in the CPSPR. This outcome, however, is not rated *achieved*, because, there remain financial issues rooted in the institutional structure and relatively weak public expenditure prioritization and management. Since 2010, the HIF budget has been delinked from HIF revenues as these became part of the state treasury budget. The health system has since been recording arrears. The total debt of the Health Insurance Fund (HIF) and health care institutions amounted to EUR34 million at end-2013 and EUR46 million at end 2014 (out of which EUR13 million in health institution's debt and EUR18.5 million for drugs). Expenditures for drugs, treatment abroad, and sick leave compensation are among the main drivers of increased debts. Public expenditure on pharmaceuticals in Montenegro increased by 60 percent between 2009 (EUR25 million) and 2014 (EUR40 million) due to inefficiencies driven by several factors: (i) lack of governance and resources to control the drug market and enforce the laws resulting in constantly increasing total costs of drugs; (ii) delays in licensing of pharmaceuticals which limit competition; (iii) delays in tender procedures which result in shortages of pharmaceuticals. Nonetheless, Bank-supported activities have increased HIF's capacity to undertake budget planning, expenditure and revenue forecasting, and analyses and resource allocation. The project also supported increasing capacity for policy planning and regulation through training and strengthening a comprehensive Health Management Information System (HMIS). These interventions were highly effective: eleven laws, including laws on medicines, health care, and health insurance, were adopted or amended, primary health care (PHC) policies were developed and refined, and a master PHC plan was adopted. In February 2012 the Government adopted a national strategy for the improvement of health care quality and safety of patients, along with a national plan for the development of human resources in health for the period 2012-2022. A secondary and tertiary care reform strategy was developed and approved, including a legislative framework for public-private partnerships in the health sector. A strategy for integrating private providers into the health system was also produced and approved.

(xiv) CPS Outcome: Improve the security and reliability of Montenegro's energy sector, Achieved. The Bank's program was successful in meeting its objective of improving the efficiency and reliability of the power system through better supply security and closer integration into the regional market. In terms of efficiency and reliability of the electricity supply, reinforcements to the Andrijevica and Mojkovac substations and transmission networks became operational in 2011 and 2013 respectively. In 2015, there was a total of 114 MWh of unserved energy in the Andrijevica substation, which corresponds to a 70 percent reduction compared to 2006. In the Mojkovac substation there was a total of 10 MWh of unserved energy, which corresponds to a 97 percent reduction compared to 2006. Therefore, the target of 40 percent reduction for both substations is achieved.

The development of a modern telecommunication network, including links to regional utilities, was completed. Montenegro's National Dispatching Center has been linked with those of neighboring countries. The two originally-planned regional links to Bosnia and Herzegovina and Serbia are operational, and an additional link to Kosovo was completed in the second half of 2014, when Kosovo completed the work within its territory with KfW financing. This outcome can be directly attributed to the Bank program.

IFC's Balkan Renewable Energy Program (BREP) provided advisory services to improve the regulatory framework related to RE. The objectives of IFC's advisory program in RE were to improve and align the Energy Law and its subordinated legislation with EC Directive 2009/28/EC, including the power purchase agreement to promote and streamline small hydro power projects investments (SHPP). Following BREP's advisory services, two successful SHPP tenders were completed. The Energy Law, which was harmonized with the EC directive, was adopted by the Parliament in December 2015.

<u>Pillar 2: Improving environmental management and reducing the costs of environmental problems</u>

(i) CPS Outcome: Strengthen solid waste management services in Bar and Uljcin, Achieved. Bank supported improved solid waste collection and disposal in two heavily populated and economically important areas through the Montenegro Sensitive Tourist Areas Project (MESTAP). The project's objective was especially important given the role of tourism in economic growth and Montenegro's preparation for EU accession. Project activities included the development of environmental infrastructure via construction of the landfill in Mozura. Two existing uncontrolled disposal sites (Grabovac, Lovanja) were closed and a pilot recycling program was initiated. Coverage of municipal collection systems meets the target of 90 percent versus a baseline value of 65 percent. These waste collection rates were maintained in 2014 and 2015 after project completion. Almost all solid waste in Bar (98 percent) and Ulcinj (70 percent), as well as other three coastal municipalities (Budva 95 percent and 100 percent respectively, Kotor (no data for 2014 and 2015), Tivat 90 percent) is now collected. The frequency of collection varies, with some communities having daily collection in the peak tourist period versus the target of once every two days in the summer and twice weekly in the rest of the year. Bar and Ulcinj began disposing into the Mozura landfill in 2012. The 90 percent target has thus been achieved. The construction and operationalization of the Mozura landfill is a particularly significant milestone for the solid waste sector in Montenegro as it is the second sanitary landfill in the country after Podgorica.

(ii) CPS Outcome: Enhancing sustainable benefits of Lake Skadar natural resources**, **Partially Achieved. The Bank provided support through the Albania/Montenegro Lake Shkoder Integrated Ecosystem Management Project (LSIEMP). National and local strategies and plans in both Montenegro and Albania identified the Lake Skadar-Shkoder area as a priority for environmental protection, sustainable natural resource management, and nature/culture-based tourism development. LSIEMP helped establish and strengthen institutional mechanisms for trans-boundary cooperation, it enhanced lake monitoring capacity by providing equipment and training, and supporting the establishment of the joint database and lake monitoring program. The program is harmonized with the EU *acquis* and the requirements of international agreements to which Albania and Montenegro are a party. At the same time, the project's sustainability and some of its outcomes have been somewhat undermined by the inadequate financing to the Skadar Lake Commission and related Working Groups, which had thus not been operational since 2014. However, the two governments have intensified the talks on the collaboration at the end of December 2015 and agreed on establishing an expert commission to work jointly on the environmental protection, sustainable natural resource management of the Lake Skadar, Bojana and Drim rivers. On Montenegro side the activity is led by MARD.

(iii) CPS Outcome: Reduce the environmental and public health risks of polluted industrial disposal sites, Not Achieved. Bank support to this outcome is to be provided via the Industrial Waste Management and Clean Up project, which was approved in July 2014 and became effective on November 17, 2014. Since the project is relatively young, no evidence exists yet towards achievement of the development objective. Negotiations were delayed as the Government was deciding on the process of the KAP bankruptcy procedure in the light of new ownership of KAP, especially as regards the ownership of the red mud basins. It also took longer than expected to finalize an arrangement for the disposal of ongoing, non-hazardous waste production from Bijela shipyard. The final decision was to dispose it at the newly constructed Mozura landfill, which was the outstanding Condition of Negotiations. Bijela shipyard has made alternative arrangements for future disposal of non-hazardous grit satisfactory to the Bank and in compliance with all applicable national legislation. Overall, much more time than originally anticipated was needed for stakeholder consultations related to the Bijela Shipyard and KAP.

A substantial body of work, which directly affects the outcome, preceded the approval of this project. Feasibility studies with site investigations, Environmental and Social Impact Assessments (ESIAs), and basic designs for all four industrial waste disposal sites were completed during project preparation and financed by the Project Preparation Facility. Mixes of remediation measures have been identified for the four selected sites: mine tailings disposal facility (Gradac-Pljevlja), coal ash disposal facility (Pljevlja), ship blasting waste and site contamination at Bijela shipyard, and red mud basins and solid waste disposal site at KAP.

(iv) CPS Outcome: Enhance the efficiency of energy use in targeted public schools and hospitals, Mostly Achieved. Bank support to this outcome was provided through the Montenegro Energy Efficiency Project and Energy Efficiency Additional Financing. Energy efficiency implementation capacity has been enhanced in the Ministries of Economy, Health, and Education, and in the construction and energy efficiency services sectors. Awareness of the importance of energy efficiency among staff and users has grown, and energy efficiency implementation capacity has been increased in the energy efficiency services and construction markets. Energy efficiency measures have been implemented in 18 public buildings. Another 7-8 buildings will be retrofitted with the benefit of the remaining additional financing during the new CPF period. In completed sub-projects, energy savings of 46.7 percent on average have been achieved versus a target of 40 percent. It should be noted that since the original loan selected public buildings with the highest savings potential, buildings included subsequently in the additional financing loan may not show the high degree of savings seen in buildings financed by the original loan.

(v) CPS Outcome: Improve Access of the Government and households to low-cost catastrophe insurance products, dropped due to a change in government priorities. The Bank started a dialogue with the Government of Montenegro on the Southeast Europe Catastrophe Risk Insurance Facility in 2010. However, when making the Europa Re facility operational took longer than expected, those negotiations were put on hold. The Southeast Europe Catastrophe Risk Insurance Facility (SEE CRIF) program that has been under implementation since May 2012 resulted in the establishment of Europa Re, a Swiss-licensed catastrophe risk reinsurer currently owned by the Governments of Albania, FYR Macedonia, and Serbia. The Bank revisited Montenegro's interest to join the program in 2014, but government priorities had by then changed. Taking a decision on foreign borrowing amounting to 23 percent of GDP for the construction of a highway, the Government wanted to minimize the subsequent increase of debt, thus, this activity was dropped.

III. WORLD BANK GROUP PERFORMANCE

10. The overall performance of the WBG in designing and implementing the CPS was *Good*. The following summary of WBG's performance elaborates on this assessment.

A. Design

11. The CPS objectives were designed to be relevant to country development goals and remained relevant throughout the implementation period. The CPS goals of strengthening institutions and aligning them with the EU requirements, and improving environmental management, fit closely with the Government's NPI and EFP development programs' proposed structural reforms to, inter alia, promote a market economy, strengthen public financial management, upgrade commercial laws, enhance environmental and agriculture standards, and improve the performance of the energy, transport, and infrastructure sectors. The CPS was prepared when Montenegro was recovering from the global financial crisis, which had precipitated a severe credit crunch. At the same time, reduced external demand for exports led to the near-collapse of the industrial sector, including the pivotal aluminum industry. The combination of reduced access to credit and the loss of export markets led to a severe recession in 2009, during which it was estimated that GDP contracted by 5.7 percent. Experiences from the post-independence bust-boom cycle, amplified by the global financial crisis, revealed structural weaknesses and emphasized the need to adjust the underlying growth model. The susceptibility of Montenegro's small, open economy to external shocks, along with the pro-cyclicality of its most important sectors and underlying tax system, placed a premium on undertaking reforms aimed at knowledge, productivity, and innovation, along with employment, social inclusion, energy efficiency, and environmental protection. Related reforms in meeting the political objective of EU integration were considered important as the European perspective, together with a strengthened judicial environment and business climate, were expected to increase investors' confidence in Montenegro's economy as a site for investment and business. Against the above background, the objectives of the CPS were appropriately designed both to help Montenegro recover from the global financial crisis and advance longer-term goals. Such objectives as the improved utilization of public finances, better oversight of the banking system, and environmental sustainability will remain relevant to WBG in Montenegro in the next CPF period.

12. CPS indicators were mostly well chosen: they were directly related to and commensurate with Bank Group operations, observable and measurable within the CPS period. Overall, the indicators nicely interpreted CPS outcomes.

13. The CPS adapted to changes in the country's circumstances. Flexibility in adapting to changing country circumstances was key in ensuring that the Bank's program remained relevant to the country's development goals. The Financial Sector PBG, originally intended to be the second operation of the programmatic financial sector DPL, directly responded to changes in country circumstances when given the steep economic decline, Montenegro's fiscal condition sharply worsened in 2011 requiring additional financing. The new operation, designed in lieu of the second in the series of programmatic DPLs, instead became a EUR60 million PBG, enabling Montenegro to leverage its borrowing considerably through a World Bank guarantee provided to a private lender. It helped Montenegro to develop and maintain its access to private capital markets.

14. Citizen engagement proved to be invaluable for enhancing project design and implementation. Projects like LAMP and MIDAS actively sought beneficiary feedback, which was subsequently used to tailor project implementation to beneficiary needs (see Box 1). The CPS also had a strong beneficiary orientation, as evidenced, for instance, by the health outcome indicators related to beneficiary satisfaction. Only one new project was approved in FY15 (Industrial Waste Management Project), which does not include a beneficiary-oriented indicator in its results framework, but does make use of citizen engagement tools, particularly consultations with representatives of natural preservation societies. Of the five active projects in FY15, one had a beneficiary-oriented indicator in its results framework.

Box 1 Mainstreaming Citizen Engagement in Operations under the CPS FY11-14

The World Bank in Montenegro has been involved in various efforts to engage citizens under the CPS FY11-14. These included awareness campaigns, consultative workshops, grievance redress mechanisms, beneficiary surveys, and, under one project, training civil servants in participatory processes. Beyond the expected influence on project design and implementation, such a comprehensive approach to citizen engagement resulted in an important positive impact on public awareness of stakeholders' rights and responsibilities, and the importance of including vulnerable groups in public discourse.

The level of citizen engagement has been evolving over the years, as evidenced by the experience of the MESTAP project, which aimed to provide a sanitary landfill for coastal municipalities. First efforts to reach out to the local community, namely, a public discussion on the Environmental Impact Assessment in 2007, went largely unnoticed. No members of the public attended the discussion. However, this did not mean that the public remained entirely disinterested. Siting the landfill took longer than expected, and in the summer of 2014 the local community expressed their discontent over the foul odor coming from the landfill. Direct communication with the local community improved their understanding of the circumstances that led to the issue, and clarified the reasons why it would not reoccur. The management of the landfill saw great value in addressing the problem directly and earned community support by being approachable and open to cooperation and suggestions.

Other success stories include LAMP and MIDAS projects. The LAMP project specifically used citizen feedback and participation to drive improvement. More than ten thousand people participated in awareness campaigns and consultative workshops, including various stakeholder groups such as NGOs, business representatives, association members, senior citizens, students, minorities, etc. While developing Spatial Urban Plans (SUPs), LAMP municipalities went beyond the national requirements for public participation by adding another three consultations to their planning processes, involving the public at every stage of the process.

The MIDAS project is another good example of effective citizen engagement. Public consultations in all municipalities in Montenegro served as an important tool to spread awareness about eligibility and to reach out to the broader farmer community. A grievance redress mechanism for rejected applicants was established to provide a channel for submission of complaints. Feedback gathered after the first round of grants included successful and unsuccessful applicants, as well as farmers who had not applied, and informed the design of the application rules in the following round. The project also supported efforts of the Ministry of Agriculture and Rural Development to reach out to female farmers by expanding networks, increasing opportunities, and raising awareness of their needs.

15. The CPS was designed specifically to complement other development partners' programs in the country. The WBGhas coordinated closely and aligned its activities with the EU (agriculture and education, Pillar 1), the EIB (solid waste, Pillar 2), and EBRD and KfW Development Bank (energy and energy efficiency respectively, Pillar 2). A substantial increase in EU pre-accession funds is contingent on Montenegro's institutions becoming stronger and more able to absorb these funds, making Pillar 1of the CPS (Strengthening institutions) highly relevant to EU integration. CPS priorities were therefore discussed with domestic counterparts as well as the EU, with a view to assess to which degree Bank programming could be aligned across institutions.

16. The ASA program provided analytical underpinnings to the CPS program and was also flexible in responding to government priorities. Analytical and advisory services further enhanced program implementation and policy dialogue. The Bank undertook several pieces of ASA not planned in the original CPS, to support the Government's needs as they arose during the implementation period. The FINSAC Center/NPL Resolution TA provided policy advice and technical analytical and advisory services to keep financial authorities abreast of the latest trends and services in financial sector oversight and management of risks. Labor Market Incentives TA helped the authorities to identify the main constraints to job creation and employment growth, and develop policies to remove constraints. The Bank also provided a highly relevant Pension Policy and Pension Modeling TA. Growth in beneficiaries and benefits, together with a shrinking contribution base, pose both short-term and long-term sustainability risks for the Montenegrin pension system. In order to capture the complexities and long term nature of the pension system and evaluate both short- and long-term impacts of pension policy options, the Bank team worked closely with the Government to develop the PROST (Pension Reform Options Simulation Toolkit) model for Montenegro.[26] The Bank also prepared a study on the growing private sector payment arrears, highlighting the risk they present to growth over the medium term, and distributed it to selected counterparts, among whom it generated considerable interest. As fiscal issues persisted, the Bank provided a technical assistance for drafting the debt management strategy as well as the policy note on the sustainability of subnational finances.

17. Lessons from the previous CPS were well reflected in the design of the new CPS program. All lessons from the previous CPS Completion Report were reflected in the CPS design and implementation. They included: (i) the need for selectivity and mutually reinforcing interventions supporting Montenegro's own goals to maximize the impact of the Bank's scarce resources; (ii) importance of ASA work in identifying needed reforms; (iii) the need to consolidate the portfolio, keeping in mind implementation capacity, and consequently the need for continued use of a central unit providing procurement and financial management services to most Bank-financed operations; (iv) the need for regional integration and leveraging regional experiences in Montenegro that has limited Bank engagement; and (v) the need for careful assessment of political economies of government agencies and stakeholders, particularly when operations involve several levels of government.

B. Implementation

18. Portfolio performance significantly improved as a result of proactive management of projects under implementation, which averaged US$88 million and 5 projects annually during the CPS. At the start of the CPS implementation period, 17 percent of projects were in problem status. By contrast, none are in problem status at the time of writing. Proactive portfolio management is also evident in the disbursement ratio, which was 14.2 in FY11 and has risen to 32.1 at the end of FY15, well above the Region's and the Bank's average (Table 2). As part of a sustained focus on portfolio implementation, opportunities to restructure projects were seized upon to improve performance. Six restructurings were undertaken during the CPS period; and for all projects that closed during this period, IEG rated Bank performance during supervision as MS or above.

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[26] PROST is the World Bank's standard tool for pension policy analysis.

Table 2: Selected Portfolio Indicators for Montenegro FY11-FY15

Fiscal year	# Proj	Net Comm Amt	Disbursement Ratio	Comm At Risk ($m)	% Commitments at Risk	No. of Problem Projects	% of Problem Projects	% Proactivity
2011	6	80.9	14.2	16.2	20.0	1	16.7	100
2012	6	84.3	27.9	16.2	19.2	1	16.7	
2013	5	70.3	35.0	9.0	12.8	1	20.0	100
2014	4	68.1	23.8	16.2	23.8	1	25.0	100
2015	5	137.0	32.1					

19. The results framework of the CPS program exhibited some shortcomings. The results framework was adjusted at CPSPR stage to reflect changes during the CPS. For example, the outcome on public expenditure management was dropped because Bank support via a Public Expenditure and Growth DPO was no longer viable due to investment decisions taken by the Government in 2013 that increased risks of the medium term fiscal framework and were likely to prevent medium-term stabilization and reduction in public debt levels. The CPS Progress Report streamlined the results framework to be more outcome-focused and to increase the evaluability of the CPS program. However, some indicator targets were specified under a shorter time horizon than the CPS, while others were set to be achieved beyond the CPS period, which made evaluability of the program more difficult. No milestones or gender-disaggregated indicators were included.

20. There were delays in the delivery of the Bank's planned lending program particularly as it relates to the second pillar. Negotiations of the Industrial Waste Management Project were delayed over the handling of the aluminum plant (KAP) site, a longstanding and complex issue in Montenegro, as well as over the non-hazardous waste disposal from Bijela Shipyard, another matter of high sensitivity.

21. Risks to the implementation of the CPS program were adequately identified and mitigated. (i) The risk of slower than expected growth in the SEE and EU dampening Montenegro's growth was addressed by several analytical pieces, notably, the Public Expenditure and Institutional Review (PEIR) and CEM, along with the FINSAC TA for strengthening risk management in the financial sector that has contributed to addressing the NPL issue. (ii) The risk of increased financial instability and constrained credit was addressed by the two policy-based loans, which strengthened the liquidity framework and supported the development of instruments to resolve problem banks. (iii) Bank provided support in diagnosing and addressing broader governance issues through analytical work, e.g., the PEIR, which highlighted how lack of progress in institutional strengthening was undermining Montenegro's path towards EU accession; the subnational finance policy note highlighted further institutional and fiscal risks. And, finally, (iv) low capacity to implement Bank-supported projects was addressed by the Bank's significantly strengthening its oversight of the Technical Support Unit (TSU, the Ministry of Finance's unit tasked with procurement and financial management responsibilities), including annual assessments of TSU workload, staffing, communications, and knowledge transfer of Bank standards and procedures. The Bank has seen an improvement in implementation capacity in the course of the CPS, particularly in the areas of land administration and energy efficiency.

22. The Bank has worked closely with international partners, particularly to support Montenegro's objective of EU accession. Considering Montenegro's EU candidate status, it was essential that the Bank coordinate extensively with the EU. The MIDAS project is an example of close collaboration with the EU in building institutions to better harmonize with EU standards in agriculture and rural development. Policy recommendations in the Bank's ASA work have been regularly exchanged with the EU and the IMF.

IV. ALIGNMENT WITH WBG CORPORATE STRATEGY

23. Although the CPS was prepared before the adoption of the WBG Twin Goals, the program was aligned with ending extreme poverty and boosting shared prosperity. The CPS objectives of strengthening institutions with a view towards EU integration and improving environmental management, targeted the need for sustainable, inclusive growth. The CPS program envisioned using both lending and ASA instruments to ensure a dynamic and sustainable rate of growth. The lending program's centerpiece was two policy-based loans to support a sound financial sector and protect deposits. The Bank's ASA services offered technical assistance *inter alia* in the area of NPL restructuring as well as employment policy effectiveness and activation to address chronic unemployment and low activation rates. The program also supported interventions in agriculture and the health system, boosting agricultural employment and access to health services for particular vulnerable groups, such as Roma. Although initially poverty significantly increased after the 2008 crisis, it has been on a declining trend since its peak in 2012, due to employment having picked up and social spending remaining protected from fiscal consolidation measures.

V. LESSONS

24. Key successes of the FY11-FY14 CPS are associated with areas in which the Bank was able to build local capacity and improve the policy and institutional frameworks, such as in the case of land administration, health, education, and agriculture sectors.

25. The Bank was able to play a useful complementary role to the European Commission in the preparation of Montenegro for EU accession. This experience could be replicated in other countries. This is especially true for highly demanding procedures both for institutions and beneficiaries such as EU IPARD. Adopting a "learning by doing approach", together with a step-wise introduction of the requirements has proved to be very successful compared to the more traditional approach focused only on strengthening institutions to meet the EU accreditation procedural requirements.

26. Focusing on two thematic areas has been appropriate in the small portfolio, and in the future a further reduction of the number of strategic goals could be useful.

27. The scope of development objectives could be refined to better reflect the impact of Bank operations. The formulation of the CPS objectives was in some instances too broad in comparison with the direct impact of Bank financed operations. At progress review stage revised outcomes directly connected to observable and measurable indicators were introduced. At completion review stage higher level goals were used for contextualizing achieved outcomes in the country's development objectives. In the new strategy objectives should be set with a closer link to what the relatively modest WBG program can influence. Similarly, an adequate monitoring and evaluation

(M&E) framework in project design is crucial to demonstrating success. Deficiencies in the M&E framework put the overall achievement of some outcomes at risk.

28. Future engagement should strike a balance between (i) flexibility in adapting to changing circumstances and (ii) persistence in implementing difficult but necessary reforms. The deterioration of the macro framework precluded the materialization of the second programmatic DPL. Its subsequent conversion to a PBG directly responded to Montenegro's 2012 financing gap and significantly leveraged the Bank's lending, without undermining the Bank's overall strategy in stabilizing the banking sector. High-level political dialogue should be maintained in an environment where difficult reforms might cause significant delays in program implementation. Although in principle the client has been committed to the implementation of the Bank program, sustained client ownership has not been consistent across the Montenegrin portfolio. Ensuring full commitment to difficult reforms at the political level will be crucial in maintaining program efficacy in the next CPF.

29. Improved public expenditure management remains a crucial goal for Montenegro's fiscal sustainability and economic development, even though it was dropped out of the WBG program during midterm review of the CPS. This issue is even more important today, and should be addressed in the new strategy.

30. Citizen engagement proved to be a factor in the success of the CPS. Transparency and inclusion at all levels of stakeholders and local communities proved to be extremely important during project preparation and implementation. Having a good communication strategy and being in direct contact with the communities where the projects were carried out contributed to the success of projects such as LAMP and MIDAS. Conversely, local opposition can be an obstacle to project implementation, especially when it comes to environmental issues such as siting landfills.

31. Good coordination within the WBG is essential for an effective engagement in a small economy such as Montenegro. The performance of the CPS benefited from complementarities between the World Bank and IFC, especially in the business environment domain.

CPS CLR Attachment 1: Results Matrix

Pillar 1: Support EU accession through strengthening institutions and competitiveness

CPS Outcomes	Progress to Date	CPS Instruments and Partners	Lessons Learned
Strengthen the Central Bank's capacity to provide liquidity as a Lender of Last Resort (LOLR), as indicated by: - Liquidity ratio in the banking sector rises from 21% in 2008 to remain compliant with CBCG's prudential norms. **Enhance public confidence in the health of the banking sector, as indicated by:** - Stabilization of the decline in bank deposits **Baseline**: Euro 1.8 billion at end-2009 **Target**: decline halted - Resumption of growth in credit **Baseline**: 15% y-y contraction in credit in December 2009 **Improve the capitalization of Montenegrin banks and their resilience to shocks, as indicated by:** - Overall banks' Capital Adequacy Ratio (CAR) reported to be 15% and remains above the 10% prudential norm mandated by CBCG **Strengthen Montenegro's capacity to resolve problem banks and financial institutions.**	**Mostly Achieved.** (i) Banks' overall liquidity ratio stood at 35.7%, well above the Central Bank's prudential norms at the end of 2014. In September 2015, the liquidity ratio stood at 32.9% (Source: CBCG) **Mostly Achieved.** (ii) Decline in bank deposits was halted and a positive annual growth exceeding pre-crisis level (€2.4 billion by June 2015) was achieved. Nascent credit growth has resumed in 2012, climbing to 9.9% y-y by June 2015. (Source: CBCG) **Mostly Achieved.** (iii) Banks' overall CAR in June 2015 was reported to be 15.8%, well in excess of the prudential norm of 10%. (Source: CBCG) **Mostly Achieved.** (iv) CBCG has increased its capacity to assess and address banking sector vulnerabilities. Since 2009, CBCG has undertaken a series of full-scope onsite inspections in all medium- and large-sized banks. Stress tests have been conducted to evaluate the likely impact of economic downturns. Based on these assessments Supervisory Action Plans (SAPs) were prepared for all systemically important banks. SAPs identified weaknesses and	<u>Closed operations</u>: Financial & Private Sector Development Policy Operation (P116787) & Financial Sector Policy Based Guarantee (P130157) <u>IFC:</u> NLB Montenegro Banka SME credit line (27115 **)** <u>ASA/ESW:</u> FY11-14 Programmatic Balkan FSD/TA Facility <u>Partners:</u> IMF, EBRD, KfW	Cooperation among international agencies (i.e. World Bank Group, IMF, KfW, and EBRD) and with the EU proved essential given that extensive technical assistance was being provided and needed to be coordinated and aligned with the country's priorities and strategic goals. Maintaining sufficient flexibility and adapting to an unfavorable macroeconomic environment was successful. Two related policy-based operations could be a rational strategy when there is a clear need for the extended period of policy dialogue and technical assistance to ensure sustainability of policy reforms. The use of a policy-based guarantee (PBG) (instead of a traditional DPL) would not undermine the effectiveness of such a strategy if the policy triggers for a PBG remain meaningful and consistent with the objectives of the entire strategy. Sustainable recovery of the banking sector requires a clearer strategy for resolution of the problem of non-performing loans (NPL). Insufficiently addressed NPLs hampers the development of the financial sector in both short and medium term, regardless of progress made on the legal, regulatory and supervision sides.

	risks, and established targets and deadlines for addressing any non-compliance with regulations with a focus on capital needs. CBCG monitored on a monthly basis progress with implementation of SAPs, including bank recapitalization, and found it generally to be satisfactory. Moreover, amendments to the Law on Banks were enacted to enhance the CBCGs enforcement powers, and strengthen the interim administration process for problem banks. Other key deficiencies addressed in these amendments included inter alia: (i) limiting the powers of the courts to suspend or revoke CBCG decisions; and (ii) establishing legal protection for the CBCG personnel as supervisory authority. (Source: CBCG) The share of non-performing loans (NPLs) at the end-2010 was 20.97%, versus 12.5% at end-2015. (Source: CBCG) IFC's program to improve liquidity and access to finance was also aimed at improving confidence in the banking sector. IFC provided long-term financing in 2010 in the form of an SME line to NLB Montenegro for EUR10 million.		
Improve public expenditure management as indicated by decreasing trend in the deficit and debt levels **2010 projected baselines**: general government deficit of 4.5 % of GDP; gross public debt 48.4% of GDP.	**Dropped.** The outcome was dropped at CPSPR stage. This outcome was specifically related to envisaged second programmatic development policy lending (Public Expenditure Development Policy Operation) that did not materialize within the CPS period. The Government engaged in sub-optimal public investment decisions—particularly debt financing of a low-rate of return highway project—that prevented medium-term stabilization and	<u>IFC:</u> City of Podgorica bridge construction loan refinancing <u>ASA/ESW:</u> Public and Institutional Expenditure Review delivered in FY11 Public Expenditure and Finance Accountability Assessment delivered in FY13. Debt management TA and Subnational Finance policy note delivered in FY15.	WBG should continue to engage with the Government of Montenegro on the improvement of public finance management.

	reduction in public debt levels. This exacerbated weaknesses in the medium term macro-fiscal framework, which rendered DPO lending unfeasible.		
Streamline property registration and business permitting, as indicated by: - Average transaction registration time reduced. **Baseline:** 25 days in 2008; **Target:** 9 days in 2014. - Decrease in time to receive a construction permit **Baseline:** 6 month in 2008; **Target:** 2 months in 2014. **Strengthen the transparency of corporate financial reporting in line with EU standards, as indicated by the establishment of the oversight authority**	**Achieved.** Average transaction registration time reduced to 8 days. The average time to issue a construction permit is 33 (municipal level) – 49 (central level) days, within the target of 2 months, both at the central and at the municipal level. **Mostly Achieved.** Montenegro has strengthened the transparency of corporate financial reporting in line with EU standards in the banking sector. CBCG successfully implemented IFRS and IAS 39 standards in bank reporting during 2013 with an aim to increase the transparency of banks' financial status and improve market discipline. A grant financed by the Institutional Development Fund, the objectives of which are to assist in establishing an oversight authority to strengthen transparency of corporate financial reporting, is active. It supports capacity building for policy in corporate financial reporting and developing the capacity of the audit profession. Work is underway on both components since November 2014, and will complete by the end of August 2016. The oversight authority is in the process of being established. The Ministry of Finance has informally designated staff that will be part of the oversight authority. However, formal establishment can only be completed with the adoption of a new Law on Auditing. This law, together with	Current portfolio: Land Administration and Management Project (P106906) ASA/ESW: CEM: Growth & Competitiveness (delivered in FY13) FY11-14 Regional REPARIS (P113105) EU REPARIS (P147928) IDF Grant Capacity building for effective oversight (P133290) IFC: Western Balkans Trade Logistics project Advice on designing and implementing PPP Partners: GTZ, UNDP, EU, Swiss State Secretariat for Economic Affairs (SECO)	Having a good communication strategy and being in direct contact with the communities where the projects were carried out contributed to the projects' success. In LAMP, engaging local TV stations to inform and raise awareness of the project activities also helped local communities to gain ownership of the project and thus enhanced its sustainability. For example, during the development of urban plans the LAMP PIU made an effort to reach local communities, to get the citizens engaged and make them part of the planning process by providing their inputs to draft plans. As a result citizens' satisfaction with the adopted plans at local parliaments was very high.

	the new Law on Accounting, will replace the current Law on Accounting and Auditing and therefore must be adopted simultaneously. Both laws have been adopted by the Government on March 31, 2016 and the next step is adoption in the Parliament, which is expected to happen within the next several months. REPARIS - The Road to Europe – Program of Accounting Reform and Institutional Strengthening - aims to assist countries of Southeast Europe adopt and implement effective corporate financial reporting systems, aligned with the EU acquis communautaire. EU-REPARIS provided support to candidate and potential candidate countries of Southeast Europe with the implementation of corporate financial reporting frameworks that are aligned with the EU acquis communautaire. The IFC's Western Balkans Trade Logistics project was instrumental in achieving significant successes in reducing regulatory and administrative bottlenecks in cross-border trade. They included reducing controls on excise goods from 100% to 23% after Montenegro Customs applied risk management methodologies and best practices; expediting processing times of customs declarations by up to 50% and bringing full transparency to the customs declarations process; and reducing documentation required of traders by Customs.		
Strengthen government capacity to deliver agricultural assistance and upgrade agricultural practices to EU standards, as indicated by:	**Achieved.** 16 analysis methods of the Veterinary Diagnostic Laboratory in Podgorica ISO17025 were accredited.	<u>Current portfolio:</u> Montenegro Institutional Development and Strengthening Project (MIDAS, P107473) MIDAS GEF (P110602)	When introducing highly demanding procedures both for institutions and beneficiaries such as EU IPARD the "learning by doing approach" together with a step-by-step introduction of the requirements has proved to be more

-The number of analysis methods of the Veterinary Diagnostic Laboratory in Podgorica ISO17025 accredited **Baseline**: 0 analysis method accredited **Target**: 16 analysis methods accredited Amount of IPARD –like grant funding awarded **Baseline**: EUR 0 **Target**: EUR 5m **Strengthen land and natural resource management focusing on Montenegro's northern regions, as indicated by:** -Land area where sustainable land management practices have been adopted as a result of the project **Baseline**: 0 Ha **Target**: 2,000 Ha	EUR 7.7m in IPARD-like grant funding have been awarded and EUR 5.7m disbursed as of April 2015. **Achieved.** Sustainable land management practices have been adopted On 2142 Ha of land as of April 2015.	<u>Partners:</u> EU, European Commission, Danish Development Agency (DANIDA)	successful than the "traditional approach" focused only on strengthening institutions to meet the EU accreditation procedural requirements but insufficient to achieve actual implementation capacity of the institutions and beneficiaries. Learning by doing approach allows to (i) gradually increase capacity of the supply and demand side and (ii) attract beneficiaries' interest and capacity to apply for available IPARD funding. Also given the specific target group success of MIDAS grants program is due to the MIDAS implementation team extensive efforts to inform and educate farmers on the application process and opportunities within the project, thus resulting in a high number of applicants and in the MIDAS project becoming one of the most publicly-recognized in Montenegro.
Assess the quality and strengthen financing mechanisms of higher education in Montenegro in line with EU developments and Bologna agreements, as indicated by: - Completion of systems assessment of the entire higher education sector (including 2 private and 1 public universities, as well as independent research faculties) by external, international expert panel **Baseline**: no system assessment completed; **Target**: entire system assessment completed by December 2014. - Finance reform: New model for finance reform including modernized funding formulas incorporation per –student and performance-based funding components designed and	**Mostly Achieved.** External evaluation of higher education institutions was completed in May 2014. This sector-wide evaluation was completed by an external evaluator (the European University Association - EUA-IEP) and their report delivered in November 2014. Analysis of possible higher education financing models in Montenegro was adopted by the Government in February 2014. The finance reforms are being targeted to the single public university. New law on higher education was adopted in October 2014. In accordance with the Conclusion of the Government, No 08-1701 of 23 July 2015, the Ministry of Education will implement, in cooperation with the Ministry of Finance, activities for implementation of the new financing model by May 2016. The Ministry of Education will, pursuant to the said	<u>Current portfolio:</u> Higher Education Research for Innovation and Competitiveness Project (P122785) <u>ASA/ESW:</u> 7B Regional Research & Development and Innovation Strategy TA (P123211) FY11-14 <u>Partners:</u> EU	Any potential finance reform initiative must build in time to perform fiscal impact assessments, including modeling based on existing and anticipated national budgets. WB procurement requirements, which offer important protections to the Government, in terms of monitoring effective and appropriate spending, cause challenges to local project beneficiaries and time should be built into all programs that require beneficiaries to utilize specific Bank norms and procedures.

instituted **Baseline**: old finance model still in force; **Target**: new finance model instituted through new or amended legislation, with documented and inclusive process of development by December 2014. **Improve the research capacity of the Montenegrin higher education and research communities, as indicated by:** -Research: Center of Excellence identified and active in expanding the research and innovation capacity of a targeted and nationally relevant researched area. **Baseline**: no Center of Excellence operational; **Target**: Center of Excellence selected utilizing international and local experts and operational by June 2014.	Conclusion, prepare a draft agreement by the end of 2016. As part of the HERIC Project, a competition was launched to hire a consultant to be tasked to develop draft agreements between the University of Montenegro and the Government on achieving results, and includes finance reforms, focused on utilizing performance-based funding for the single public university—the University of Montenegro. Financing agreements have not been finalized between the UoM and the Government but the new model is meant to be implemented in stages, beginning with Autumn 2016 and fully by Autumn 2017. So, though adopted by the Government, the actual realization of the reform will not be completely achieved until the new model is in effect in the financing of the University. **Achieved** Negotiations and signing of Center of Excellence contract completed and funds disbursed to recipient research group in June 2014. As of June 2015, the BIO-ICT Center of Excellence (http://www.bio-ict.ac.me) - was fully operational and showing results, including active public-private partnerships in both marine farming and traditional agriculture, two international academic partnerships with Russian and Danish institutions, and extensive analysis and published findings on ICT and Agriculture and ICT Ecological Monitoring.		

Improve the quality and coverage of PHC services in and outside Podgorica, as indicated by: - Increase in PHC utilization rates **Baseline**: 37% of general population report visiting general practitioner in 2009; **Target**: 40% by 2012. - Increase in client satisfaction with PHC services **Baseline**: 66% of population in Podgorica *totally satisfied* in 2008; 61% of population outside Podgorica *satisfied* in 2008 **Target**: 70% in 2012. **Improve the financial sustainability of the health sector, as indicated by:** - HIF maintains a zero deficit in 2012 **Baseline**: small projected deficit in 2009.	**Mostly Achieved.** 44% of the general population and 82% of the Roma use the services of a chosen doctor. In Podgorica 77% of population satisfied and 19% partially satisfied. Nationally, 70% satisfied and 24% partially satisfied. Roma satisfaction 82.1%. Surveys on PHC utilization rates and patient satisfaction were carried out under the Health Systems Improvement Additional Financing Project as a part of regular monitoring and evaluation. The Bank was not present in the health sector of Montenegro after the project closed in 2013. Baseline data on health access for Roma (2008-2009) is not available. **Mostly Achieved.** The Health Insurance Fund (HIF) annual deficit decreased from EUR2.2 million in 2004 to zero in 2012, technically meeting the target stated in the CPSPR. However, since 2010, the HIF budget has been delinked from HIF revenues as these became part of the state treasury budget. The health system has since been recording arrears. The total debt of the Health Insurance Fund (HIF) and health care institutions amounted to EUR34 million at end-2013 and EUR46 million at end 2014 (out of which EUR13 million in health institution's debt and EUR18.5 million for drugs). Expenditures for drugs, treatment abroad, and sick leave compensation are among the main drivers of increased debts.	<u>Closed project:</u> Health Systems Improvement Additional Financing (P114275) <u>Partners:</u> World Health Organization (WHO), CIDA, UNDP	A desire for rapid project preparation must be balanced with the quality of a project at entry. In this case, preparation was quite rapid, based on a desire to benefit from IDA financing (Montenegro graduated from IDA to IBRD on July 6, 2007), with only nine months from concept review to Board approval. Neglected design and preparation elements eventually negatively impacted implementation, especially during the initial years. Lack of proper M&E design inevitably negatively impacts the overall quality of project design and implementation. Without proper monitoring, it is impossible to document project achievements, to build on successes, and to make adequate and appropriate mid-course adjustments. Health sector reforms must be recognized as long-term and complex. This project supported key reforms at all levels of care, with appropriate sequencing. The project had particular impact on the quality and reliability of primary care, which is an important prerequisite for hospital rationalization. Reforms in the expensive hospital sector are necessary for realization of outcomes related to efficiency and financial sustainability, requiring long-term investment in institutional capacity and political commitment.
Improve the security and reliability of Montenegro's energy sector, as indicated by:	**Achieved.** The telecommunication system is completed and is fully integrated into region and ENTSO-E highway. Links to	<u>Closed project:</u> Energy Community of Southeast Europe APL 3 (P106899)	Projects need to be formulated on the basis of realistic cost estimates and sufficient implementation time allowed to avoid needless uncertainties. Efforts need

-EPCG integrated into the UCTE (ENTSO-E) telecom highway. (The telecom system enables the connection with ENTSO-E operation facilities. Having this new telecommunication system will significantly improve (i) the power system's observability and controllability, (ii) the regional coordination of system operation, (iii) the defense and restoration plan and (iv) the reliability of supply, thereby reducing the number and duration of outages). **Baseline**: partial integration in 2010 **Target**: full integration by 2011 - Reduction in power interruptions in Andrijevica and Mojkovac regions **Baseline**: 381 MWh and 369 MWh, in 2006, in Andrijevica and Mojkovac respectively; **Target**: Reduce interruptions by 50%	Bosnia and Herzegovina and Serbia have been completed. The link to Kosovo was completed in 2014 and is fully operational. In 2015, power interruptions in the Andrijevica substation were reduced by 70% (there was a total of 114 MWh of unserved energy), while in the Mojkovac substation power interruptions were reduced by 97% (there was a total of 10 MWh of unserved energy). Therefore, the target for both substations were exceeded. IFC's Balkan Renewable Energy Program (BREP) provided advisory services to improve the regulatory framework related to RE. The objectives of IFC's advisory program in RE were to improve and align the Energy Law and its subordinated legislation with EC Directive 2009/28/EC, including the power purchase agreement to promote and streamline small hydro power projects investments (SHPP). Following BREP's advisory services, two successful SHPP tenders were completed. The Energy Law was adopted by the Parliament in December 2015.	AAA/ESW IFC: Balkan Renewable Energy Program (BREP **595728)** Partners: EBRD, EIB, KfW, USAID, the Canadian International Development Agency (CIDA), and the Governments of France, Greece, Italy, and Switzerland.	to be made to formulate the indicators and targets as practical, logical and measurable.

Pillar II: Improving Environmental Management

CPS Outcomes	Progress to Date	CPS Instruments and Partners	Lessons Learned
Strengthen solid waste management services in Bar and Ulcinj, as indicated by:	**Achieved.** Almost all solid waste in the five coastal municipalities is now collected. A new sanitary landfill "Možura" for municipalities Bar and Ulcinj has been	Closed project: Additional Financing for MESTAP (P120659) Partners:	Perhaps the most important lesson learned from the project is that local opposition to siting landfills can be a serious stumbling block to project implementation, resulting in lengthy delays and potential project

- Increase in the percent of solid waste collected and disposed of in proper facilities **Baseline**: 65% in 2010; **Target**: 90% in 2011.	completed and Bar and Ulcinj began disposing into the sanitary landfill in mid-2012. The target to collect and dispose of 90% of solid waste in proper facilities for these two municipalities has thus been achieved as of November 2012. The three other coastal municipalities (Budva, Kotor and Tivat) have also been disposing some of their waste into "Možura" landfill in previous years, as a temporary solution, while the joint landfill plans for those municipalities remain to be finalized. Although not initially planned and not formalized as a long-term solution, it had an additional positive impact as portion of the waste from those three municipalities has been properly disposed of, protecting the environment and improving the overall cleanliness of the coastal tourist areas.	EIB	failure. This can arise even if extensive consultations with stakeholders have been undertaken. The practical recommendation for any future regional landfill in Montenegro would therefore be to never underestimate the risks of local opposition. In this regard, the experience from this project has wider relevance for Bank projects involving landfills in other countries; it underlines the importance of ensuring all necessary due diligence, as well as full compliance with all applicable safeguard policies. A related broader lesson that can be drawn is that since landfill projects are inherently risky from a non-technical standpoint, a multi-municipality and multi-site approach can help mitigate these non-technical risks.
Enhancing sustainable benefits of Lake Skadar natural resources through: (i) <u>strengthening the Lake regulatory and institutional capacity</u> **Baseline**: no Skadar Lake Commission (SLC) and Working Groups (WGs) in place; no lake-wide database. **Target**: Operational costs (OCs) of maintaining and participating in SLC, lake-wide database and WGs included in Governments' budgets. <u>(ii) reducing immediate and longer term threats to Lake water quality</u> **Baseline**: (a) Long term threat: lack of institutional mechanisms, data, and analytic tools; initial monitoring data baseline to be agreed; no Predictive Hydrological Model (PHM); no joint Lake Monitoring Plan. (b) Immediate threat: improperly stored hazardous waste at KAP site; inadequate	**Partially Achieved.** (i) Scadar Lake Commission (SLC) met regularly during the project implementation, and the governments had confirmed their commitment to fund SLC meetings beyond 2013. While the budget allocations for SLC, lake-wide database, and Working Groups were made for 2013, the groups did not receive support in 2014 and 2015. This has reversed the regulatory and institutional strengthening results achieved at the project closure. (ii.a) Monitoring baseline was agreed in 2009, numeric values were provided in 2010, and all remained unchanged through the project closure; the Predictive Hydrology Model has been completed, operational and its joint use guaranteed though a bilateral agreement. Joint Lake Monitoring Plan has been established and is in operation. (ii.b) Feasibility Study for hazardous waste management has been completed	<u>Closed project</u>: Lake Skadar GEF – (TF091939)	It is preferable to finalize a project's monitoring and evaluation arrangements at appraisal, including provision of the baseline data for benchmarking progress in the course of implementation. In the initial stage of the project implementation efforts were concentrated on getting the key operational functions of the implementing entities flowing and organizing other start-up activities, while M&E got less attention. Expectations of the baseline monitoring data to be collected and organized in the early phase of the project implementation did not fully materialize and negatively affected the quality of M&E throughout the project implementation. In many of the Bank's client countries the governments and local communities have deficient information on the advantages and disadvantages of using constructed

outdated information on nature and quantity of legacy waste and site conditions; no basis for analysis of options; no action plan or agreement on way forward. **Target**: (a) Agreed monitoring data baseline maintained or improved; PHM developed; joint Lake Monitoring plan in place and used; (b) Government of Montenegro and KAP agreement reached on preferred solution and joint action plan adopted for hazardous waste dump at KAP site.	and EIA carried out. Nevertheless, final solution that would allow for the reduction of immediate threats from KAP site has not been agreed on. The Skadar Lake Project has, nevertheless, provided the basis for continuing the work on this area, and the Bank continues the dialogue with the Government within the Industrial Waste Management and Cleanup Project, towards the options for remediation of KAP's red mud basins and hazardous waste dumpsite area, which are primary threats to Lake Skadar.		wetlands for waste water treatment, and lack trust in this technology. Demonstration pilot investments in the construction wetlands had been considered or planned under a number of projects in Europe and Central Asia (ECA) region, but in a number of cases got rejected at the preparation or even at the implementation phase. The conclusion is that including establishment of a constructed wetland into a project design needs to be approached very carefully. Confidence in a true buy-in by the beneficiaries and stakeholders is critical, and so is the quality assurance of feasibility studies and designs. It is preferable that the latter are covered by the projects and are carried out with the support from the Bank's Task Teams rather than being produced externally, without advice and quality control from the Bank.
Reduce the environmental and public health risks of polluted industrial disposal sites, as indicated by: Environmental remediation completed of four industrial disposal sites (KAP in Podgorica; lignite thermal power plant in Pljevlja; lead-zinc tailings pond in Pljevlja; and the Bijela shipyard)	**Not Achieved.** A substantial body of work, which directly affects the outcome, preceded the approval of Industrial Waste Management and Cleanup Project. Feasibility studies with site investigations, Environmental and Social Impact Assessments (ESIAs), and basic designs were completed for all four industrial waste disposal sites during project preparation and financed by the Project Preparation Facility. A mix of remediation measures have been identified and developed for the four selected sites: mine tailings disposal facility (Gradac-Pljevlja); coal ash disposal facility (Pljevlja); ship blasting waste and site contamination at Bijela shipyard; and red mud basins and solid waste disposal site at KAP. Negotiations of the project, however, were delayed by KAP bankruptcy and new	<u>Current portfolio:</u> Industrial Waste Management and Cleanup Project (P122139)	

	ownership, including the ownership of the red mud basins. It also took longer than expected to finalize an arrangement for the disposal of ongoing, non-hazardous waste production from Bijela shipyard; the final decision was to dispose of it at the newly constructed Mozura landfill. Overall, much more time than originally anticipated was needed for consultations and getting all stakeholders on board for arrangements related to the Bijela Shipyard and KAP. The outcome is expected to be achieved during the next CPF.		
Improve access of the Government and households to low-cost catastrophe insurance products as indicated by: Increase in share of households covered against climate-related and geo-perils from participation in CRIF (baseline: 0% in 2010; 10% by 2014)	**Dropped.** The outcome was dropped at CPSPR stage. This outcome was dropped due to a change in government priorities. The Bank started dialogue with the Government of Montenegro on the Southeast Europe Catastrophe Risk Insurance Facility in 2010. However, when making the Europa Re facility operational took longer than expected, those negotiations were put on hold. The Southeast Europe Catastrophe Risk Insurance Facility (SEE CRIF) program has been under implementation since May 2012. The program resulted in the establishment of Europa Re, a Swiss-licensed catastrophe risk reinsurer currently owned by the Governments of Albania, FYR Macedonia, and Serbia. The Bank revisited Montenegro's interest to join the program in 2014, but the Government's priorities had by then changed and this activity was dropped.		
Enhance the efficiency of energy use in targeted public schools and hospitals, as indicated by:	**Mostly Achieved.** Energy efficiency measures completed in 14 buildings. The results from TM&E show total energy savings of 46.7% on average. The original loan selected	<u>Current portfolio:</u> Montenegro Energy Efficiency Project & Energy Efficiency Additional Financing (P107992)	

- Quantified energy savings of at least 25% on average in the targeted buildings, measured through TM&E **Baseline**: 0%; **Target**: 40% - Number of building retrofitted with energy efficiency improvement schemes **Baseline**: 0 buildings in 2009; **End target** 27 in 2017	buildings with the highest savings potential; subsequent buildings included in the additional financing may have somewhat lower savings. Energy efficiency implementation capacity has been enhanced and by the end of the CPS period (June 2015) 18 buildings had benefited from energy efficiency retrofits. Another 7-8 buildings/subprojects will be retrofitted in the new CPF period.	<u>Partners:</u> German Agency for Technical Cooperation (GTZ), KfW	

CPS CLR SUMMARY OF OUTCOME RATINGS

Pillar	Number of outcomes	Achieved	Mostly Achieved	Partially Achieved	Not Achieved	Dropped
Support EU accession through strengthening institutions and competitiveness	14	3	10	0	0	1
Improving Environmental Management	5	1	1	1	1	1
OVERALL CPS: Outcomes as designed at start of CPS	**19 (100%)**	**4 (21%)**	**11 (58%)**	**1 (5%)**	**1 (5%)**	**2 (11%)**
OVERALL CPS Outcomes as adjusted at CPSPR	**17 (100%)**	**4 (24%)**	**11 (65%)**	**1 (6)%**	**1 (6%)**	**--**

CPS CLR Attachment 2: Planned Financing program and Actual Deliveries

Original CPS Lending Program (US$ m)		**Status 3/17/2016 (US$ m)**	
FY11 – FY12			
Financial Sector DPO I	**85.0**	Financial Sector DPO I (P116787)	**85.0**
Solid Waste AF	**5.7**	Solid Waste AF (P120659)	**5.5**
Financial Sector DPO II	**20.0**	Policy-Based Guarantee (P130157)	**79.2**
Higher education, R&D	**20.0**	Higher education, R&D (P122785)	**16.0**
CRIF (disaster management- P127044)	**5.0**	*Put on hold*	
FY11 - FY12 Total	**135.7**	***FY11 - FY12 Total***	**185.7**
FY13 - FY14			
Industrial Waste Management (P122139)	**60.0**	*Delayed to FY 15*	
Unassigned Project (TBD)	**20.0**	Energy Efficiency AF (P145399)	**6.8**
Proposed Public Expend. & Growth DPO (P130170)	**50.0**	*Dropped*	
FY13-14 Total	**130.0**	***FY13-14 Total***	**6.8**
Progress report plans (5/30/2014)		**Status 3/1/2016**	
FY14-FY15			
Industrial Waste Management (P122139)	**68.9**	Industrial Waste Management (P122139)	**68.9**
CRIF (P127044)	**2.5**	Dropped	
Fiscal and Debt Management (P150439)	**34.5**	Dropped	
Subnational Finance Sustainability SUFIS (P157838)	**30.0**	Dropped	
Revenue Administration Reform (149843)	**24.0**	*Delayed to FY16*	
Health System and Quality Improvement (P149752)	**50.0**	*Moved to FY17*	
FY Total	**209.9**	***FY15 Total***	**68.9**
		OVERALL TOTAL	***261.4***

CPS CLR Attachment 3: Planned Non-lending Activities and Actual Deliveries (FY11-FY15)

Planned Completion FY	Activity	Planned in CPS	STATUS (21/03/2017) Actual, Dropped, or Moved to a Different FY
FY11	Accounting & Auditing ROSC Follow-up on Country Action Plan	X	Delivered (P123426, FY14
FY12	Pension Reform TA	X	*Dropped*
FY11	Public Expenditure and Investment Review - Follow Up	X	Delivered (P120752, FY12)
FY11	Public Expenditure and Financial Accountability Follow up TA	X	Delivered (P112847, FY12)
FY13	CEM Growth and Competitiveness	X	Delivered (P127778, FY13)
FY13	Public Sector Institutions & Fiduciary Review	X	*Dropped*
FY12	Labor Market Incentives TA		Delivered (P127558, FY12)
FY14	Agriculture Assessment	X	*Dropped*
FY11-FY14	Statistical Capacity Building and Poverty Monitoring	X	*Dropped*
FY11-14	FINSAC Center/Non-Performing Loans (NPL) Resolution TA		Delivered (P143745, FY14)
FY14	Montenegro Municipal Public Finance Review (MPFR) (P147102)		*Dropped*
FY14	Public Expenditure and Financial Accountability TA PEFA Update (P131561)		Delivered (P131561, FY14)
FY15	Money Laundering and Terrorist Financing National Risk Assessment of Montenegro		Delivered (P149742, FY16 subtask of P154884)

Planned Completion FY	Activity	Planned in CPS	STATUS (21/03/2017) Actual, Dropped, or Moved to a Different FY
FY15	Transport Policy Note		Delivered (P147431, FY15)
	REGIONAL	**Planned in CPS**	**STATUS (21/03/2017)** **Actual, Dropped, or Moved to a Different FY**
FY11-FY12	Western Balkans Public Financial Management	X	Delivered (P127609, FY14)
FY11-FY14	Western Balkans REPARIS	X	Delivered (FY14: P113105)
FY11-FY13	Western Balkans 7B Regional Research & Development and Innovation Strategy	X	Delivered (123211, FY14)
FY12-FY13	Western Balkans Programmatic Financial Sector Development	X	Delivered (P127525, FY 2013)
FY12-FY15	Western Balkans Programmatic Gender Monitoring	X	Delivered (P133412, FY15)
FY 12-FY14	Western Balkans Trade Logistics project IFC	X	Delivered
		X	
FY12-FY14	Advice on designing and implementing PPP IFC		Delivered
FY13-FY15	South East Europe Regular Economic Report		Delivered (FY13-15)
FY13-15	Western Balkans Poverty Assessment		Delivered (P132666, FY15)
FY13	Regional Activation and Smart Safety Nets Programmatic Analytical Work		Delivered (P122434, FY13)
FY13-17	EU REPARIS (Road to Europe – Program of Accounting Reform and Institutional Strengthening)		Ongoing (P147928) Programmatic delivery planned for FY18)

Planned Completion FY	Activity	Planned in CPS	STATUS (21/03/2017) Actual, Dropped, or Moved to a Different FY
FY14	Land and Leadership in Western Balkans		Delivered (P145047, FY14)
FY14-15	Western Balkans Jobs Challenges		Ongoing, Programmatic (P133003, delivery in FY16)
FY14-FY15	Western Balkans Financial Sector Outlook		Delivered (P146662, FY14)
FY14	Monitoring and Evaluation Capacity Development for the Western Balkans and Turkey		Delivered (P128734, FY14)
FY14	Western Balkans Energy Efficiency Scale-Up in Buildings		Delivered (P133200, FY14)
FY15	Directions for the Energy Sector in the Western Balkans		Moved to FY16 (P133231)
FY15	Biomass Based Heating in the Western Balkans		Moved to FY16 (P148325)
FY15	Regional Deep Dive: Turn Down the Heat		Delivered (P148173, FY15)
FY15	Western Balkans Pensions Technical Assistance		(Ongoing P151957, delivery planned for FY16)

Annex 4. Selected Indicators of Bank Portfolio Performance and Management

As of 05/18/2016

Indicator	FY13	FY14	FY15	FY16
Portfolio Assessment				
Number of Projects Under Implementation [a]	5.0	4.0	5.0	4.0
Average Implementation Period (years) [b]	5.0	6.0	5.9	6.9
Percent of Problem Projects by Number [a, c]	20.0	25.0	0.0	0.0
Percent of Problem Projects by Amount [a, c]	12.8	23.8	0.0	0.0
Percent of Projects at Risk by Number [a, d]	20.0	25.0	0.0	0.0
Percent of Projects at Risk by Amount [a, d]	12.8	23.8	0.0	0.0
Disbursement Ratio (%) [e]	35.0	23.8	35.7	12.0
Portfolio Management				
CPPR during the year (yes/no)				
Supervision Resources (total US$)				
Average Supervision (US$/project)				

Memorandum Item	Since FY80	Last Five FYs
Proj Eval by OED by Number	9	4
Proj Eval by OED by Amt (US$ millions)	157.8	114.5
% of OED Projects Rated U or HU by Number	33.3	25.0
% of OED Projects Rated U or HU by Amt	17.2	11.3

a. As shown in the Annual Report on Portfolio Performance (except for current FY).

b. Average age of projects in the Bank's country portfolio.

c. Percent of projects rated U or HU on development objectives (DO) and/or implementation progress (IP).

d. As defined under the Portfolio Improvement Program.

e. Ratio of disbursements during the year to the undisbursed balance of the Bank's portfolio at the beginning of the year: Investment projects only.

* All indicators are for projects active in the Portfolio, with the exception of Disbursement Ratio, which includes all active projects as well as projects which exited during the fiscal year.

Annex 5. Operations Portfolio (IBRD/IDA and Grants)
As of 04/30/2016

Closed Projects	12
IBRD/IDA*	
Total Disbursed (Active)	36.66
of which has been repaid	10.80
Total Disbursed (Closed)	165.68
of which has been repaid	96.11
Total Disbursed (Active + Closed)	202.34
of which has been repaid	106.91
Total Undisbursed (Active)	75.02
Total Undisbursed (Closed)	0.00
Total Undisbursed (Active + Closed)	75.02072284

Active Projects

Project ID	Project Name	Last PSR Supervision Rating: Development Objectiv	Last PSR Supervision Rating: Implementation Progress	Fiscal Year	Original Amount in US$ Millions: IBRD	IDA	Grants	Cancel.	Undisb.	Difference Between Expected and Actual Disbursements a/: Orig.	Frm Rev'd
P107992	ENERGY EFFICIENCY IN PUBLIC BUIL	MS	MS	2009	16.2	0.0		0.5	2.9	-2.1	1.4
P122785	HIGHER ED COMPTET	S	MS	2012	16.0	0.0		0.0	5.4	5.2	0.0
P122139	INDUSTRIAL WASTE MGT	MS	MS	2015	68.9	0.0		0.0	66.1	6.6	0.0
P107473	INSTIT DEV & AGR STRENGTH	S	MS	2009	15.7	0.0		0.0	0.1	1.7	1.3
P110602	MONTENEGRO INSTITU DEV AND AGF	#	MS	2009	0.0	0.0	4.0	0.0	0.5	0.5	0.5
Overall Result					**116.8**	**0.0**	**4.0**	**0.5**	**75.0**	**11.9**	**3.3**

* Disbursement data is updated at the end of the first w eek of the month.

a. Intended disbursements to date minus actual disbursements to date as projected at appraisal.

Annex 6. Statement of IFC's Held and Disbursed Portfolio

As of 04/30/2016

(US$ MILLION)

		Committed					Disbursed Outstanding				
FY Approval	Company	Loan	Equity	**Quasi Equity	*GT/RM	Participant	Loan	Equity	**Quasi Equity	*GT/RM	Participant
FY08	GINTASMONT	6.26	0.00	6.05	0.00	0.00	6.26	0.00	6.05	0.00	0.00
FY11	PODGORICA	7.71	0.00	0.00	0.00	0.00	7.71	0.00	0.00	0.00	0.00
FY12	PODGORICA	9.87	0.00	0.00	0.00	0.00	9.87	0.00	0.00	0.00	0.00
Total Portfolio:		**23.84**	**0.00**	**6.05**	**0.00**	**0.00**	**23.84**	**0.00**	**6.05**	**0.00**	**0.00**

Annex 7. Coordination among development partners in Montenegro

1. **Alongside the WBG, the EU Delegation, UN Agencies and Organization for Security and Cooperation in Europe (OSCE) are the main development partners in Montenegro, with the EU playing by far the largest role.** There is also a number of other important IFIs, such as the European Bank for Reconstruction and Development (EBRD), European Investment Bank (EIB) and KfW Development Bank (KfW).

2. **Overall development partners' coordination has traditionally been led, in an informal way, by the Ministry of Foreign Affairs and European Integration.** The Ministry is currently in the process of defining the basis for the establishment of an institutional and strategic framework for the management of humanitarian and development aid, based on existing best practices and available knowledge. Due to a small size of the international community, the absence of a formal venue has not been a major impediment. Coordination among development partners has been mostly informal, yet regular; at sector or sub-sector level the interaction has mainly been bilateral, i.e. between agencies collaborating in their respective sectors of engagement. There is, however, a strong interest in stepping up multilateral coordination, not least for presenting a joint position to the Government on strategic policy matters.

3. **Whether it plays a leading or supporting role in a given sector, the WBG coordinates closely with other IFIs and other development partners to exploit synergies and avoid overlaps.** The preparation of the new CPF was no exception, and the framework has been informed by consultations with the Bank's development partners. Several agencies have expressed an interest in the World Bank taking the lead in putting in place a multilateral coordination mechanism under the auspices of the new CPF. The World Bank will initiate monthly updates among the partners and consult the Ministry of Finance and the Ministry of Foreign Affairs and European Integration on ways to help facilitate joint coordination sessions with the Government.

4. **The World Bank coordination with international partners revolves largely around supporting Montenegro's objective of EU accession.** The EU Pre-accession financial assistance for the period 2014-2020 focuses on two pillars: (i) Democracy and Rule of Law, and (ii) Competitiveness and Growth. Under the Rule of Law and Fundamental Rights sector, particular attention is paid to reforms improving the independence, accountability and professionalism of the judiciary, strengthening the fight against corruption and against organized crime, enhancing border control and managing migration flows, as well as to reforms tackling the shortcomings in the protection of fundamental rights and minorities. Under the Democracy and Governance sector, strengthening the democratic institutions and reforming the public administration, both at central and local level, and promoting the involvement of civil society represent key priorities for EU assistance. Specific focus is given to supporting the reform of the public financial management system. Under the Competitiveness and Growth pillar, the program focuses on the reform needs of Montenegro for meeting the economic criteria for EU membership, specifically in the area of economic governance, competitiveness and human resources development, improving the business environment for small and medium-sized enterprises (SMEs), addressing skills gaps and mismatches between the labor market and the education system, as well as strengthening social inclusion. IPA II will furthermore focus on improving the interconnection with the other countries of the region, promote sustainable development and the protection of the environment, and

contribute to the efficiency of the agriculture sector while maintaining rural communities, also with regional support from the Western Balkans Investment Facility (WBIF).

5. EBRD focuses on supporting SMEs in sectors with growth potential, sustainable tourism, and energy security and efficiency through cross-border regional integration of energy markets. EBRD is supporting interconnections with countries in the region through projects aimed at improving energy security, advancing energy efficiency and leading to greater competition in the energy market. EBRD's investments in tourism have been aimed at supporting private sector investments in the south and central part of Montenegro, and on the development of low-density, high-quality tourism projects. To advance development and reform in the agribusiness sector, the EBRD seeks to increase its presence in those parts of the sector where export and competitive advantages exist, such as processing, logistics and retail distribution, as well as local food processing companies that could supply and cater to the hospitality industry and tourism sector. EBRD is currently preparing a new strategy document for 2017-2020. It is expected to be adopted by the end of 2016.

6. KfW has been mainly active in the energy sector, municipal infrastructure, supporting micro, small and medium-sized enterprises, and providing municipal credit lines. Under the Energy Efficiency Program, KfW supported lowering energy consumption of schools and day care centers. KfW is also funding the modernization of two hydropower plants that play a key role in Montenegro's energy supply, and has been providing support to improve the water supply and water quality and reduce water losses in the coastal communities of Herceg Novi, Kotor, Tivat, Bar, Ulcinj, and Cetinje. KfW has also invested in improving the sewage system as well as construction of new sewage treatment plants and sewer systems, and provides micro-entrepreneurs' access to financial services by working with a local micro-finance institution.

7. UNDP's focus on promoting sustainable human development is also aligned with Montenegro's EU accession priorities. There are a number of areas of common focus with UNDP, such as support to overall reforms in the country, enhancing employment, providing support in environmental management, e-governance and ICT. UNDP's recent human development reports have addressed issues such as resource efficiency and informal work providing recommendations on tackling informal labor in priority economic sectors. Through the Joint Government and UNDP programme – Centre for Sustainable Development – UNDP supports Government on energy, climate change, eco-system management, and low carbon tourism. UNDP is currently finalizing a new Country Program Document for the period 2017-2021.

8. In the areas of WBG's non-lending services and proposed projects there is a mutual interest in and room for continued dialogue with UNICEF on early childhood development and social protection and with WHO on health.

9. A particularly close coordination is in place between WBG and the EU in the areas of agriculture and education, especially in addressing the skills mismatch between education and the labor market. The partnership established within the MIDAS project among the Bank, Ministry of Agriculture and Rural Development (MARD), and EU has allowed a constructive tripartite dialogue, ensuring coordination of activities supported by the EU and the Bank. The broad cooperation that has ensued due to the MIDAS grants' success has resulted in the establishment of an EU-supported Trust Fund administered by the Bank to provide further IPARD-like grants to Montenegro in 2014. At the end of 2015 additional EU funding to the TF has been processed to support increasing capacities of both institutions and industry in the agro-processing sector.

10. In the areas of environment, infrastructure and tourism development, WBG coordinates closely with EBRD and KfW on energy efficiency and sustainable tourism development.

11. During consultations with development partners on the proposed CPF it was concluded that there were no counterproductive overlaps among their programs, and that there was complementarity and a framework for coordination of projects in all areas of mutual engagement. At the same time, participants perceived a need for a regular venue for presenting their unified position to the Government of Montenegro and expressed commitment to finding an adequate venue for such communication in order to strengthen the impact of their advice and development programs.

Table I: Coordination of development partners in Montenegro on MDD, ERP, and EU Accession Program Key Strategic Areas

Key Strategic Sectors	**Leading Partner**	**Supporting Partner**	**Development Partners' Area of Focus**
Public Finance, Taxation, Fiscal Sustainability	***WBG***	EU, IMF	▪ ***WBG*** **-** sustainable fiscal policy; efficiency of public finances ▪ EU **-** public financial management system within the public administration reform ▪ IMF **-** macro-fiscal monitoring
Labor Market	***WBG,*** EU	UNDP	▪ ***WBG*** **-** addressing skills mismatches and disincentives for work ▪ EU - skill gaps; grant schemes for self-employment ▪ UNDP – policy responses to informal work, women's entrepreneurship, youth in labor market.

Business climate and competitiveness, ICT	***WBG***, EU, EBRD	KfW	▪ ***WBG*** **-** private sector-led job creation; private sector investments in sustainable tourism and agriculture; access to finance for SMEs ▪ EU **-** competitiveness and innovation; education, employment and social policies; enhancing competitiveness of local SMEs through cluster development ▪ EBRD **-** SMEs support ▪ KfW **-** SMEs support, microcredit
Tourism	***WBG***, EBRD	KfW, UNDP	▪ ***WBG*** **-** sustainable tourism ▪ KfW **-** municipal infrastructure ▪ EBRD **-** hotels; supporting infrastructure ▪ UNDP –Low carbon tourism
Agriculture	EU, ***WBG***		▪ ***WBG*** **-** supporting sustainable agriculture, investments in agricultural and rural development in line with IPARD measures; institutional capacity building for accessing IPARD funds ▪ EU **-** agriculture and rural development
Energy	EBRD, KfW	***WBG,*** UNDP	▪ ***WBG*** **-** energy efficiency of public buildings in education and health ▪ EBRD **-** energy security and efficiency and regional integration of energy markets ▪ KfW **-** energy efficiency and renewable energy, small hydro plants ▪ UNDP – improving energy efficiency of public buildings and local public spaces
Financial Sector/Financial Institutions	***WBG,*** EBRD, KfW	IMF	▪ ***WBG*** **-** financial sector stability ▪ EBRD **-** support to banking sector ▪ KfW **-** support to micro credit institutions ▪ IMF **-** financial sector assessment

Environment and Climate Change	EU	***WBG***	▪ ***WBG*** **-** industrial waste management and cleanup, sustainable agriculture and tourism ▪ EU **-** sustainable development and the protection of the environment under IPA II
Infrastructure	EBRD, KfW	***WBG,*** UNDP	▪ ***WBG*** **-** industrial waste management and cleanup, initial assessments of other infrastructure needs, capacity building ▪ EBRD **-** support of private sector, especially energy and communications ▪ KfW **-** municipal infrastructure (sewage, water) ▪ UNDP – ensuring climate change targets and environmental protection measures are integrated into National policies and planning; Integrated waste management; Management and conservation of ecosystems

Annex 8. Map of Montenegro