

**PROJECT INFORMATION DOCUMENT (PID)
ADDITIONAL FINANCING**

Report No.: PIDA36599

Project Name	Montenegro Additional Financing EU/IPA Ag & RD Institution Build. Proj (P154111)
Parent Project Name	Montenegro Institutional Development and Agriculture Strengthening (MIDAS) (P107473)
Region	EUROPE AND CENTRAL ASIA
Country	Montenegro
Sector(s)	Public administration- Agriculture, fishing and forestry (40%), General agriculture, fishing and forestry sector (30%), Agro-industr y, marketing, and trade (30%)
Theme(s)	Rural markets (40%), Rural non-farm income generation (40%), Managing for development results (20%)
Lending Instrument	Investment Project Financing
Project ID	P154111
Parent Project ID	P107473
Borrower(s)	Ministry of Finance
Implementing Agency	Ministry of Agriculture and Rural Development
Environmental Category	B-Partial Assessment
Date PID Prepared/Updated	03-Nov-2015
Date PID Approved/Disclosed	04-Nov-2015
Estimated Date of Appraisal Completion	26-Oct-2015
Estimated Date of First Grant Approval	16-Dec-2015
Appraisal Review Decision (from Decision Note)	

I. Project Context

Country Context

Montenegro is a small and open transition economy that gained independence in 2006 and is negotiating accession to the European Union. Montenegro has a population of 624,000 and a GNI per capita of \$7,240 (Atlas method). Montenegro is an upper-middle-income country with significant growth potential, particularly on tourism. It started negotiations with the European Union in June 2012 and strives to join by 2020 ahead of other countries in the Western Balkans. In the negotiation process so far, two chapters have been provisionally closed and twenty chapters have been opened, which together sketch out a comprehensive reform agenda in the area of the rule of law. As Montenegro moves towards EU accession this will increase the focus on improving governance institutions. In turn, this will improve service delivery and citizen trust in the state.

Montenegro has gone through a period of economic boom and poverty reduction followed by one of stagnation. The economic boom, from 2000 to 2008, was triggered by a large inflow of capital that stimulated aggregate demand and led to a steady increase in the rate of growth, and a fall in the rate of unemployment. During the boom, there was a steady decline in the percentage of households below the poverty line and an increase in the income of households in the bottom 40 percent. The recession of 2009, followed by economic stagnation, from 2009 to 2013, was triggered by the stop in capital inflows—prompted by the international financial crisis. Montenegro’s use of the Euro may have helped shield the country from the worst effects of the 2008 financial crisis.

Montenegro’s economic growth cycle follows closely the business cycle in Europe. The correspondence between the path of Montenegro and Europe’s GDP illustrates the vulnerability of the economy to the business cycle in a region that has not yet fully recuperated from the financial crisis of 2008-10. The high unemployment rate (ranging at 17-20 percent) is cause of concern, particularly in the less developed and more mountainous northern region.

The development challenges facing Montenegro are a combination of cyclical and structural factors and require a two-pronged approach. The cyclical factors are the state of the economies in Europe, Russia and South Eastern Europe (SEE)—the short- to medium-term prospects of these economies; and the country’s macro-fiscal situation. The main structural factors are the level of regional integration, the level and quality of human and physical capital, the legacy of a socialist past, and the development of the private sector. The legacy of socialism is visible in the still large influence of the public sector and in the weight of the pension system and public administration cost in overall government expenditure. The weakness of the private sector is evident in the state of the financial sector, the development of private firms, and the limited trade links between Montenegro and the rest of the world.

Sectoral and institutional Context

The importance of agriculture to Montenegro’s rural economy remains significant, as it represents a key source of employment, income generation, and food security for some of the most vulnerable parts of society. According to official statistics, agricultural primary production represents around 10% of GDP, yet official data likely underestimate the contribution of agriculture to the economy because a large share of agricultural production is carried out informally. Historically, the region of Southeast Europe has had a tradition of growing food at home and many families still grow fruits and vegetables and sometimes raise animals (even urban dwellers often have rural second houses called *vikendica*). This production is not accounted for in most national statistics, as is the case with agricultural employment. For instance, according to the official statistics provided by the Statistical Office of Montenegro (MONSTAT), the number of persons formally employed in agriculture was 2,347 in 2010. However, the 2010 Agricultural Census reported the equivalent of 46,473 Annual Work Units for agriculture, indicating that only 5% of agricultural employment is formal. This implies that 95% of agricultural employment is not reported in official statistics. In turn, this also means that a large share of this production may not be reported, neither as production nor as consumption. The importance of agriculture is also expressed through the growing demand for agricultural products that contributes to a large and increasing trade deficit. Agricultural exports have been increasing by around 4% annually during the last 8 years, while agricultural imports have been increasing much faster, around 16% annually. This divergence has resulted in a worsening agricultural trade deficit that increased from US\$166 million in 2005 to US\$473 million in 2012.

Agriculture's share within the goods trade deficit increased from 21% to 27% over the same period.

Montenegro's agricultural development is held back by constraints similar to those witnessed elsewhere in the region of Southeast Europe: (i) low levels of education among farmers and their reluctance and/or inability to adopt modern technologies; (ii) small average farm size and a limited or sub-optimal land rental market; (iii) slow uptake in development of agricultural cooperatives that could improve storage, packaging and marketing of produce; (iv) the effects of climate change, especially increased risks of weather-related natural disasters such as floods, and to a lesser extent droughts, the former often resulting in damaging land erosion. Comparing the agricultural value added per hectare of land with other countries in the region, it seems that agriculture in Montenegro has potential for growth.

In addition to productivity and competitiveness improvement, Montenegro's agriculture needs to address the prospect of regulatory integration with the EU. Both primary agricultural production and agro-processors will need to invest in new skills and new technologies to comply with demanding EU food safety regulations. At the same time, due to the progressive integration into the EU single market, Montenegro's agriculture will come under increasing pressure both domestically and in export markets. While EU regulations allow flexibility for 'small-scale' and 'traditional' food production, their implementation requires the development of national legislation that is aligned with EU rules and the development of local capacity. For larger food establishments, adherence to EU food safety requirements is a must.

II. Proposed Development Objectives

A. Current Project Development Objectives – Parent

The Project Development Objective is to improve delivery of government assistance for sustainable agriculture and rural development in a manner consistent with the EU's pre-accession requirements.

B. Proposed Project Development Objectives – Additional Financing (AF)

The new objectives of the Project are: (i) to improve delivery of government assistance for sustainable agriculture and rural development in a manner consistent with the EU's pre-accession requirements; (ii) to increase the experience of Montenegrin authorities in administering rural development grants in accordance with EU-IPARD core rules, and (iii) to support a selected number of food establishments in upgrading towards EU standards.

III. Project Description

Component Name

Component 1 – Strengthening MAFWM's rural development program

Comments (optional)

Building on the positive experience of the Montenegro Institutional Development and Agriculture Strengthening (MIDAS) project and the on-going project Montenegro EU/IPA Agriculture and Rural Development Institution Building project (P144994), the component will support the provision of grants for a gradual introduction of the IPARD approach to improve competitiveness of the agricultural sector. With the Additional Financing (AF) the scope of the Rural Development Measure to be supported by the grants under this Component will be broadened, as the grant scheme will support beneficiaries in agro-processing industry in addition to agricultural holdings that have been supported until now.

Component Name

Component 2 – Strengthening MAFWM’s administrative and management capacity in accordance with EU pre-accession requirements

Comments (optional)

35. This Component will fund all the activities necessary to:

- (a) support the implementation and monitoring of the grant scheme including: (i) the implementation of a monitoring support system to measure results achieved by the grant scheme; (ii) the provision of support to the Sector Monitoring Committee for Rural Development responsible for implementation of the monitoring arrangements; and (iii) the enhancement of knowledge and capacity in implementing the tasks foreseen under the future IPARD for the relevant staff of MARD’s Sectors for Rural Development and for Payments, as well as of Technical Bodies, Advisory Services. And
- (b) carry out a baseline survey in the first year of project implementation and a final survey, providing support for the fiduciary and safeguard requirements

IV. Financing (in USD Million)

Total Project Cost:	4.72	Total Bank Financing:	0.00
Financing Gap:	0.00		
For Loans/Credits/Others			Amount
Borrower			0.00
Free-standing TFs for ECA SD Sector Unit			4.72
Total			4.72

V. Implementation

The Recipient Executed Grant will be implemented by the Ministry of Agriculture and Rural Development with support of the Technical Service Unit under the Ministry of Finance. Such implementation arrangements have been successfully tested under the Montenegro Institutional Development and Agricultural Strengthening (MIDAS) Project.

VI. Safeguard Policies (including public consultation)

Safeguard Policies Triggered by the Project	Yes	No
Environmental Assessment OP/BP 4.01	x	
Natural Habitats OP/BP 4.04		x
Forests OP/BP 4.36		x
Pest Management OP 4.09	x	
Physical Cultural Resources OP/BP 4.11		x
Indigenous Peoples OP/BP 4.10		x
Involuntary Resettlement OP/BP 4.12		x
Safety of Dams OP/BP 4.37		x
Projects on International Waterways OP/BP 7.50	x	
Projects in Disputed Areas OP/BP 7.60		x

Comments (optional)

VII. Contact point

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