

**DOCUMENT OF THE EUROPEAN BANK  
FOR RECONSTRUCTION AND DEVELOPMENT**

**STRATEGY FOR MONTENEGRO  
2010 - 2013**

**As approved by the Board of Directors at its meeting on 14 September 2010**

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## LIST OF ABBREVIATIONS

EU	European Union
SME	Small and Medium Enterprises
FDI	Foreign Direct Investments
IBRD	International Bank for Reconstruction and Development
EIB	European Investment Bank
WBIF	Western Balkans Investment Framework
LEF	Local Enterprise Facility
WeBSEDF	Western Balkan Sustainable Energy Direct Financing Facility
WeBSECLF	Western Balkan Sustainable Energy Credit Line Facility
IFI	International Financial Institution
TC	Technical cooperation
NLBM	NLB Montenegro bank
EFSE	European Fund for Southeast Europe
MEI	Municipal and Environmental Infrastructure
EB	Euromarket Banka
KAP	Aluminium Plant Podgorica
DPS	Democratic Party of Socialists
EC	European Commission
SEEC	South Eastern Europe Cooperation Process
BEEPS	Business Environment and Enterprise Performance Survey
CPI	Corruption Perception Index
UNESCO	United Nations Educational, Scientific and Cultural Organization
EPA	Environmental Protection Agency
GDP	Gross Domestic Product
EPCG	Electricity Utility
KfW	Kreditanstalt für Wiederaufbau
ZICG	Montenegro Railway Infrastructure Company
PPP	Public Private Partnership
MonteCargo	Montenegro Railways Cargo Company
MSME	Micro, Small and Medium sized Enterprises
IAIS	International Association of Insurance Supervisors
TAM/BAS	Turn-Around Management/Business Advisory Services
IPA	Instruments for Pre-Accession
PHARE	Poland and Hungary: Assistance for Restructuring Economies
ISPA	Instrument for Structural Policies for Pre-Accession
SAPARD	Special Accession Programme for Agriculture and Rural Development
IFC	International Finance Corporation
IDF	Institutional Development Fund
GEF	Global environmental Facility
FPDPL	Financial Sector Development Policy Loans
IMF	International Monetary Fund
SAA	Stabilisation and Association Agreement
WTO	World Trade Organization\
SEE	South Eastern Europe
EKIP	Agency for Electronic Communications and Postal Affairs
ERA	Montenegrin Energy Regulatory Agency

UNFCC	United Nations Framework Convention on Climate Change
RES	Renewable Energy Company
GHG	Greenhouse Gas Emission
EE	Energy Efficiency
RE	Renewable Energy
NGO	Non-Governmental Organization
IPPC	Integrated Pollution Prevention and Control
UNDP	United Nations Development Programme
ILO	International Labour Organisation
OHS	Occupational Health and Safety
PR	Performance Requirements
ESAP	Environmental and Social Action Plan
OECD	Organisation for Economic Co-operation and Development
UNCITRAL	United Nations Commission on International Trade Law
PPL	Public Procurement Law
IOSCO	International Organisation of Securities Commissions
CT	Montenegrin Telecom
SE4F	Southeast Europe Energy efficiency Fund

#### **CURRENCY CONVERSIONS**

EUR	EURO
USD	United States Dollar

Exchange rate as of 8 April 2010: EUR 1 = USD 1.1428

## EXECUTIVE SUMMARY

Montenegro continues to fulfil the conditions specified in Article 1 of the Agreement Establishing the Bank.

The country has made further progress on structural and institutional reforms. The progress in EU approximation culminated with the formal application for EU membership in December 2008. The European Commission is expected to deliver an Opinion in the second half of 2010.

Since the last Country Strategy was approved (BDS/M/09-07) and up until the onset of the crisis, Montenegro's macroeconomic performance was impressive. The country experienced several years of sustained economic growth. After achieving about 11 per cent growth in real terms in 2007, the economy continued to grow at a strong pace in 2008, with real GDP growth estimated at 7 per cent. However, the economy was severely affected by the global financial and economic crisis, with GDP estimated to have fallen by 5.3 per cent in 2009. The medium-term outlook remains positive: the recovery is expected to be slow, with real GDP growth anticipated to be slightly negative in 2010.

The Bank's portfolio almost tripled during the previous Strategy period (from €36.2 million to €102.9 million at the end of 2009). Operating assets were €54.8 million as of end-2009 with no impaired assets. Infrastructure projects continue to dominate the portfolio, even though the Bank has managed to shift gradually its focus to the private sector.

Although Montenegro has made substantial progress in reforms during the past years, the country still faces significant transition challenges, including:

- Improving infrastructure to support economic activity, enhance regional economic integration and allow further expansion of the SME sector, especially for the development of the tourism sector. Progress in reforms are needed in the transport sector, in access to financing for municipalities and restructuring of the power sector to improve efficiency and security of supply;
- Support for competitiveness and economic diversification, to compensate for possible negative developments in the few existing large industrial concerns and support the creation and strengthening of an extensive network of competitive SMEs as the basis for future economic growth;
- Strengthening the financial system in the post-crisis environment and maintaining adequate access to financing for the private sector and especially SMEs;
- Tackling the high levels of carbon intensity by developing and delivering sustainable energy projects;
- Further improving the business environment to continue attracting foreign direct investments (FDIs) and better management and corporate governance in local companies; and
- Completing the restructuring and privatisation of the few remaining state-owned enterprises and the commercialisation via private concession schemes of key assets, such as ports and airports, to achieve greater efficiency and competitiveness.

The global crisis will have a significant medium-term effect on Montenegro, highlighting the need for growing Bank financing in the coming years, as crisis response and in support of the recovery process. The Bank's focus over the next three years will be on the following operational priorities:

**Infrastructure:** The Bank will continue lending for key infrastructure projects with significant transition impact. Priority will be given to projects in transport, energy and municipal infrastructures with a material impact on regional integration and environmental improvement. The Bank will support corporate restructuring in the electricity, roads, maritime, port infrastructure and railway sectors. The Bank will seek to advance commercial financing to municipalities. Given Montenegro's tight fiscal space, the Bank will enhance its cooperation with the IBRD, the EIB, and the EU, and will work with all partner IFIs in the context of the newly established Western Balkans Investment Framework (WBIF) to consolidate financial resources and raise needed grant funds.

**Financial Institutions:** In the financial sector, the Bank will support commercial banks and microfinance institutions, including with equity investments and with specific products (e.g. risk sharing, energy efficiency) to allow the banks to resume and grow further their lending activities and eliminate their balance sheet mismatches; it will also support the development of the insurance sector. In addition, the Bank will endeavour to provide support to the Deposit Protection Fund, to further strengthen confidence in the banking system.

**Industry, Commerce and Agribusiness:** Given the strategic relevance of economic diversification in the country, the Bank will invest in all sectors where local SMEs can have competitive advantages and where there is a prospect of regional expansion. Given the limited size of local SMEs, this will mostly be done through financial intermediaries, the EBRD – Italy Local enterprise Facility (LEF) and the Western Balkans Sustainable Energy Direct Financing Facility (WeBSEDF). Montenegro's tourism and property sector is one of the areas where the Bank will play an important role by providing funding to both foreign and local investors, and by supporting SMEs connected to the industry.

Across sectors and in view of the high carbon intensity in Montenegro, the Bank will intensify its activities under the Sustainable Energy Initiative in energy efficiency and renewable energy projects, including through the Western Balkans Sustainable Energy Credit Line Facility (WeBSECLF) and the WeBSEDF.

In carrying out the above priorities, the Bank will continue to co-ordinate very closely with other IFIs, the EU, other key international actors and the international donor community, especially in the context of the WBIF. The Bank is an active participant in the donor coordination and will work with donors and the Government to link TC and grant co-financing to its priority investments in transport, energy and municipal projects.

## 1. THE BANK'S OPERATIONS TO DATE AND CURRENT PORTFOLIO

### 1.1 Overview of Activities to Date

As of December 31, 2009, the Bank had made commitments in total of €102.9 million (€4.9 million debt and €7.9 million equity) in Montenegro. The largest share of the portfolio is in infrastructure (71 per cent) followed by the financial (16 per cent) and the corporate (14 per cent) sectors.

The majority of the Bank's commitments are to the State (€74.9 million) while private ones are €28.0 million. The current portfolio is €88.7 million.

**Table 1: Bank's Portfolio in Montenegro as of end March 2010**

SECTOR	NET CUMULATIVE BUSINESS VOLUME				CURRENT PORTFOLIO STOCK				
	Number of projects	Total Project Cost	EBRD signed	Weight by Sector Operating assets	Number of projects	Portfolio	Weight by Sector	Operating assets	Operating assets
<i>Amount in EUR million</i>									
<b>Industry, Commerce &amp; Agribusiness</b>	6	15.8	14	14%	5	11.7	13%	7.6	13%
Agribusiness	2	9.2	8.1	8%	2	8.1	9%	5	9%
Manufacturing & Services	2	4.5	3.8	4%	1	1.5	2%	1.5	3%
Property and Tourism	1	1.6	1.6	2%	1	1.6	2%	0.6	1%
Telecom, Informatics, Media	1	0.5	0.5	0%	1	0.5	1%	0.5	1%
<b>Financial Institutions</b>	9	18.6	16.3	16%	6	8.3	9%	5.2	9%
Bank Equity	1	5.0	3.3	3%	0	0	0%	0	0%
Bank Lending	6	10.5	9.9	10%	4	5.2	6%	5.2	9%
Equity funds	2	3.1	3.1	3%	2	3.1	3%	0	0%
<b>Infrastructure</b>	6	146.2	72.6	71%	6	68.7	77%	45.3	78%
Municipal & Environmental Infrastructure	1	52.5	18	17%	1	18	20%	16.3	28%
Transport	5	93.7	54.6	53%	5	50.7	57%	29	50%
<b>TOTAL</b>	<b>21</b>	<b>180.6</b>	<b>102.9</b>	<b>100%</b>	<b>17</b>	<b>88.7</b>	<b>100%</b>	<b>58.1</b>	<b>100%</b>

### 1.2 Implementation of the Previous Country Strategy

During the previous Strategy period, eleven projects were signed, representing commitments of €62.5 million. The last Country Strategy, approved in September 2007 (BDS/M/09-07), outlined the following strategic priorities for the Bank in Montenegro:

- **Infrastructure:** *Lending for key infrastructure projects where clear transition impact and an emphasis on involvement of a private sponsor wherever possible and with a stress on cooperation with the EIB, the IBRD and the EU; priority was to be given to the tourism and property sectors, in supporting reform in the electricity, utility and transport sectors, and in advancing commercial financing to municipalities.*

The Bank invested €18 million in the Regional Water Supply Project and €30 million in the Montenegro Rail Infrastructure Emergency Project (€15 million for the rehabilitation of the Bar – Bijelo Polje line and financing of the redundancy program, and €15 million for the Rehabilitation of Niksic – Podgorica railway line).

- **FI:** Consolidation and expansion of strong commercial banks and support to micro-lending institutions. In addition, support in energy efficiency was to be provided under the Bank's regional facilities established to support renewable energy and industrial energy efficiency projects to small and medium-sized enterprises in the Western Balkans.

The Bank signed three new transactions totalling €2.3 million: two capital increases in NLB Montenegrobanka (€0.4 million each) and a micro finance credit line to Alter Modus (€1.5 million). In addition, through its investment in the European Fund for SouthEast Europe (EFSE), the Bank has indirectly supported the local banks in Montenegro who have benefited from credit lines provided by EFSE.

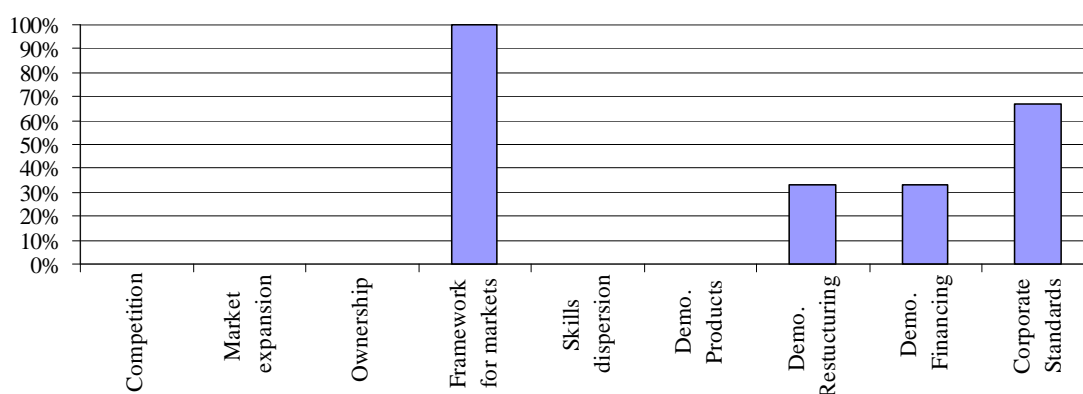
- **Industry, Commerce and Agribusiness:** Promoting investments in local private corporate clients in new technology and environmental improvements; financing of SMEs mainly via LEF; supporting the privatisation process and post-privatisation restructuring, with a particular attention to the tourism and property sectors.

The Bank invested €0.6 million during the previous strategy period in three corporate sector projects through LEF (€5 million for Mesopromet, a meat production company, €3.1 million for Voli, the largest retailer in Montenegro, and €1.5 million for Cosmetics Market, a cosmetics goods retailer).

### 1.3 Transition Impact of the Bank's Portfolio and Lessons Learned

The Bank's investments in the infrastructure, financial, and industry, commerce and agribusiness sectors in Montenegro have supported the introduction of sectoral reforms, strengthened the institutional framework and provided demonstration effects of better standards of business conduct and governance. *Figure 1* below highlights the pursuit of such objective, and in particular shows that all rated projects focused on improvements in frameworks for markets.

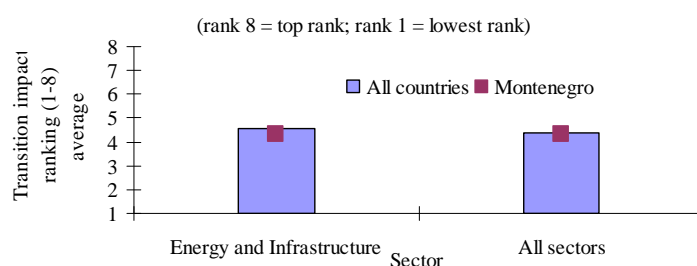
**Figure 1: Percentage of projects pursuing given transition objectives, 2005-2009**



- **Infrastructure:** The infrastructure sector has been a priority for the Bank's investments, with 72 per cent of its portfolio located in the segments of Transport and MEI. Projects in this sector have been rated on average with "Good" transition impact potential. On average, the combination of potential and risk to achieving such potential has been in line with projects across the portfolio, as shown in *Figure 2* below.



**Figure 2: Transition Impact ranking (1-8) of projects in Montenegro**



In Transport, the Bank invested in the reform of the railways sector and rehabilitation of railways infrastructure. Through these loans, tariff reform and improvements to regulatory and institutional development were achieved. The Montenegro Airports Modernisation project, signed in 2003, aimed at the commercialisation of a newly established state-owned airport company with the introduction of tariffs on a full commercial basis and the elimination of cross-subsidisation. With the Montenegro Regional Road Rehabilitation project, signed in 2005, the Montenegro Government approved a new transport sector strategy.

In MEI, the Bank supported the Regional Water Supply Project, signed in 2007. This will provide potable water from Lake Skadar to the municipalities along the Montenegrin coast - a priority project for the development of tourism in the coastal region.

- **FI:** The Bank's involvement in the financial sector has been focused on promoting MSME financing. Starting from 2002, the Bank has developed a long-standing partnership with the then Euromarket Banka (EB) – now part of the NLB Group and renamed NLB Montenegrobanka (NLBM) – which has played an important role in improving the bank's management, operations, business conduct and corporate governance practices and contributed in making it an attractive target for acquisition by a strategic investor. A lesson learnt from the Bank's engagement with NLBM is that difficult macroeconomic environments require viable co-investors that share the same strategy of the Bank. In 2003, the Bank provided a credit line to Montenegro's Opportunity Bank (later acquired by Erste Bank) under the US/EBRD SME framework, which proved to be very successful in stimulating lending activities to the smallest market. The Excellent Transition Impact rating and the Low Transition Risk assigned to this project are remarkable. In addition, the Bank has supported the microfinance sector by providing three credit lines to Alter Modus, of which the first has been completed and rated as "Good" given that all objectives of the project were met and substantial demonstration effects generated.
- **Industry, Commerce and Agribusiness:** In 2003, the Bank funded international consultancy services for the Government through a pre-privatisation loan to KAP, the aluminium smelter, and processed two TC projects for facilitating transparency and environmental requirements in KAP operations. The project faced several difficulties during implementation; however, some notable achievements were made in the area of health and safety, as well as in the environmental legislation and monitoring practices. A lesson learnt from the Bank's project with KAP is that sustainable privatisation needs to take fully into account the environmental costs and

related actions from the planning stage (PE07-384T). During the previous Strategy period, the Bank contributed to the improvement of transparency, corporate governance and environmental standards in a number of local companies (Mesopromet, Voli and Cosmetics Market) financed under LEF.

The Bank's recent commitments in Montenegro are almost fully disbursed and there is little risk to Transition Impact due to cancellation or lack of disbursement of transactions. The quality of the portfolio remains good. At present the average portfolio risk rating is [6W] with no impaired or problematic assets.

#### **1.4 Portfolio Ratio**

The majority of the Bank's commitments are to the State (72.4 per cent). The reason for such a proportion is due to the large needs for improving underdeveloped infrastructure in the country. The number of private sector deals in the forthcoming Strategy period is expected to exceed public sector transactions, but despite the Bank's efforts the very small average private deal size compared to public ones is unlikely to lead to a significant rebalancing of the public/private sector ratio.

## **2. OPERATIONAL ENVIRONMENT**

### **2.1 The General Reform Environment**

#### **2.1.1 Political Developments**

The ruling party, pro-reform Democratic Party of Socialists (DPS), which was the main architect of Montenegro's independence and has been in power ever since, continues to enjoy relatively high level of popular support, which has not been affected much by the global financial crisis. It has further consolidated its power following the return to politics of its long time leader Milo Djukanovic, who became the Prime Minister in February 2008. DPS won convincingly early general elections held on 29 March 2009, which, according to OSCE assessment, "met almost all international standards". A new constitution of Montenegro, which is based on European and international standards, was adopted in October 2007. Among remaining challenges is full harmonisation of the electoral legislation with the new Constitution.

The EU approximation process remains the main external anchor for reform. Montenegro formally applied for EU membership in December 2008. In April 2009, the EU Council invited the European Commission (EC) to submit its Opinion regarding this application, which is being prepared and expected in the second half of 2010. According to the latest annual progress report on Montenegro and the Conclusions of the EU Council of 8 December 2009, Montenegro made progress in many areas, but needs to strengthen administrative capacity and to do more in the area of the rule of law, including the independence of the judiciary, and show sustainable results in the fight against corruption and organised crime.

The country has managed to maintain balanced relations with its neighbours and actively participates in cross-border projects and regional cooperation, including the South Eastern Europe Cooperation Process (SEEC) whose chairmanship it holds in 2010.

### **2.1.2 Business Environment**

Montenegro has had some success in creating a favourable business climate and in attracting reputable foreign investors. This is reflected in the World Bank Doing Business Index 2010, which ranks Montenegro 71<sup>st</sup> out of 183 countries surveyed (77<sup>th</sup> in the previous year). Montenegro performs better than most countries in the Western Balkan region however lags behind the new EU member states. The Council for the Elimination of Business Barriers, established in mid-2008, adopted several measures to simplify administrative procedures, such as the establishment of an electronic company register. In addition, Montenegro introduced a new construction law and brought some labour market laws in line with EU *acquis*. During the first half of 2009, in spite of the global economic crisis, registration of new enterprises continued at a rate only slightly lower than in 2008.

Notwithstanding this substantial progress, further efforts are needed to strengthen the investment climate. Data from the latest Business Environment and Enterprise Performance Survey 2009 (BEEPS 2009) highlights that several obstacles still affect the operation of business in the country, including electricity supply, access to finance, business licensing and permits, practice of competitors in the informal sector and tax rates. According to the Transparency International Corruption Perception Index 2009 (CPI), Montenegro is ranked as 69<sup>th</sup> out of 180 countries, and with CPI score of 3.9 is positioned better than any other Western Balkans country. This is an improvement from the CPIs of the previous years. However, corruption remains a problem that affects business operations.

One sector where much remains to be done is infrastructure. Montenegro suffered from a decade in the 1990s of limited investment and widespread neglect of vital infrastructure such as roads, railways, municipal environment and power supply. While power supply from domestic generation is below the level of demand, subsidies on electricity prices to the two biggest industrial companies, especially to KAP (where subsidies have been recently renewed), materially distort the market and hinder the development of other economic activities.

### **2.1.3 Physical Environment**

The geography of Montenegro is mostly mountainous with elevations in excess of 1,000 meters with a narrow coastal plain adjacent to the Adriatic Sea. Inland much of the country is forested and around 15 per cent is used for agriculture. Notable geographic features include Lake Skadar, which has Ramsar protected wetlands, and the Bay of Kotor, which is a UNESCO World Heritage Site.

The constitution of Montenegro established the country as an “ecological state”. It has applied for membership of the European Union and is harmonising its environmental legislation with EU requirements. The national requirements for Environmental Impact Assessment are modelled on EU legislation and include provisions for public hearings and consultation.

The Ministry for Environment and Spatial Planning has overall responsibility for environmental legislation and administration within Montenegro. The Ministry regards the natural environment of the country as a strategic resource and a potential competitive advantage over other countries, particularly with regard to tourism. The

current priorities of the Ministry include urban regeneration, addressing the problem associated with unregulated development, and improving infrastructure for solid waste and wastewater treatment. Day-to-day management and supervision of environmental issues is delegated to the Environmental Protection Agency (EPA).

There is a high degree of agreement amongst stakeholders in Montenegro as to the main environmental challenges and opportunities for Montenegro. The main challenges identified are:

- *Environmental Awareness:* There is a widespread consensus that awareness of, and interest in, environmental issues is low amongst the general population.
- *Enforcement:* The legislative framework in Montenegro is well developed and comparable to EU members. Enforcement of this legislation still appears to be lacking in many cases.
- *Industrial Pollution:* Montenegro has a small number of large industrial sites that are highly polluting but also vital to the local economy. The Government appears to be adopting a pragmatic strategy of engagement and incremental improvement, and the World Bank is providing assistance.
- *Waste Management:* There is a clear need for investment in waste management infrastructure, both for solid waste landfill sites and waste water treatment. This has been identified as a priority by the Government.
- *Illegal developments:* The Government estimates that there are between 40,000 and 80,000 illegal developments in the county. The Ministry is investigating the possibility of bundling small loans to home owners to fund upgrades to these buildings.
- *Lack of data:* Proper environmental management is hampered by a lack of data on the current state of the country's ecology and land use. The lack of data on land registration also creates significant uncertainties for potential project developers and can hinder economic growth.

Despite these problems, Montenegro does have some structural advantages that will help it to address its environmental issues. As a new country, established in 2005, it has been able to start from a relatively clean slate in terms of environmental legislation and enforcement mechanisms. The country has adopted a sensible, forward-looking strategy in modelling its regulations on the EU and in actively engaging with the European Environment Agency. The proposed move towards an IPPC-style framework for industrial pollution control is another positive step. The importance of its natural environment to Montenegro's tourist industry and, consequently its economic development means that environmental protection is aligned to some extent with economic and social interests.

#### **2.1.4 Legal Reform**

Montenegro has made significant changes to its legal system in recent years, with the aim of attracting foreign investment and harmonising its legal system with EU requirements. The most important legislative acts adopted in recent years include laws governing business activities and corporate governance, public procurement, insolvency, securities and capital markets and secured transactions. Another example of legislative acts designed to support the business environment reform is the Law on Concessions enacted in 2009, whose primary objective was to approximate local laws

regulating private sector participation in public projects with those of the EU's. However, the new law has attracted criticism of the EU Commission, which was concerned, in particular, with the public authorities' ability to award concessions for large infrastructure projects of strategic importance without competitive procedures.

A new constitution of Montenegro was adopted in October 2007. The new Montenegrin constitution is in line with European standards, especially in the fields of human and minority rights, judiciary, national defence and security forces control. In addition, the Government of Montenegro has been conducting a wide-ranging judicial reform program in recent years. As part of this program, the Law on Judicial Council was adopted in 2008, which confers the rights to elect, promote and dismiss judges on the Judicial Council.

Despite significant progress towards the establishment of a free market-oriented economy and stable democratic institutions, the Government of Montenegro is still facing numerous challenges on its path. The Montenegrin Government needs to focus on improving its administrative capacity to be able to implement and enforce its newly adopted legislation aiming at such key areas as capital markets, free movement of goods, competition, and public procurement. In addition, special efforts are required in the areas of justice, freedom, security and eradication of corruption and organised crime, which remain a serious problem.

## **2.2 Progress in Transition and the Economy's Response**

### **2.2.1 Macroeconomic Conditions for Bank's Operations**

Montenegro experienced several years of sustained economic growth owing to a buoyant domestic demand fuelled by record FDI inflows and rapid credit growth. After achieving about 11 per cent growth in real terms in 2007, Montenegro's economy continued to grow in 2008, with real GDP growth estimated at 7 per cent. On the supply side, services continued to drive growth. Credit provided by the banking sector continued to expand fuelling the boom of the economy. Following a record credit growth at 175 per cent in 2007, credit growth reached 85 per cent in 2008. As a result of the rapid expansion, Montenegro accumulated very large external imbalances, with current account deficit reaching 30 per cent of GDP in 2007 and about 34 per cent of GDP in 2008, mostly financed by FDI inflows. Demand-driven inflationary pressures built up, with inflation reaching 7.4 per cent in 2008, from about 4 per cent in 2007. On the other hand, Montenegro enjoyed a very comfortable fiscal position for several years. After a record fiscal surplus of more than 6 per cent of GDP in 2007, the fiscal balance recorded a surplus estimated at 1 per cent of GDP in 2008.

Montenegro's economy was severely affected by the global financial and economic crisis. The impact of the crisis started to be felt in the last quarter of 2008 and fully unfolded during 2009. Real GDP contracted by an estimated 5.3 per cent, with industrial production contracting by about 32 per cent year on year in 2009, following the sharp contraction in mining and manufacturing activities. Furthermore, real growth in the construction and tourism sectors is estimated to have significantly slowed down. Demand-driven inflationary pressures eased, with inflation slowing down to 3.4 per cent year on year in 2009.

Following the negative impact of the crisis on domestic growth, Montenegro's external imbalances significantly reduced. The current account is estimated to have contracted to about 27 per cent of GDP in 2009. Imports contracted by about 34 per cent year on year in 2009 while exports declined by 35 per cent year on year. However, despite the weak external environment, FDI inflows in the Montenegrin economy continued to be strong as FDI inflows increased by about 31 per cent in 2009. This upsurge mostly reflected the successful partial privatisation of EPCG, the state-owned national power utility, to the Italian company A2A in September 2009.

Montenegro's fiscal policy turned into expansionary in response to the crisis. After years of fiscal surpluses fuelled by the booming economy, the overall fiscal balance turned into a deficit to about 3 per cent of GDP in 2009. The Government implemented a fiscal stimulus package to support the economy. The package included an increase in capital expenditures, a reduction in the rate of social contributions, the elimination of certain fees and subsidies for electricity payments for SMEs and households. In addition, the partial re-nationalisation of KAP was approved, with the state acquiring a 29 per cent stake in the plant and a 31 per cent stake in the related Niksic Bauxite mine in exchange for a guarantee worth €135 million. As a result, public debt increased to 39 per cent of GDP in 2009 from 29 per cent of GDP in 2008.

The Montenegrin banking sector was severely hit by the global financial crisis which revealed the vulnerabilities of the system related primarily to the strong reliance on the real estate/construction sector which came almost to a halt in 2009 and the banks' balance sheet structural mismatches. However, the measures taken by the Montenegrin authorities managed to avoid the collapse of any bank. A slowdown in the banking sector became apparent in the last quarter of 2008 and accelerated dramatically in 2009. After years of booming lending, banking sector's credit to the economy contracted by 14.3 per cent year-on-year in 2009, with non-performing loans rising to 13.5 per cent in December 2009. An episode of sudden loss of confidence in the banking system took place in October 2008, with households withdrawing about 12 per cent of their deposits. The authorities implemented several measures to prevent a liquidity crisis and stabilise the banking system, including a law authorising the Government to provide direct support to banks, in the form of credit lines and re-capitalisation. The Government provided such support in two cases: a loan of €14 million to bail out the financially troubled Prva Banka, and a guarantee of €150 million to cover KfW and EIB loans to Montenegrin banks to finance SMEs.

Despite the short-term sharp contraction in real growth, the medium-term outlook for Montenegro remains positive. The recovery is expected to be slow, with real GDP growth forecast to decline by 0.1 per cent in 2010. FDI inflows and resumed credit to the private sector are expected to support domestic demand in the coming years. In addition, external demand is expected to pick up moderately following the recovery in the Euro area. The recovery is expected to gain strength in the medium term, reflecting a stronger pace of consumption and investment.

### **2.2.2 Transition Success and Transition Challenges**

Montenegro successfully implemented several structural and institutional reforms since starting the path to a market economy in the late-1990s. So far, reforms have advanced well in several areas, notably price and trade liberalisation, privatisation and financial sector. The main remaining transition challenges include:

- Improving infrastructure to support economic activity, enhance regional economic integration and allow further expansion of the SME sector, especially for the development of the tourism sector. Reforms are needed in the transport sector, in access to financing for municipalities and restructuring of the power sector to improve efficiency and security of supply;
- Support for competitiveness and economic diversification, to compensate for possible negative developments in the few existing large industrial concerns and to support the creation and strengthening of an extensive network of competitive SMEs as the basis for future economic growth;
- Strengthening the financial system in the post-crisis environment and maintaining adequate access to financing for the private sector and especially SMEs;
- Tackling the high levels of carbon intensity by developing and delivering sustainable energy projects;
- Further improving the business environment to continue attracting foreign direct investments (FDIs) and better management and corporate governance in local companies; and
- Completing the restructuring and privatisation of the few remaining state-owned enterprises and the commercialisation via private concession schemes of key assets, such as ports and airports, to achieve greater efficiency and competitiveness.

**Infrastructure:** Increased private sector participation should be encouraged in the transport sector. In the road sector, responsibility for primary and secondary roads as well as for motorways was retained at the central level, while the responsibilities of community roads were transferred to municipalities. The road maintenance company was privatised in 2003, but it remains a monopoly. Road user charges were introduced and are sufficient to cover maintenance and rehabilitation costs, however, they form part of the budgetary income with partial annual transfers for road expenditure subject to annual Governmental approvals – the sector does not have as yet an independent dedicated stream of revenues under its direct control. A new concession law came into effect in February 2009 and was tested during the tendering for the PPP contract for the Bar-Boljare motorway. However, the transaction has not yet closed and the implication of this PPP for the legislative and policy framework will need to be further assessed.

Several reforms were implemented in the railways sector. The Government adopted a restructuring plan in line with EU directives and track access was given to third parties. Labour restructuring progressed and efficiency generally improved. Through the support of the Bank, the Railways Infrastructure Company (ZICG) in 2008-09 reduced its workforce by 300 people, introduced a Network Statement and tariffs for the use of tracks, managed to renew most of the critical sections of the main railway line towards Serbia. However, ZIGC is still loss-making and continues to receive large state subsidies. The Government is considering a concession of the real estate part of the company and it has also issued a tender for the privatisation of the Railways Cargo Company (MonteCargo).

Continuing power sector restructuring remains a priority reform to improve the electricity supply and support economic activity, especially in the tourism sector. Montenegro has made considerable progress in restructuring its power sector, notably through full legal unbundling of the transmission system operator and the introduction of the Italian utility A2A as a major investor and manager of the vertically integrated

electricity company EPCG. The power sector is still dominated by EPCG and Montenegro faces major challenges in a number of areas. These include investing in generation to meet growing demand and bring the existing coal fired plant at Pljevlja into compliance with EU environmental standards, reducing network losses from the current high levels, introducing a support mechanism for renewable energy and facilitating the construction of renewable energy plants, improving the tariff framework to reduce cross subsidisation, and in liberalising the sector in order to facilitate supply competition. In addition, Montenegro has the opportunity to become an important node in the regional power market, principally through the proposed high voltage interconnection to Italy and the related connections to neighbouring countries – the realisation of this project will have important benefits for the whole Balkans.

Full corporatisation of water utilities, tariff reform and improved contractual arrangements both in the water and urban transport sector remain to be addressed. Local infrastructure has been transferred to municipalities but water utilities are normally not converted into joint stock companies. Tariffs are set by municipalities without a transparent price formula, which together with weak contractual arrangements make tariff setting and operational targets subject to political interference. Cross-subsidies between consumer groups are still widespread.

**Financial Institutions:** Maintaining the necessary supply of credit to the private sector, especially to MSMEs, is key. The banking sector is dominated by foreign banks. This has intensified competition, although the sector remains highly concentrated. The banking sector has been growing very rapidly in the years prior to the crisis, with credit growth reaching record levels of more than 100 per cent p.a. in 2006 – 2008. The necessary banking sector supervision and regulation have been put in place. The Montenegrin banking sector was severely hit by the global financial crisis. The authorities responded promptly preventing a liquidity crisis or the collapse of any major bank. The banking system is liquid and foreign banks have remained committed to supporting their subsidiaries in Montenegro. However, the commercial banks have tightened their lending standards and credit to the private sector has shrunk significantly. Furthermore, the banking system is weakly capitalised and deposit protection schemes need to be further strengthened. Therefore, strengthening the banks' capitalisation, providing them with adequate funding sources and improving private sector access to financing remains one of the main challenges on the way towards economic recovery.

The non-banking financial sector is still at an early stage of development. Insurance penetration remains modest and there are currently no private pension funds operating in the country. Insurance legislation and regulation fall somewhat short of the IAIS standards. The leasing market has been largely developed in recent years. A commercial private equity sector is yet to develop and to date the country has not attracted significant interest of international private equity funds.

**Industry, Commerce and Agribusiness:** Montenegro's corporate sector is dominated by only two main industrial producers, KAP and Niksic Steel. This renders the country highly vulnerable to their economic viability and it is therefore of the utmost importance that Montenegro accelerates and intensify actions for economic diversification. SMEs will play a critical role in such diversification process in all sectors, but in particular in those connected with the tourism industry. This will also be possible by maintaining adequate access to financing for the private sector and especially SMEs. Privatisation is



well advanced in Montenegro, with about 85 per cent of state assets having been privatised. However, in July 2009, the Government approved the partial re-nationalisation of the financially troubled KAP, and the related Niksic Bauxite mine. Completing the privatisation of the few remaining state-owned enterprises and the commercialisation via private concession schemes of key assets, such as ports and airports to support greater efficiency and competitiveness, will be important.

Further efforts are needed to improve the business environment and continue attracting FDIs. Montenegro has had some success in creating a favourable business climate and in attracting reputable foreign investors. Several measures have been introduced to improve the business environment but obstacles affecting businesses remain. According to the BEEPS 2009, the lack of supply of electricity is the most severe hindrance to business operation, closely followed by access to finance, business licensing and permits. Finally, corruption continues to affect the business environment in Montenegro and remains a challenge to business operations.

Improvements in infrastructure and availability of long-term financing remain key for the development of the property and tourism sector. The market for modern commercial property is at early stages of development. A number of experienced real estate developers and investors are considering entering the market in a wide range of asset types including office, hotel, retail, industrial and housing (permanent and holiday homes). However, progress is inhibited by the lack of adequate infrastructure and the non-availability of long-term financing.

### **2.3 Access to Capital and Investment Requirements**

On 30 April 2009, Moody's downgraded Montenegro to Ba3, as the outlook remained negative, while Standard & Poor's confirmed their BB+ rating. Industrial output is on a downturn, having dropped 31.6 per cent in the January–October period compared to the same period of 2008. In contrast, tourism increased slightly by 2.2 per cent. In the course of 2009, the Government has borrowed €90 million from Credit Suisse and €30 million from Erste Bank for budget support. Financing has been difficult for private sector corporates to obtain except at very high prices compared to the Euro base rate. The Government is considering its first Eurobond issue in the first half of 2010.

## **3. STRATEGIC ORIENTATIONS**

Economic diversification is the key strategic objective for Montenegro. This will allow a reduction of its dependence on large industrial assets via the development of key sectors for long term growth, in particular manufacturing and service sectors linked to tourism. Investment in a few, selected tourism projects will have an excellent demonstration effects in terms of sustainability and low environmental impact (low density/ top end). Given the scale of local enterprises, most of the investments in the private sector will be via LEF.

A precondition for private sector development and tourism in particular, is the presence of a solid infrastructure which will require investments in municipal and environmental projects. The Bank continues its engagement in the infrastructure sector in roads and railways, municipal infrastructure, and electricity. Given the very limited fiscal space and the great extent of needs, the Bank will intensify its cooperation with partner IFIs.

This will also be possible within the context of the WBIF. Whenever possible, the Bank will seek to provide funding on a non-sovereign basis.

Considering that energy and carbon intensity are high in Montenegro, the Bank will focus on energy efficiency and sustainable energy projects. Therefore, investment opportunities will be pursued through the WeBSECLF and the WeBSEDF, as well as larger-scale investments in the power generation sector and the electricity transmission, and distribution networks. In addition, the Bank will look to support projects which enhance Montenegro's connections to other countries, reflecting both its important location in the regional network and the small size of its domestic power sector.

In the financial sector, the Bank will focus on continuing its support to commercial banks and microfinance institutions, including with equity and with specific products to allow the banks resume and grow further their lending activities (e.g. risk sharing and energy efficiency). In addition, the Bank will endeavour to provide support to the Deposit Protection Fund, as a way to further strengthen confidence in the banking system.

### **3.1 Bank's Priorities for the Strategy Period**

While the Bank will continue to focus on investments in the private sector, the portfolio ratio will only increase over the medium term, but it is unlikely to do so during this strategy period. This reflects the considerable infrastructure investment needs in Montenegro, as well as the small size of private companies. However, in terms of number of transactions, private sector deals will likely dominate the Bank's activity during the forthcoming Strategy period.

The Bank will continue and intensify its policy dialogue with the authorities, with the objective of accelerating reforms and have a greater transition impact. Policy dialogue will cover different areas, among which the following should be noted:

- Improvement of business environment to allow a further strengthening of local companies, especially SMEs, and their competitive position, with the view of supporting a greater economic diversification in the country. In this context, the Bank will engage in supporting the Government to take transparent actions for the completion of outstanding privatisations and the resolution of unresolved issues on existing industrial assets.
- Support the EU accession process, by providing project-based reform agendas which fit the process of EU approximation, especially in areas such as restructuring of public sector companies and concessions of public assets in infrastructure and tourism.
- Robust effort to tackle energy security and energy efficiency issues, by promoting reform agendas and a more conducive environment for renewable and energy efficiency projects via dedicated resources available under existing facilities.
- Allocation of fiscal space which, given the tight limits, should transparently and consistently be allocated on priority projects that are key for regional integration. The Bank will endeavour to work with its partners within the WBIF to achieve a consistent co-ordination on project prioritisation and planning.

## 3.2 Sectoral Challenges and Bank Objectives

### 3.2.1 Infrastructure

**Transition goals:** Increase the country's regional integration within the Western Balkans, by focusing on critical regional projects in transport (especially on main pan-European road corridors) and energy (in view of the need to develop and execute the South-Eastern Europe Energy Community). Improvement in priority transport infrastructure (road and rail network as well as strengthening of port and airport accessibility) and increase in private sector participation, especially through competitive award of PPP contracts. Restructuring of the power sector and support private sector involvement. Corporatisation of water utilities and tariff reform at the municipal level.

#### **Operational priorities:**

**Transport:** The Bank will continue to support the upgrading of transport networks in Montenegro with emphasis on regional linkages and regional integration, in order to facilitate trade and economic growth and will also review opportunities to develop viable logistics activities linking key transport modes. Where appropriate and feasible, the Bank will support greater involvement of the private sector in the development of transport infrastructure, for example, through PPPs or other forms of concession financing in the port and road sectors. This could also include financing of public and/or private investments in facilities focusing on distribution and logistics associated with ports, road and rail terminals.

**Energy:** The Bank will work with the vertically integrated electricity company EPCG to finance needed investments and will work with the Government to identify possible investments in generation and to work for compliance with EU environmental standards. Montenegro has the opportunity to become an important node in the regional power market, principally through the proposed high voltage interconnection to Italy and the related connections to neighbouring countries – the realisation of this project will have important benefits for the whole Western Balkans. Given the very high carbon intensity, energy efficiency will be a priority area for the Bank, especially via the WeBSECLF and the WeBSEDF.

**Municipal and Environmental Infrastructure:** The Bank will capitalise on the successful case of the Regional Water Supply Project, including the high level of co-operation among IFIs and donors, to develop further its involvement in municipal financing. The ability of the Bank and commercial lenders to finance municipal infrastructure is restricted due to limited project size and financial weakness of local Governments and utilities (which do not have sufficient budgetary independence/revenues to achieve cost recovery). However, the Bank will aim at identifying a few best municipalities and pulling grant resources through the WBIF to address affordability and fiscal space issues.

### 3.2.2 Financial Institutions

**Transition goals:** Improve the availability of risk capital and long term funding for private businesses, targeting in particular the SME sector, and energy efficiency and renewable energy projects. Further strengthening of the regulatory environment,

including the Deposit Protection Fund. In light of uncertainty arising from the global financial crisis and its impact on the banking system, eliminate balance sheet mismatches, support the banking system's capitalisation and provision of credit via partner banks and non-bank MFIs to the private sector, including for sustainable energy investments provide appropriate policy and funding responses should banks require support.

**Operational priorities:** The Bank is actively monitoring its existing bank partners and remains in dialogue with the Central Bank to ensure that it can quickly respond should there be a greater need for funding and/or capital. In particular, the Bank may be called upon to extend equity, quasi-equity and debt investments to banks which until now have been able to rely on deposit growth to fund balance sheet growth. Banks have become more risk-averse and are seeking greater diversification of portfolios. In this environment, the Bank will intensify its efforts to offer risk sharing products which aim to ensure continued lending to the real economy while at the same time strengthening the banks' risk profile and their lending policies and procedures.

As one of the major challenges will be to maintain the level of lending and thereby ease the impact of the crisis, the Bank will seek to design adequate lending products, where possible coupled with donor funded subordinated resources, to support SME development as well as energy efficiency and renewable energy projects. Whenever needed, these investments will be coupled with technical assistance for a more efficient way of delivering the transition impact in the post crisis environment.

The Bank will engage with the Deposit Protection Fund to increase overall confidence in the banking system and will provide adequate TC resources support local authorities to improve the banking regulatory framework, including for supervision.

### **3.2.3 Industry, Commerce and Agribusiness**

**Transition goals:** Economic diversification is the key strategic objective for Montenegro and this can be achieved through the expansion of the country SME network. This will allow a reduction of its dependence on large industrial assets and the support to emerging sectors such as tourism. Enhancement of transparency and corporate governance of local enterprises will be key factors for their expansion. Complete the privatisation of the few remaining state-owned enterprises and further improvement in the business environment to continue attracting FDI are also important transition objectives.

**Operational priorities:** The Bank will seek to expand its investment activities in sectors where Montenegro companies have relative export advantages or where it is currently dependent on imports. These include agribusiness (including processing, logistics and retail distribution, and local food processing companies that could supply and cater for the hospitality industry), light manufacturing, retail, property and construction materials. In particular, the Bank will seek to support sectors connected to the growing tourism sector in order to make it viable on a long-term basis. The Bank will support projects in the tourism sector, including the development of low-density.

High-end tourism projects, with strong backward linkages. The property sector has experienced a shake-out due to the crisis. However, the sector will remain important for the country and the Bank will look at prospective investments. LEF and the

WeBSEDF will be effective mechanisms to finance viable local enterprises. TAM/BAS will be instrumental to strengthen the institutional capacity of local companies.

#### 4. COOPERATION WITH THE EUROPEAN UNION

The European Union is playing important role in Montenegro political and social development, as a part of the accession process. Montenegro signed the Stabilisation and Association Agreement on 15 October 2007 and submitted an application for EU membership on 15 December 2008. As of 19 December 2009 EU visa were altered, allowing Montenegro's citizens visa-free access to all 25 Schengen member states within the Union.

Financial assistance has been provided under the new Instrument for Pre-Accession (IPA) from 2007. The IPA is a single and unified pre-accession program, replacing PHARE, ISPA and SAPARD. The IPA programme is concentrated on institution building and preparation for the implementation of the EU's common agricultural policy and cohesion policy. IPA has a budget for the first three years of almost €100 million for Montenegro. The IPA programme has two components:

- **Transition assistance and institution building** – examples: fight against corruption / police reforms, justice and prison conditions, labour and safety at work, environmental protection railways, enhancing capacities of the civil society and media, technical assistance in development of selected areas of statistics, public finance, taxation, procurement; and
- **Cross-border co-operation** – the main strategic document is: IPA Adriatic cross border co-operation 2007 – 2013 program, signed by Montenegro, Croatia, Italy, Greece, Serbia, Bosnia and Herzegovina, Albania, and Slovenia.

**Table 2: Montenegro Indicative Financial Allocation per Component in EUR Million**

Component	2007	2008	2009	2010	2011	2012
Transition Assistance and Institution Building	27.4	28.1	28.6	29.2	29.8	30.4
Cross-border Co-operation	3.9	4.4	4.6	4.7	4.8	4.9
<b>TOTAL</b>	31.4	32.6	33.3	34.0	34.7	35.4

In response to the economic crisis, an IPA **crisis package** has been created, comprising EUR 200 million for the Western Balkan region which are expected to leverage investments of at least €1 billion, co-financed by the partner financial institutions. The country will benefit from a share of multi-beneficiary funds for competitiveness, SMEs, energy efficiency and banking sector regulation. In addition, the country benefits from Montenegro-earmarked multi-beneficiary funds to accelerate the infrastructure investments.

## **5. OTHER IFIS AND MULTILATERAL DONORS**

The Bank maintains a good relationship with other IFIs. Joint financing opportunities are regularly discussed and evaluated and to date the Bank has implemented joint operations with all IFIs and is working closely with the EU, which is taking the leading role in terms of TC for reforms and institutional strengthening. The WBIF provides an important tool to consolidate financial resources and instruments at the European level and enhance the cooperation with the EU, EIB and CEB, in particular on infrastructure projects, but increasingly also in other sectors such as SMEs and energy efficiency. In the previous Strategy period, the Bank has co-financed transactions with both EIB and the World Bank. In addition, the Bank is working closely with the Government of Montenegro and the EU to prepare projects which will fit the priorities and meet the criteria for EU IPA grant co-financing.

### **5.1 European Investment Bank (EIB)**

EIB started operations in Montenegro in 2001 when Montenegro was still part of FR Yugoslavia (Serbia & Montenegro) and has become a significant lender for public sector infrastructure and to the financial sector. As of end of 2009 EIB's total exposure in Montenegro amounted to €205 million out of which €93 million (45 per cent) in lines of credit through local banks, €77 million (38 per cent) for transport infrastructure (roads, railways and airports), €32 million (16 per cent) for environment, and €3 million (1 per cent) for energy.

The EIB priorities are the environmental sector (waste water treatment) and transport infrastructure sector (motorways and railways). In 2008 and 2009 EIB's activities were mainly focused on lines of credit through local banks (€84 million), transport (€42 million) and environment (€32 million). The largest loans were for road and bridge rehabilitations (€30 million), credit line for Hypo Alpe Adria Group Montenegro (€30 million) and solid waste management (€27 million).

### **5.2 World Bank Group**

Montenegro became a member of the World Bank Group on 18 January 2007. The investments of the World Bank Group in Montenegro have been made through the International Bank for Reconstruction and Development (IBRD) or the International Finance Corporation (IFC).

#### **5.2.1 International Bank for Reconstruction and Development (IBRD)**

In Montenegro the IBRD has supported 15 projects of a total value of USD 123 million. Nine of these projects to the amount of USD 76 million are still active. The most important ones are institutional development and strengthening of agriculture (USD 15.7 million), land administration and management (USD 16.2 million), two projects in energy (USD 18.4 million), healthcare system (USD 14.1 million), pensions and environment. These investment are in line with the base case financing scenario to support the Government's overall reform program in key areas, such as energy sector, solid waste management, and reform of health and pension services.

The IBRD has provided twelve loans to Montenegro to the total amount of USD 83 million. The grants have been approved from the Global Environmental Facility (GEF) and the Institutional Development Fund (IDF).

The most important project in IBRD pipeline is USD 85 million worth Financial Sector Development Policy Loans (FPDPLs). This should be used in support of a banking sector reform program with the aim of maintaining satisfactory macroeconomic framework, restoration of stability in the banking sector and strengthening its resilience to future shocks.

### **5.2.2 International Financial Corporation (IFC)**

Since Montenegro became a member in 2007, IFC has committed some 46 million of its funds. IFC's investment in the country has been in the financial and general manufacturing sectors.

Besides loans, IFC's activities in Montenegro comprise several advisory projects on corporate governance, international standards, alternative dispute resolution, and preparation of the feasibility study for the highways.

### **5.3 International Monetary Fund (IMF)**

Montenegro joined the IMF in January 2007. During the latest consultations held in February 2010, between the Government and Central Bank officials and the IMF, several key risks for the country's stability were detected: wage and cost competitiveness erosion, a high current account deficit, weakness of the banking system, large public sector employment and comparatively high wages, spending on social transfers and poor statistics on international trade and national accounts. The IMF representatives have suggested the following measures: tightening public finances, particularly tackling large public sector employment and broadening the tax base, strengthening of the Central Bank's supervisory and regulatory vigilance, labour market deregulation, carrying out structural reforms, improve business environment.

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## **ANNEX 1: POLITICAL ASSESSMENT**

Montenegro is committed to and applying the principles of multiparty democracy, pluralism and market economics in accordance with the conditions specified in Article 1 of the Agreement establishing the Bank.

Montenegro has continued to make progress on key political reforms, geared towards integration into the European Union. Its progress in EU approximation culminated with formal application for membership submitted in December 2008. Democratic institutions in Montenegro are robust, with the functioning separation of powers. Elections are generally conducted in a manner deemed by the OSCE and the Council of Europe to be free and largely in line with international standards, although increasing public confidence in the elections remains a challenge given frequent, even if unsupported, allegations of electoral misconduct.

Political stability increased in the aftermath of the adoption of the new Constitution, which is based on European and international standards, in 2007. It has been further maintained by relatively high level of popular support enjoyed by the ruling political party, pro-reform Democratic Party of Socialists, which was the main architect of Montenegro's independence and has been in power ever since. The global financial crisis has not eroded popular support for the Government's overall pro-reform course.

### **Elections**

The existing legal framework enables an adequate basis for the conduct of democratic elections. The key challenge is removing remaining inconsistencies in the electoral legislation and its full harmonisation with the new Constitution, the work that is currently ongoing.

Reports from previous elections in the country (OSCE Office for Democratic Institutions and Human Rights – ODIHR - observed elections in 2006, 2008 and 2009) noted relatively low public confidence, highlighted by frequent, even if unsupported, allegations of blurring of state and party structures, pressure on voters, fraud and other electoral misconduct.

The latest general elections were held on 29 March 2009. The new Constitution, adopted in 2007, envisaged new parliamentary elections by the end of 2009, but the Government decided to go for early elections seeking a renewed mandate in order to carry out necessary anti-crisis measures and key reforms related to EU integration. According to OSCE/ODIHR Election Observation Mission, these early elections, despite some remaining shortcomings, "met almost all OSCE and Council of Europe commitments". Overall the elections were organised professionally, the voting went in a peaceful atmosphere, and the counting and tabulation were conducted orderly.

In accordance with the Election Law, the allocation of mandates was done on the basis of a proportional list system within a single nationwide constituency, while several mandates were allocated to a 'special' constituency in areas populated primarily by ethnic Albanians. The governing coalition led by DPS and its junior coalition partner SDP (for these elections they were also joined by an ethnic Croatian (HGI) and an ethnic Bosniak (BS) parties) further consolidated their lead in the Parliament as compared to the first post-independence elections in 2006. DPS-led governing coalition

now has 59 per cent of mandates in the Parliament; its representative also won the presidential elections in 2008.

### **Rule of Law**

In the past few years since independence the authorities have made progress in setting up new administrative structures, reform of public administration and the strengthening of the rule of law. The legal framework has been strengthened, but further efforts are needed to empower the independence of judiciary and to improve co-ordination of law-enforcement agencies. The overall administrative capacity remains limited, highlighted, inter alia, by lack of human and financial resources alongside structural weaknesses. Establishing a stable, professional and merit-based civil service and further reform of public administration remain among top priorities of the authorities and a key requirement for further progress in EU integration.

Significant progress has been achieved in the integrated border management, on issues of migration, asylum, and visa policy, where authorities actively cooperate both with the EU and their regional neighbours. Sustained efforts designed to implement reforms required to reach the benchmarks of the roadmap for visa liberalisation resulted in inclusion of Montenegro among the first three Western Balkan countries to which the Council of EU decided to grant visa free travel to and through the Schengen area starting from 19 December 2009.

The authorities have made progress over the last years in strengthening the legal and administrative capacity to fight organised crime. Progress has been made in enhancing preventive and investigative anti-corruption bodies. According to the Transparency International Corruption Perception Index 2009 (CPI), Montenegro is ranked as 69 out of 180 countries, and with CPI score of 3.9 is positioned better than any other Western Balkans country. This is an improvement from the CPIs of the previous years. However, corruption remains widespread and affects business operations.

### **Protection of Civic and Human Rights**

Montenegro is a signatory to all major international human rights instruments. The Constitution and relevant laws prohibit discrimination on grounds of sex, race, language, religion, national or social origin, property or social status. The Constitution guarantees the basic freedoms and rights of citizens recognised in international law, while international treaties are directly enforceable by domestic courts and their status superior to the domestic law. The constitutional guarantees of freedom of thought, conscience and religion are generally respected.

The country has been assessed in the latest report by Freedom House as regards political rights and liberties for the first time as 'free' (previously was ranked as 'partially free'). The Government has not interfered in the continuing dispute between the Serbian Orthodox Church (SOC) and the Montenegrin Orthodox Church (MOC) on the canonical status of the latter, which remains unrecognised and largely isolated in the Orthodox World. The Government has so far taken a firm approach regarding the protection of the property of the SOC, which the MOC seeks to overtake. Montenegro has a diverse media environment, generally enabling freedom of expression. However cases of violence and intimidation against journalists have continued. The nationwide Montenegrin public service broadcaster, RTCG, remains by far the most important

source of news and information, but it faces competition from private channels and stations.

Although gender anti-discrimination provisions are enshrined in the Constitution and in the 2007 Gender Equality Law, women continue to play a marginal role in political and public life. Women comprise only 8.6 per cent of MPs in the National Parliament. At the local level, only one of 21 current Mayors is a woman. Traditional attitudes regarding gender roles persist, especially in rural areas, as does domestic violence. In order to ensure implementation of the positive measures required by the law, the Government adopted an “Action Plan for the Achievement of Gender Equality 2008-2012”.

There has been some progress in the fight against trafficking of human beings, although the practical results are mixed. Montenegro continues to be used primarily as a transit country for the trafficking of women and girls to Western Europe for the purpose of commercial sexual exploitation. Further efforts are needed to increase awareness, effectively prosecute traffickers, and protect victims among vulnerable groups.

### **Inter-Ethnic Issues**

The new independent state inherited a highly heterogeneous ethnic composition. Montenegrins, according to the latest census, comprise 43 per cent of the population. Ethnic Serbs comprise 30 per cent. The largest other minorities are Bosniaks (7 per cent), who live predominantly in the north-east, and Albanians (5 per cent), who are concentrated in the southern municipalities of Ulcinj and Plav and the Tuzi district of the capital Podgorica.

In April 2006, a Law on Minority Rights and Freedoms was adopted by the Parliament, which provided for a general framework for the protection of minorities and affirmed the multi-ethnic character of Montenegro, including non-discrimination of ethnic and other minorities, use of language, free association and participation of minorities in public and social life. It also envisaged the establishment of minority National Councils, which have since become operational and were allocated funding. However this Law still has to be harmonised with the new Constitution, adopted in 2007, particularly regarding minority representation in the Parliament, for which an agreement on a comprehensive mechanism for ‘authentic representation’ is needed.

More remains to be done to protect smaller ethnic minorities, particularly the most vulnerable Roma, Ashkali and Egyptian community (RAE). Some steps have been taken by the authorities to improve their situation, but they continue to face difficult living conditions and discrimination. The social and economic situation of displaced persons remains a concern.

### **EU Approximation**

EU integration remains both the key priority of the Government and, objectively, the main external anchor for continuing reforms. The commitment to EU reform agenda remains high and there is a strong consensus on this issue among all mainstream political parties and among the citizens.

The country formally applied for EU membership on 15 December 2008. In April 2009

the Council of EU invited the European Commission to submit its 'Opinion' on Montenegro's application, which is currently being prepared and is due to be released in autumn 2010.

Despite significant regional challenges the country has managed to maintain balanced relations with its neighbours. Montenegro has continued to participate actively in regional cooperation initiatives, including the South East Europe Cooperation Process (SEECP), whose chairmanship it will hold in 2010.

## ANNEX 2: ASSESSMENT OF TRANSITION CHALLENGES

Montenegro faces a number of important transition challenges in all sectors. The assessment below is based on the 2009 Assessment of Transition Challenges. The table below provides an overall Assessment of Transition Challenges rating for 2009 and 2005. Scores range from negligible, small, medium and large. “Negligible” means that the remaining challenges are minor and that the sector is well advanced in moving towards a well-functioning market economy. “Large” means that the remaining challenges are major and that this dimension of the sector is at an early stage of reform.

Montenegro	Overall 2009	Overall 2005
<b>Corporate</b>		
Agribusiness	Medium	N/A
General Industry	Large	N/A
Property and Tourism	Large	N/A
Telecom	Medium	N/A
<b>Infrastructure</b>		
MEI	Medium	N/A
Natural Resources	Medium	N/A
Power	Large	N/A
Sustainable Energy	Large	N/A
Transport	Medium	N/A
<b>Financial Institutions</b>		
Banking	Medium	N/A
Insurance and financial services	Large	N/A
MSMEs	Medium	N/A
Private equity and capital markets	Large	N/A

### Corporate sector

**Agribusiness:** Montenegro provides limited price and trade support to its agricultural sector. An SAA with the EU entered into force in 2008 and it is negotiating for membership to the WTO. Agricultural production is structured by traditional vegetable markets and small privately-owned family farms, of which the average size is estimated to be less than 5 hectares. The food industry is small and in need of further restructuring and quality upgrades. The institutional framework supporting the sector is weak even in regional SEE comparison – land ownership problems remain while building a warehouse and registering property have been evaluated as very cumbersome. Finance to the sector remains scarce.

**General Industry:** Montenegro has made progress with privatisation in recent years. As of end 2008, about 85 per cent of state assets had been privatised, but these are mainly small and medium-sized companies. In March 2008, the Government adopted a new privatisation plan, which included a number of strategic companies. The Government also launched the tender for the publisher Pobjeda and the shipyard Jadran Bijela, both unsuccessful so far. Restructuring has been slow and additional improvements to corporate governance are required in most enterprises. Energy shortages still occur. The two biggest industrial companies continue to enjoy heavily subsidised electricity prices. Montenegro has had some success in creating a favourable investment climate and in

attracting reputable foreign investors. Several business-friendly measures have been in place for a number of years, including a corporate tax rate of 9 per cent, the lowest in the region. Nonetheless, significant challenges remain in lowering the barriers to business creation, especially in the area of licenses and obtaining construction permits.

**Property and Tourism:** The market for modern commercial property is at early stages of development, and the supply gap across all sub-segments is considerable. A number of experienced real estate developers and investors are considering entering the market in a wide range of asset types including office, hotel, retail, industrial and housing (permanent and holiday homes). However, progress is inhibited by the lack of adequate infrastructure and the non-availability of long-term financing. The office market is in its infancy and remains highly fragmented. As purchasing power in Montenegro further increases, the retail sector continues to grow also fragmented and highly concentrated on Podgorica and Bijelo Polje. The potential for growth of the property sector is strong, in line with increased demand from regional and international companies for institutional quality commercial space. Availability of real estate long-term financing is still limited, and the property-related business environment is weak, in particular with respect to dealing with construction permits. Tradability of land is limited de jure.

**Telecommunication:** Montenegro adopted a new Law on Electronic Communications in August 2008, with which the regulator, AGENTEL, was transformed into the Agency for Electronic Communications and Postal Affairs (EKIP). The incumbent, T-Crnogorski Telekom, has been privatised and the Government has no stake in it, but it continues to dominate the fixed-line market, as it enjoyed a de facto monopoly in the international voice market until January 2007. A number of licenses were awarded in 2007 to encourage fixed-line market competition and development of the cable TV market. Mobile telephony has grown rapidly, services are offered by three operators and penetration is very high. 3G and HSDPA services were launched in 2007, enabling the launch of the new mobile broadband services. Internet usage is high for the region at just below 50 per cent, but Internet subscriber penetration is much lower. Broadband Internet is available through a variety of platforms, including WiMAX, but subscriber levels are still very low.

## **Energy and Infrastructure**

**Municipal and Environmental Infrastructure:** Local infrastructure has been transferred to municipalities but water utilities are normally not converted into joint stock companies. The financial operations are overall satisfactory although revenues come from both tariffs and municipal subsidies as the tariffs are often falling short of covering operational costs. Although meters have been introduced in several municipalities, collection rates can still be improved in many of the smaller towns. Private sector participation is significant in the urban transport sector and all bus lines in Podgorica are operated by private companies generating competitive pressures on various market segments. Tariffs are set by municipalities without a transparent price formula, which together with weak contractual arrangements make tariff setting and operational targets subject to political interference. Cross-subsidies between consumer groups are still widespread. Transition challenges are substantial and include full corporatisation of water utilities, effective tariff reform based on transparent methodology and regulation, and improved contractual arrangements both in the water and urban transport sector.

**Natural Resources:** Montenegro still does not have access to international sources of natural gas. While it has small coal reserves, it is fully reliant on imports of oil, which account for about 60 per cent of total energy imports. The downstream petrol retail market is liberalised and there is participation by private, foreign companies (Lukoil, Hellenic Petroleum). Petrol prices are liberalised. Institutions and policies to support market structure need strengthening. Montenegro signed the 2005 Energy Community Treaty, which aims to extend the EU's internal energy market to south-eastern Europe and create an integrated market for electricity and gas in the region. According to the latest EC Progress Report "...continued efforts are still needed to meet the requirements of the Energy Community Treaty promptly". A National Energy Development Strategy, covering the period up to 2025, was adopted on 13 December 2007. Although there are plans to open up the market gradually, no eligibility thresholds have been set and random requests by customers for other sources of supply do not generate sufficiently powerful momentum to develop a gas market. Work on a draft law on prospecting, exploration and exploitation of oil and gas is still ongoing.

**Power:** The sector is still dominated by the vertically integrated state-owned power utility EPCG. However, some progress has been made in improving the market structure by starting the unbundling process. Thus, generation, distribution and supply have been functionally unbundled and separate financial accounts have been established. In 2009 transmission was legally unbundled into a separate company. Private sector participation in the power sector has been so far minimal but in early 2009 the Government called a tender to introduce a minority private investor into EPCG, while transmission will remain state owned. The liberalisation of the sector is still at an early stage and competition is very limited. The quality of Montenegrin institutions needs to be further strengthened. The 2003 Energy Law is the main legislative basis for the reforms already undertaken in the sector. It established the Montenegrin Energy Regulatory Agency (ERA), and paved the way for the unbundling and privatisation of EPCG. The regulator is responsible for issuing the relevant licences and regulating tariffs but its independence in practice is still partial. Notably, a cost-reflecting tariff methodology is applied but commercial losses remain high and cross-subsidies are still significant. The implementation of a five year transition plan to increase residential tariffs and eliminate cross subsidies, announced in 2007, has been continually postponed. Efforts have been made to introduce a feed-in tariff mechanism to support renewables but these have had limited success because they do not offer a stable long-term price.

**Sustainable Energy:** Montenegro has a generic legal framework and policies for energy efficiency and institutions are too weak to pursue its implementation. Cost reflective tariffs are applied but cross-subsidies still persist and environmental costs are not included in energy prices. The government adopted the Energy Development Strategy of the Republic of Montenegro by 2025, but concrete programs and implementation instruments to promote renewable energy and energy efficiency are yet to be established. Feed-in tariffs for RES have been introduced but their design does not encourage project development especially given the pervasiveness of institutional barriers and the lack of a clear and stable legal framework. Montenegro ratified the UNFCCC and Kyoto protocol in 2007 where it holds the status of Non-Annex 1 Party. No GHG emission targets or policies were adopted. Remaining challenges include the establishment of a predictable legal and institutional framework to enable market penetration of EE and RE projects.

**Transport:** The railway network includes just two main lines. The government adopted a railways restructuring plan in line with EU directives (i.e. vertical separation). Track access is being given to third parties. The authorities are considering some private sector participation in station management and possibly in other areas. Labour restructuring progressed and efficiency generally improved.

In the road sector, road directorates for primary and secondary roads as well as for motorways were established, while the responsibilities of community roads were transferred to municipalities. The road maintenance company was privatised to a Slovenian company in 2003, but it remains a monopoly. Road user charges, including fuel excise tax and fuel levy and vehicle charges and transit fees, were introduced, and are sufficient to cover maintenance and rehabilitation costs. A law on private sector participation in public services was adopted but there have been no PPP projects to date.

## **Financial Institutions**

**Banking sector:** The banking sector is dominated by foreign banks that have entered the market in the past five years. This has intensified competition and contributed to a rapid increase in financial intermediation. The necessary banking sector supervision and regulation is in place. Bank lending grew at a very rapid pace of more than 100 per cent per year up to the beginning of 2008, prompting the Central Bank to introduce several credit-tightening measures. Domestic credit is about 90 per cent of GDP, among the highest ratios in South-east Europe. Although competition has increased significantly the sector remains highly concentrated. As in other countries, the international financial crisis has revealed the system's vulnerabilities related to the reliance on parent bank support and large non-performing loans brought about by rapid credit growth. Banks' governance of risk and portfolio management remains a challenge.

**Insurance and financial services:** Insurance legislation and regulation fall somewhat short of the IAIS standards, in particular with respect to the effectiveness of the regulator (who is not currently a member of the IAIS and is perceived to be substantially understaffed). Insurance penetration remains modest (in particular in the case of life insurance products), and there are currently no private pension funds operating in the country. The leasing market has been largely developed in recent years.

**Micro, Small and Medium-sized enterprises:** Access to credit is relatively easy. Most enterprises access credit from commercial banks or NGOs specialised in provision of commercially based microfinance, supporting the demand for credit of local MSMEs. Bankruptcy procedures are supportive of MSME lending. Legislation to regulate the establishment of Credit Guarantee Funds was approved in 2008. Banks can accept movable assets as collateral and that the definition of collateral is flexible. The cadastre covers about 51 per cent of the territory (mostly urban areas), or 79 per cent of cadastral parcels. A Secured Transaction Registry is in place for registration of pledges and liens. On the basis of the contract with the Registry, authorised persons (lawyers and commercial banks) can file a notification statement electronically. A public credit registry is in place and started sharing information with banks and micro credit financial institutions (MFI's) in the second half of 2007. However, legislation is not yet in place to ensure that all individuals can access their data.

**Private equity and capital markets:** Quality of securities legislation showed only small gaps, with accounting sound, though weaknesses in other areas. Disclosure requirements in public prospectuses were found to be poor. A commercial private equity



sector is yet to develop and to date the country has not attracted significant interest of international private equity funds. A challenging business environment, limited investment opportunities and poor exit prospects all conspire against this sector. While the domestic equity market has a sizable capitalisation, turnover is low, deterring investors, and limiting the attractiveness of public equity issuance as a source of capital.

## **ANNEX 3: ENVIRONMENTAL AND SOCIAL DEVELOPMENT**

### **Environmental Setting**

Montenegro is a relatively small country in south east Europe, with an area of around 14,000 square kilometers and a population of 670,000. In the coastal region the climate is Mediterranean, with long, hot summers and relatively mild winters. Further inland, winters are colder with heavy snowfall. Most of the country is mountainous with elevations in excess of 1000m, with a narrow coastal plain adjacent to the Adriatic Sea. Inland much of the country is forested and around 15 per cent is used for agriculture. Notable geographic features include Lake Skadar and the Bay of Kotor. Skadar, which is shared with Albania, is one of the largest lakes in Europe and one of its most important bird reserves. It is home to over 270 bird species, including one of the last remaining populations of pelicans in Europe. The shores of the lake are protected under the Ramsar Convention as wetlands of international importance. The Bay of Kotor on the Adriatic Coast is noted for its scenery and cultural importance. It is a site with numerous churches and monasteries. It is an important tourist area and is a designated UNESCO World Heritage Site.

### **Environmental Legislation and Administration**

The constitution of Montenegro established the country as an “ecological state”. It has applied for membership of the European Union and is harmonising its environmental legislation with EU requirements. The national requirements for Environmental Impact Assessment are modelled on EU legislation and include provisions for public hearings and consultation.

The Ministry for Environment and Spatial Planning has overall responsibility for environmental legislation and administration within Montenegro. The Ministry regards the natural environment of the country as a strategic resource and a potential competitive advantage over other countries, particularly with regard to tourism. The current priorities of the Ministry include urban regeneration, addressing the problem associated with unregulated development, and improving infrastructure for solid waste and wastewater treatment.

Montenegro has ratified all of the major international environmental conventions and treaties, including:

- Kyoto Protocol to the Framework Convention on Climate Change
- Convention on Biological Diversity
- Montreal Protocol on Substances that deplete the Ozone Layer
- Stockholm Convention on Persistent Organic Pollutants
- Convention of the Law of the Sea
- Aarhus Convention on Access to Information, Public Participation in Decision-making and Access to Justice in Environmental Matters
- Espoo Convention on Environmental Impact Assessment in a Transboundary Context

Day-to-day management and supervision of environmental issues is delegated to the Environmental Protection Agency (EPA). This is an executive body of the Ministry of Environment and Spatial Planning. It was established in 2008 and has 40 staff organised into five sections: monitoring; permitting; inspection; cooperative/budget; and

communication/IT. The agency carries out inspections on industrial facilities and can issue penalty notices in respect of any non-compliances. Forty such penalty processes were initiated during 2009. The EPA also carries out national data collection and reports to the European Environment Agency in Copenhagen. An Integrated Pollution Prevention and Control (IPPC) framework for major pollution is planned, again modelled on EU requirements. The Agency estimates that this will take up to five years to develop and implement this framework.

## **Climate Change**

Montenegro has ratified the Kyoto Protocol and was a participant in the UN Climate Change Summit in Copenhagen. The Government is working with UNDP to develop the first National Communication on Climate Change, which is scheduled for publication in summer 2010. This will include an action plan for major industrial emitters.

There is a limited awareness of climate change amongst the general population in Montenegro. There is also a widespread lack of appreciation of the potential benefits of energy efficiency. Similarly, climate change adaptation is not an issue that is currently receiving any significant attention, either within the Government, or amongst wider stakeholders. Given the importance of the tourist industry, and the inadequacy of existing water and wastewater infrastructure, climate change could have significant economic and environmental impacts in Montenegro.

## **Labour and Health and Safety**

Montenegro has ratified the core International Labour Organization (ILO) conventions on freedom of association and collective bargaining, discrimination, forced labour, and child labour. The legal instrument to secure the health and safety of workers was implemented using the Safety at Work Law in 2004. This provision places legal obligations on both employers and employees. Although this law is supported by more specific regulations, bye laws and ordinance, it has been recognised that substantial amendments and timely adoption is still necessary to align Occupational Health and Safety (OHS) at Work legislation within Montenegro with the European Union acquis. The Labour and OHS Inspection Department within the Ministry of Labour are responsible for OHS enforcement, although it has been documented that they are not strong enough to tackle Montenegro health and safety problems. Industries such as construction, metal, forestry and ship building have been acknowledged as problematic, causing many work related injuries and ill health within these sectors. The Ministry of Health believes that these problems are due to a lack of trained workers, old technology and the general working environment workers are exposed to. Issues associated with working conditions and occupational health and safety are common to many countries in EBRD's region, in that the legislative framework is adequate but awareness and enforcement of safety issues are often lacking. For EBRD projects, with a focus on tourism and infrastructure, the main requirement will be to ensure that safety standards in project construction are adequate. This will require a particular focus on contractor management.

## **Challenges and Opportunities**

EBRD has consulted a range of stakeholders in Montenegro, including Government bodies, civil society groups and the World Bank. There is a high degree of agreement amongst each of these groups as to the main environmental challenges and opportunities for Montenegro. The main challenges identified are:

*Environmental Awareness:* There is a widespread consensus that awareness of, and interest in, environmental issues is low amongst the general population in Montenegro. There is virtually no uptake of, for example, measures relating to energy efficiency or recycling. Several NGOs are running small scale education programmes in schools but there could be clear benefits in more widespread public awareness campaign.

*Enforcement:* The legislative framework in Montenegro is well developed and comparable to EU members. Enforcement of this legislation still appears to be lacking. The creation of the Environmental Protection Agency will help in this respect but it is still developing its procedures and capacity, and is likely to require more resources to be fully effective.

*Industrial Pollution:* Montenegro has a small number of large, highly-polluting industrial sites. These are mainly associated with metal processing industries. They have a significant impact on air and water quality, and are significant carbon dioxide emitters. Their importance to the economy and for local employment means that shutting them is not a viable option, and concerns about credit worthiness mean that there is limited scope for investment in new plant and equipment. The Government appears to be adopting a pragmatic strategy of engagement and incremental improvement and the World Bank is providing assistance.

*Waste Management:* There is a clear need for investment in waste management infrastructure, both for solid waste landfills sites and waste water treatment. This has been identified as a priority by the Government. There is also a need to address hazardous waste disposal. There is currently no viable disposal mechanism and at present this waste is stored. As the volume produced in-country are small, a dedicated facility for Montenegro may not be feasible, and a regional solution is likely to be more appropriate.

*Illegal developments:* The Government estimates that there are between 40,000 and 80,000 illegal developments in the county. Most of these are residential buildings that not connected to municipal sewage systems and have poor standards for energy efficiency. The Ministry of Environment and Spatial Planning is keen to halt further developments and regularise existing ones. The Ministry is investigating the possibility of bundling small loans to home owners to fund upgrades to these buildings.

*Lack of data:* Proper environmental management is hampered by a lack of data on the current state of the country's ecology and land use. For example the last biodiversity survey reportedly dates from 1964. The lack of data on land registration also creates significant uncertainties for potential project developers and can hinder economic growth. This has been recognised by the World Bank who have funded a survey of agricultural land use.

Despite these problems, Montenegro does have some structural advantages that will help it to address its environmental issues. As a new country, established in 2005, it has been able to start from a relatively clean slate in terms of environmental legislation and

enforcement mechanisms. The country has adopted a sensible, forward-looking strategy in modelling its regulations on the EU and in actively engaging with the European Environment Agency. The proposed move towards an IPPC-style framework for industrial pollution control is another positive step. The Government, and other stakeholders, have a clear view of what the main environmental challenges are, and what needs to be done to address them. Whilst additional capacity and resources are needed to fully implement the necessary measures, the consensus on what the priority issues enhances the likelihood of the country moving in a positive direction. Lastly, the importance of its natural environment to Montenegro's tourist industry and, consequently its economic development means that environmental protection is aligned to some extent with economic and social interests.

### **International Finance Institutions**

The World Bank, IFC and EIB are active in Montenegro. The World Bank has a small resident office with four full time staff, supplemented by two or three mission from Washington each year. Many of its projects have an environmental focus, such as water supply systems, solid waste facilities and energy efficiency improvements in schools and hospital. Future projects are likely to include work on remediation of existing industrial facilities.

### **Civil Society**

Montenegro has many environmental NGOs and civil society groups, but they tend to be small, self-contained organisations. Mass-membership environmental groups are not currently very active in the country. Funding generally comes from private sector organisations or international donors. The main focus of NGOs is on conservation of habitats and biodiversity, and on education programmes for schools. The protection of Lake Skadar and of forest areas are two priorities. The education and awareness raising programmes are worthwhile and could have significant long term benefits for environmental protection in Montenegro, particularly if they can be maintained and expanded.

### **EBRD Response**

EBRD's priorities for Montenegro are set out in the main body of this strategy and include a focus on infrastructure, corporate lending (including tourism) and financial intermediaries. All EBRD operations in Montenegro are subject to the Bank's Environmental and Social Policy and incorporate, where appropriate, Environmental Action Plans into the legal documentation in order to address issues raised during due diligence, in line with the Bank's mandate to actively support environmentally sound and sustainable development through its investment projects. The Bank will also consider opportunities for environmentally focused Technical Cooperation projects, particularly where these can enhance the benefits of EBRD investments.

#### *Case Study: Tourism*

EBRD is currently considering a tourism project in Montenegro and carrying out environmental and social due diligence for the proposed project to assess whether the project has been designed to comply with the Bank's Performance Requirements (PRs) defined in the 2008 Environmental and Social Policy. The Bank is examining the

project's suitability for the country's sustainable tourism development policy, adequacy of the project design in the city planning, the status of permits, provision of environmental infrastructure for the project (water supply, waste water treatment, solid waste management) and traffic impacts. Social issues being assessed include seasonal changes in the population and labour demand, impacts on the local population (their livelihood and culture) and potential for additional corporate social responsibility initiatives relating to benefit sharing for the local community. If the Bank decides to finance the project, an Environmental and Social Action Plan (ESAP) and Stakeholder Engagement Plan will be developed and agreed with the project client. The Bank will monitor environmental and social performance of the project through reviewing an annual environmental and social report and periodic site visits.

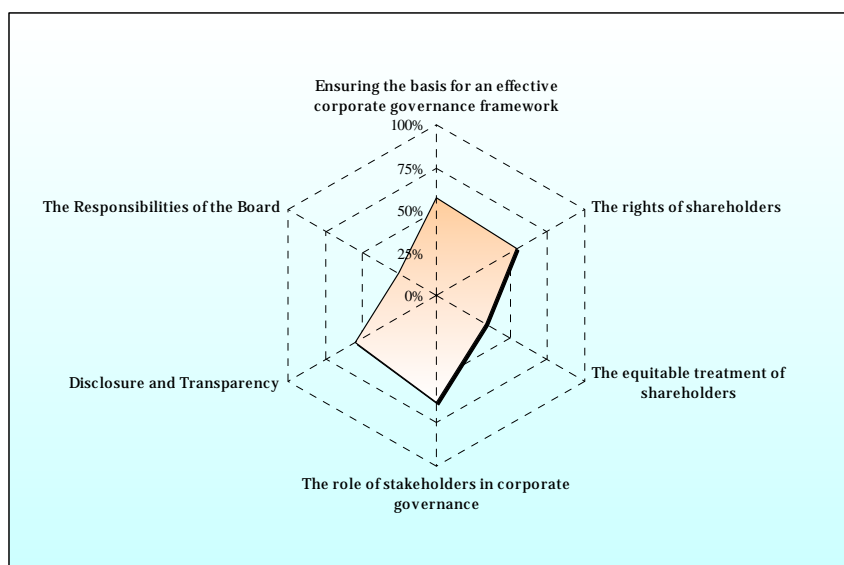
## ANNEX 4: COMMERCIAL LAWS OF MONTENEGRO

The EBRD has developed and regularly updates a series of assessments of legal transition in its countries of operations, with a focus on selected areas relevant to investment activities: capital markets, company law and corporate governance, concessions, secured transactions and telecommunications. In 2010, assessments will be conducted for the first time in the judicial capacity and procurement focus areas. The existing tools assess both the quality of the laws “on the books” (also referred to as “extensiveness”) and the actual implementation of such laws (also referred to as “effectiveness”). All available results of these assessments can be found at [www.ebrd.com/law](http://www.ebrd.com/law). This annex presents a summary of the results for Montenegro, accompanied by critical comments from the Bank’s legal experts who have conducted the assessments and other research in the relevant areas.

### Company Law and Corporate Governance

Corporate governance regulation in Montenegro is essentially entrusted in the “Business Organisation Law” enacted in February 2002. According to this law, joint stock companies are organised under a one-tier system where the general shareholders meeting appoints the board of directors. In May 2009, the Montenegro Stock Exchange adopted a voluntary corporate governance code.<sup>1</sup> Listed companies willing to improve their corporate governance practices are requested to harmonise their practices with the code’s recommendations and produce an annual corporate governance report explaining any deviance from the code. Currently only four companies have adopted the code.<sup>2</sup>

### Quality of corporate governance legislation – Montenegro (2007)



*Note: The extremity of each axis represents an ideal score, i.e., corresponding to OECD Principles of Corporate Governance. The fuller the ‘web’, the more closely the corporate governance laws of the country approximate these principles*

Source: EBRD Corporate Governance Sector Assessment, 2007 assessment

According to the results of the EBRD’s 2007 Corporate Governance Sector Assessment<sup>3</sup> (see chart above) under which the quality of corporate governance

<sup>1</sup> The 2009 Corporate Governance Code is available at:

<http://www.ebrd.com/country/sector/law/corpgov/codes/monte.pdf>

<sup>2</sup> Information as of 23 February 2010, <http://www.montenegroberza.com/code/navigate.asp?Id=817>

<sup>3</sup> For more information see: <http://www.ebrd.com/country/sector/law/corpgov/assess/index.htm>

legislation in force in November 2007 was assessed, Montenegro resulted to be in “very low compliance” with the OECD Principles of Corporate Governance, showing a framework under an urgent need for reform in all sectors under consideration. When considering the effectiveness of corporate governance legislation, the 2005 EBRD’s Legal Indicator Survey<sup>4</sup> revealed that limited avenues are available to minority shareholders for obtaining disclosure from a company and corporate information is generally not of good quality. Judicial proceedings are slow, providing the defendant with numerous possibilities for obstruction, without incurring procedural penalties. Judgements are difficult to enforce as there is no effective penalty for not obeying court decisions in enforcement proceeding.

The legislator should carefully assess the compliance of national legislation with international standards and consider improving both the framework and the capacity of institutions in effectively implementing the legislation.

### **Concessions**

In 2009 Montenegro enacted a new Law on Concessions replacing the Law on the Participation of the Private Sector in Delivery of Public Services.

To an extent, the new legislation may be seen as an attempt to approximate the local law standards with those of the EU’s. However, according to the EU Commission’s Montenegro 2009 Progress Report “*the new Law on Concessions falls short of the requirements of the acquis*”. This largely concerns the definitions and concession awarding procedures. In particular, the Commission’s assessment notes that the new Law on Concessions does not distinguish clearly between concession contracts and public work or public services contracts.

The new law is a fairly extensive piece of legislation covering all the aspects usually seen in similar laws in the other EBRD countries of operations. Some specific issues, however, the likes of the concessions register, detailed tender procedures, administrative capacity of a relevant agency/commission to deal with concessions, are left to be governed by the secondary legislation. It is worthwhile noting that not all of such regulations are yet in place.

Perhaps, one of the more controversial areas raising some criticism is the opportunity to award concessions for large infrastructure projects of strategic importance without competitive procedures.

As a rule the maximum duration of a concession set by the Law is 30 years, with a possibility of an extension up to 15 years to a current concessionaire. A 60 year concession may be awarded in the event it is granted by the National Assembly.

A number of tenders have been announced within the past year based on the new legislation, including in power sector.

It is yet to be seen how the new rules work, to what extent they facilitate private sector participation and whether any of the planned concessions prove successful or even reach financial close.

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<sup>4</sup> For more information see: <http://www.ebrd.com/country/sector/law/corpgov/lis/index.htm>

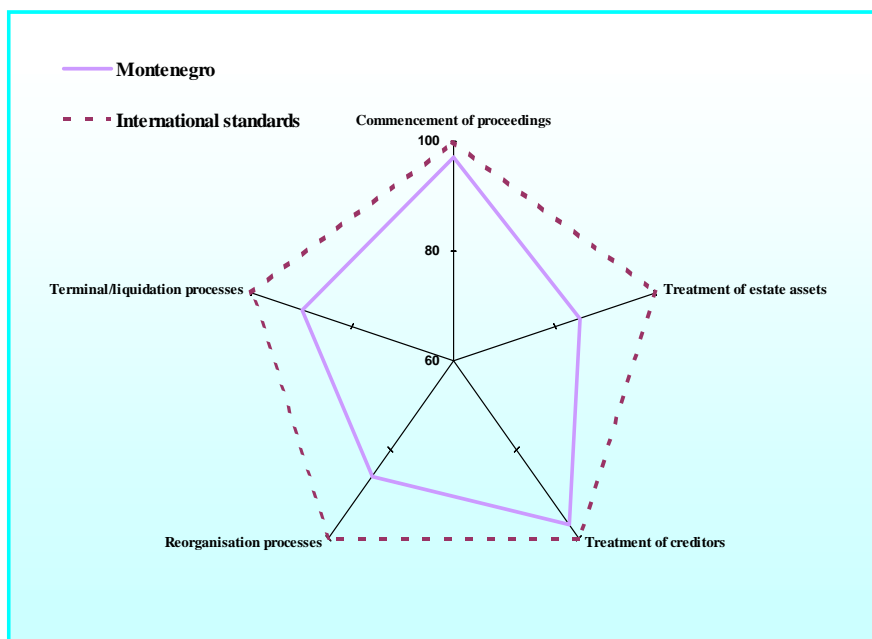


## Insolvency

Insolvency is governed by the Law on Business Organisations Insolvency (2002), as amended (the “Law”). The Law is of very high quality and provides most of the tools essential for an efficient and effective insolvency system. In the 2009 EBRD Insolvency Sector Assessment, which examined the quality of insolvency laws against international standards, the Law was the only one which scored “very high compliance.” This result is an improvement over the 2006 EBRD Insolvency Sector Assessment as a result of certain intervening amendments, although the Law received a very high rating in that assessment as well. In fact, the Law was only one of five insolvency laws to achieve a score of “high compliance” at that time.

As demonstrated in the chart below, the Law is of a high quality throughout with no areas of significant weakness. It is particularly strong in the areas of commencement of proceedings, treatment of creditors and terminal proceedings. The Law provides for a clear definition of the criteria which must be met to start an insolvency proceeding; it sets out reasonably short deadlines and detailed provisions regarding the timing of the filing and hearing of applications; it provides for self-induced or creditor induced liquidations and reorganisations, administered by an insolvency administrator; and it provides for extensive recognition and cooperation in respect of cross-border insolvencies, adopting the UNCITRAL Model Law almost without change.

### Quality of insolvency legislation – Montenegro (2009)



*Note: The extremity of each axis represents an ideal score, ie corresponding to the international standards such as the World Bank’s Principles and guidelines for Effective Insolvency and Creditor Rights Systems, the UNCITRAL Working Group on “Legislative Guidelines for Insolvency Law”, and others. The*

*fuller the ‘web’, the more closely insolvency laws of the country approximate these standards.*

Source: EBRD Insolvency Sector Assessment 2009.

The Law has many protections for creditors, including providing for “adequate protection”. Where estate property is secured by a pledge, lien or security interest, and the creditor cannot enforce his security rights due to the moratorium, the creditor is entitled to adequate protection to maintain the condition and value of the property as it

was at the time the moratorium came into being. The “adequate protection” can include cash payments, security over additional property, or insurance as required. Creditor rights are also protected by provisions for the avoidance of certain transactions by the debtor and in the significant role that the law allows creditors to take in overseeing the insolvency process.

Despite its strengths, however, there is some room for improvement, especially in the provisions relating to insolvency administrators. Indeed, although Montenegro scored “very high compliance” for the main insolvency law provisions, the EBRD’s 2009 Assessment separately looked at the laws relating to insolvency administrators and concluded that Montenegro scored “low compliance” in this discreet area. This is because the law does not provide for professional work standards for insolvency administrators; there are no guidelines for the court in selecting an insolvency administrator for appointment; and there are no provisions relating to the supervision, regulation or discipline of an insolvency administrator.

## **Judicial Sector**

In Montenegro, specialised Commercial Courts have been in place since 2005, with jurisdiction over company law, insolvency, intellectual property rights and competition law. Appeal from the Commercial Courts lies to the Appellate Court, and from the Appellate Court to the Supreme Court of Montenegro. For non-commercial matters, the Basic Courts are the jurisdiction of first instance. Here, appeals lie to the High Court, and then to the Supreme Court. The Administrative Court hears matters relating to administrative law.

The Government has in place a wide-ranging judicial reform programme for 2007-2012. Part of this programme saw the passage of the Law on the Judicial Council in 2008, which confers on the Judicial Council the power to elect, promote and dismiss judges. The reform programme also intends to establish a High Commercial Court or a specialist chamber in the Supreme Court dedicated to hearing appeals in commercial cases. Some judges have suggested further specialisation in order to streamline caseloads and develop expertise for complicated economic matters.

Whilst progress has been made on judicial reform, concerns remain about the efficiency and independence of the judiciary. Judicial proceedings in civil matters are reported to be slow, and enforcement of legal rights in the commercial sphere can be uncertain. There remains public distrust in the courts, as in other public institutions, although the frequency of irregular payments to civil courts is considered to be low. The commercial court system faces challenges, such as the introduction of new legislation, and developing new systems of operations, including IT systems.

## **Public Procurement**

Public procurement in Montenegro is regulated by the Public Procurement Law (PPL), which came into force in July 2006, and related secondary legislation, adopted in 2008.

Montenegro’s PPL is based on the UNCITRAL model and has been partly harmonised with EU Public Procurement Directives. The PPL applies to any contract awarded on behalf of state and local authorities. The utilities sector is not expressly subject to the

PPL, nevertheless some of the utilities contracting entities would be covered as state-owned, public undertakings.

The PPL include six different procurement procedures: (i) open procedure; (ii) restricted procedure (which may only be used under specific circumstances and the award criterion must be lowest price); (iii) negotiated procedure with or without prior publication of a contract notice; (iv) direct solicitation of tenders (which is a shopping method only for goods and services contracts below €10,000 and works contracts below €30,000); (v) direct agreement (which is only applicable for contracts below €2,000) and (vi) the framework agreements, which are subject to prior administrative approval of the Public Procurement Directorate – a national public procurement authority.

The award criteria provided by the PPL are both lowest price and economically most advantageous tender.

The public procurement eligibility rules and qualification criteria are in line with the relevant international standards, but the PPL requires an extensive list of qualification documents that may be costly and time-consuming for tenderers. Further, the minimum time limits for submission of tenders and applications are significantly shorter than those commonly recommended.

The PPL describes planning and conducting of the public procurement process and the examination, evaluation and comparison of tenders in comprehensible manner. Roles and responsibilities of the contracting authority are clearly defined and allocated.

However, the public procurement procedures are complex and inflexible which may affect the operational efficiency of the process. For instance, the PPL does not explicitly allow the contracting entities to invite tenderers to supplement or clarify the qualification of documents that have been submitted. As a result, the procurement process and public purchasing in utilities sector should be reformed.

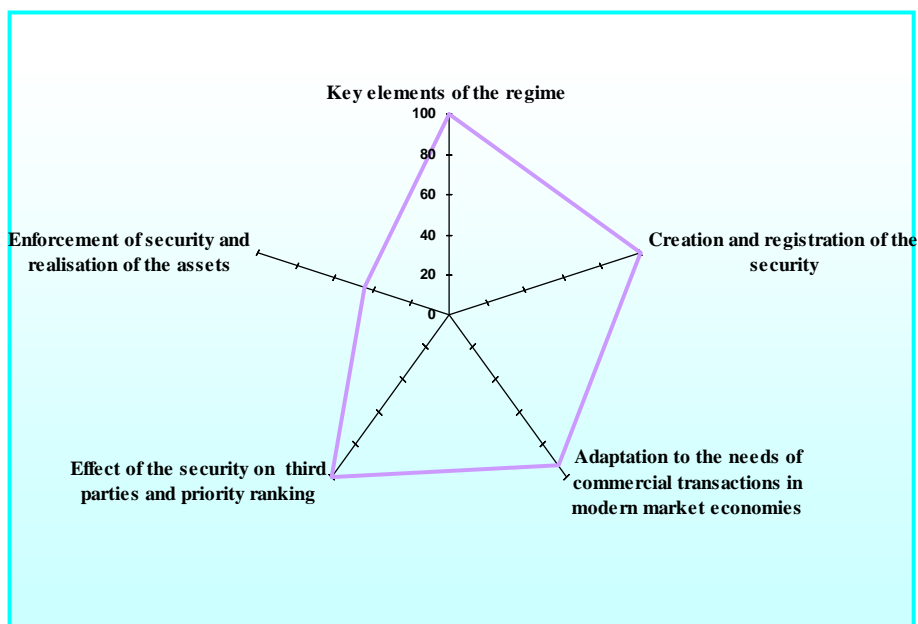
### **Secured Transactions**

Security over movable assets in Montenegro is governed by the Law on Secured Transactions for the Republic of Montenegro No. 38/02. This law is based on Article 9 of the US Uniform Commercial Code.

The Law's objective is to provide the exclusive means by which pledges (that is, security rights) over movable assets are created and become effective against third parties. As a result, the law applies to all transactions intended to create a pledge, regardless of their respective form.

The Law has been in force since 1 January 2003. The Pledge Registry, run by the Commercial Court in Podgorica, started operating in July 2003. The Registry is electronic and has its website at [www.rzcg.gov.me](http://www.rzcg.gov.me). Registration takes place either on-line for registered users, or by way of submitting an application form available on the registry's website, either personally or by fax. Only lawyers (members of the Montenegrin Bar Association) and commercial banks can be registered users. Searching however is available freely on the internet.

## Legal and Practical Regime for Taking Security over Movable and Intangible Property in Montenegro (2006)



*Note: Scoring on a scale from 1 to 100, where 100 represents the most advanced legal and practical regime*

*Source: EBRD Regional Survey of Secured Transactions, 2006*

Generally, the law provides for a modern, flexible and transparent system and the register appears to function well – its use remains limited but it may be unavoidable in a small economy as that of Montenegro. The biggest uncertainty remains in relation to enforcement, where it is unclear whether the mechanisms provided in the law are able to operate as intended.

### Securities Markets

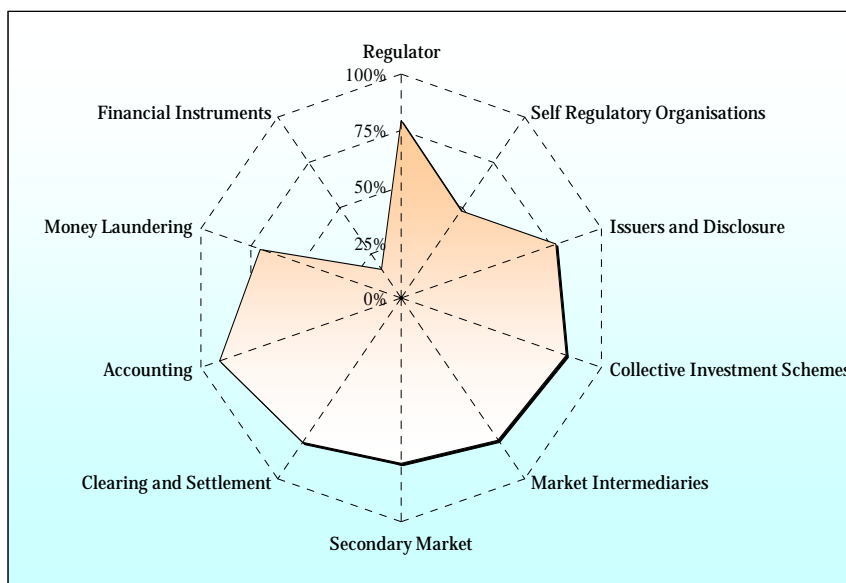
In Montenegro the basic legislation on the securities markets is comprised by the Law on Securities enacted in 2000 (as amended). The Law on Securities regulates the types of securities, their issuance and trade, the rights and obligations of the subjects involved in the securities' markets and the scope and activities of the securities markets regulator in Montenegro. The securities market regulator is Securities Commission of the Republic of Montenegro, while the Central Bank is the regulatory body in charge for banking, insurance and other financial activities performed in the country.

There are two stock exchanges in Montenegro: the Montenegro Stock Exchange and the NEX Montenegro. At the end of 2009, the market capitalisation of the Montenegro Stock Exchange was about USD 4.29 billion with 65 companies listed,<sup>5</sup> while the market capitalisation of NEX Montenegro was about €2.04 billion.<sup>6</sup> Clearing and settlement of securities is performed by Central Depository Agency.

<sup>5</sup> Info from the Federation of Euro-Asian Stock Exchanges website (<http://www.feas.org/Member.cfm?MemberID=35>) accessed on 22 February 2010.

<sup>6</sup> Info from the NEX website ([http://www.nexmontenegro.com/media/periodicni/e\\_g\\_2009.pdf](http://www.nexmontenegro.com/media/periodicni/e_g_2009.pdf)) accessed on 22 February 2010.

## Quality of securities market legislation – Montenegro (2007)



*Note: The extremity of each axis represents an ideal score, i.e., corresponding to the standards set forth in IO스코's Objectives and Principles for Securities Regulations. The fuller the 'web', the closer the relevant securities market legislation of the country approximates these principles.*

Source: EBRD Securities Market Legislation Assessment 2007

In 2007, the EBRD benchmarked the securities markets legislation of Montenegro against the “Objectives and Principles of Securities Regulation” published by IO스코. The assessment showed that national securities markets legislation is in “medium compliance” with international standards (see chart above). Among the major flaws, it is worth noting the lack of comprehensive legislation on self regulatory organisations, bonds and derivatives.<sup>7</sup> In order to understand how securities markets legislation works in practice, in the same year the EBRD undertook a Legal Indicator Survey asking practitioners in the region to comment on a hypothetical case study.<sup>8</sup> The Survey concentrated on effectiveness of prospectus disclosure requirements, private and public enforcement mechanisms and authority of the market regulator. The Survey revealed that IPOs are not common in Montenegro. Information included in the prospectus is not comprehensive or considered reliable as to identify risks of the proposed investment. Private enforcement mechanisms allow for some course of action but they are generally lengthy and burdensome. Finally the capacity of courts, regulator and prosecutors in investigating complex securities cases need to be improved. The legislator should carefully assess the compliance of national legislation with international standards and consider improving both the framework and the capacity of institutions in effectively implementing the legislation.

### Telecommunications

The Ministry of Maritime Affairs, Transportation and Telecommunications is responsible for oversight of the electronic communications sector (the “Sector”) in Montenegro. Its main functions are: developing Sector policy and legislation for telecommunications; adopting secondary legislation; and, supervising regulatory implementation.

<sup>7</sup> For more information see: <http://www.ebrd.com/country/sector/law/capital/assess/index.htm>

<sup>8</sup> For more information see: <http://www.ebrd.com/country/sector/law/capital/survey/index.htm>

Regulatory implementation is the responsibility of the Agency for Electronic Communications and Postal Services (EKIP). EKIP is functionally independent of all entities operating in the Sector and is established as a self-financing entity, funded from administrative fees, numbering fees and spectrum fees.

A new Law on Electronic Communications (the “EC Law”) was adopted in July 2008 defining the legal and institutional framework for the Sector, including the responsibilities of the Government, the relevant ministry and EKIP. It replaced the previous 2000 Law and was intended to bring Montenegrin law into line with the European Union (EU) 2003 regulatory framework. The new law provides for market analyses, the definition of relevant markets, Significant Market Power (SMP) designations and the imposition of remedies on SMP operators based on the principles of the EU 2003 regulatory framework. EKIP is understood to have begun assessing the market for the purposes of confirming SMP designations.

Montenegro formally introduced full liberalisation in January 2004. The EC Law introduces a general authorisation regime where networks and services not requiring the use of limited resources can be provided without individual licences. Individual authorisations are issued by EKIP for the right to use radio spectrum and numbers. In March 2005, the state sold its 76.53 per cent shareholding in incumbent former monopolist Crnogorski Telekom (CT) to Magyar Telekom, a Hungarian subsidiary of Deutsche Telekom. Private investors hold the remainder shares. The Government stake in mobile operator ProMonte, now owned by the Norwegian operator Telenor, was sold in 2001. The fixed market continues to be dominated by CT, with licences for alternative operators only being issued in 2007/8. In practice, competition has only emerged in mobile, with the market entry of Promonte in 1996, and T-Mobile, CT’s mobile subsidiary in 2000. A third mobile operator, mtel, owned by the Serbian incumbent Telekom Srbija entered the market in 2007. All three operators have been issued spectrum licences for provision of 2G services and 3G services.

Few of the key competitive safeguards foreseen under the EU 1998 regulatory framework have been yet been implemented in Montenegro. Montenegro made good progress in aligning its legal and regulatory framework with international practices during the earlier part of this decade. Unfortunately, implementation has been slow and many of the key measures necessary to support a liberalised and vibrant electronic communications market remain missing. Similarly, the legal and institutional framework has failed to keep up with modern best practice and evolving EU norms, with the recent EC Law representing a step backwards in a number of respects. Of particular concern has been the absence of public consultation on the recent EC Law; the slow adoption of the secondary legislation; and the power given to the ministry to review EKIP decisions.

The ministry and EKIP are understood to be working to address these concerns in terms of increased harmonisation with the EU electronic communications regulatory framework and accelerated implementation. Key areas of focus for this work should be on implementation of competitive safeguards (carrier pre-selection, number portability and local loop unbundling, completion of market analysis and methodologies for price control of wholesale tariffs).

## ANNEX 5: PORTFOLIO TRENDS

Operation Name	Total Project Value	EBRD Finance	DEBT / EQUITY / OTHER	PRIVATE / STATE	ACTIVE / COMPLETED
<b>Industry, Commerce &amp; Agribusiness</b>					
<b>Agribusiness</b>					
LEF: Voli Trade doo	4.2	3.1	Debt	Private	Active
WBLEF: Franca Mesopromet	5.0	5.0	Debt	Private	Active
<b>Manufacturing &amp; Services</b>					
DIF - Progas	1.1	0.4	Equity	Private	Completed
Pre-Privatisation loan for Kombinat Aluminium Podgorica	1.9	1.9	Debt	State	Completed
LEF: MPM doo	1.5	1.5	Debt	Private	Active
<b>Financial Institutions</b>					
<b>Bank Equity</b>					
NLB Montenegrobanka	5.0	3.3	Equity	Private	Active
<b>Bank Lending</b>					
NLB Montenegrobanka	3.0	3.0	Debt	Private	Completed
US/EBRD SME - Opportunity Bank	3.0	2.7	Debt	Private	Completed
US/EBRD SME - Alter Modus	2.0	1.8	Debt	Private	Active
US/EBRD SME - Alter Modus	1.0	0.9	Debt	Private	Completed
Western Balkans MSME FW - Alter Modus III	1.5	1.5	Debt	Private	Active
<b>Infrastructure</b>					
<b>Municipal &amp; Environmental Infrastructure</b>					
Montenegro Regional Water Supply Project	52.5	18.0	Debt	State	Active
<b>Transport</b>					
Montenegro Airports: Urgent Rehabilitation Plan	29.0	11.0	Debt	State	Active
Montenegro Regional Road Rehabilitation Project	14.1	10.9	Debt	State	Active
Montenegro Rail Infrastructure Emer. Rehab Project II	17.9	15.0	Debt	State	Active
Montenegro Rail Infrastructure Emer. Project	30.0	15.0	Debt	State	Active
<b>Regional</b>					
Regional Operation	7.9	7.9			
<b>COUNTRY TOTAL</b>	<b>180.6</b>	<b>102.9</b>			
	Amount		Number	Weight	
Private	23.2	24%	10	63%	
State	71.8	76%	6	38%	

<i>EUR million</i>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010*</u>
Net Cumulative Business Volume	39	57	73	103	103
Cumulative Total Project Costs	66.4	150.4	155.9	182.6	182.6
Portfolio	36	51	62	89	89
Cumulative number of operations	10	14	16	21	21
Performing Assets	21	20	36	55	58
Annual New Business	0	17	16	32	0
Gross Cumulative Disbursements	6	3	20	21	4
Annual Cancellations	1			2	
Private Sector Share	30%	26%	21%	23%	22%



## ANNEX 6: LIST OF PROJECTS SIGNED TO DATE

Year	Sovereign	Operation Name	Direct / Regional	Total Cost	EBRD Amount	Debt	Equity	Stage
2002		NLB Montenegrobank a	Direct	5.0	3.0	3.0	0.0	Completed
2002		NLB Montenegrobank a		5.0	3.3	0.0	3.3	Disbursing
2002		DIF - Progas	Direct	1.1	0.4	0.0	0.4	Completed
		<b>Total 2002</b>		<b>11.1</b>	<b>6.7</b>	<b>3.0</b>	<b>3.7</b>	
2003	x	Pre-Privatisation loan for Kombinat Aluminium Podgorica	Direct	1.9	1.9	1.9	0.0	Completed
2003	x	Montenegro Airports: Urgent Rehabilitation Plan	Direct	29.0	11.0	11.0	0.0	Repaying
2003		US/EBRD SME - Opportunity Bank (Montenegro)	Direct	3.0	2.7	2.7	0.0	Completed
		<b>Total 2003</b>		<b>33.9</b>	<b>15.6</b>	<b>15.6</b>	<b>0.0</b>	
2004		US/EBRD SME - Alter Modus	Direct	1.0	0.9	0.9	0.0	Completed
		<b>Total 2004</b>		<b>1.0</b>	<b>0.9</b>	<b>0.9</b>	<b>0.0</b>	
2005	x	Future Air Traffic Management Modernisation & Upgrade	Regional	33.5	2.7	2.7	0.0	Repaying
2005		US/EBRD SME - Alter Modus	Direct	2.0	1.8	1.8	0.0	Repaying
2005	x	Montenegro Regional Road Rehabilitation Project	Direct	14.1	10.9	10.9	0.0	Repaying
		<b>Total 2005</b>		<b>49.6</b>	<b>15.4</b>	<b>15.4</b>	<b>0.0</b>	
2006		Europolis 3	Regional	52.5	1.6	0.9	0.6	Repaying
		<b>Total 2006</b>		<b>52.5</b>	<b>1.6</b>	<b>0.9</b>	<b>0.6</b>	
2007		Western Balkans MSME FW - Alter Modus III	Direct	1.5	1.5	1.5	0.0	Repaying
2007	x	Montenegro Regional Water Supply Project	Direct	52.5	18.0	18.0	0.0	Disbursing
2007	x	Montenegro Rail Infrastructure Emergency Project	Direct	30.0	15.0	15.0	0.0	Disbursing

Year	Sove reign	Operation Name	Direct / Regional	Total Cost	EBRD Amount	Debt	Equity	Stage
		<b>Total 2007</b>		<b>84.0</b>	<b>34.5</b>	<b>34.5</b>	<b>0.0</b>	
2008		ViaOne	Regional	10.0	0.5	0.0	0.5	Disbursing
2008		WBLEF: Franca Mesopromet	Direct	5.0	5.0	5.0	0.0	Disbursing
		<b>Total 2008</b>		<b>15.0</b>	<b>5.5</b>	<b>5.0</b>	<b>0.5</b>	
2009	x	Montenegro Rail Infrastructure Emer Rehab Project II	Direct	17.9	15.0	15.0	0.0	Disbursing
2009		LEF: MPM doo	Direct	1.5	1.5	1.5	0.0	Disbursing
2009		European Fund for SouthEast Europe (EFSE) II	Regional	30.0	1.8	0.0	1.8	Signed
2009		LEF: Voli Trade doo	Direct	4.2	3.1	3.1	0.0	Signed
2009		Southeast Europe Energy Efficiency Fund (SE4F)	Regional	25.0	1.3	0.0	1.3	Signed
		<b>Total 2009</b>		<b>78.6</b>	<b>22.7</b>	<b>19.6</b>	<b>3.1</b>	
		<b>Overall 2002- 2009</b>		<b>325.7</b>	<b>102.9</b>	<b>94.9</b>	<b>7.9</b>	

**ANNEX 7: PROJECTS SIGNED IN 2007-2009**

Year	Sovereign	Operation Name	Direct / Regional	Total Cost	EBRD Amount	Debt	Equity	Stage
2007		Western Balkans MSME FW - Alter Modus III	Direct	1.5	1.5	1.5	0.0	Repaying
2007	x	Montenegro Regional Water Supply Project	Direct	52.5	18.0	18.0	0.0	Disbursing
2007	x	Montenegro Rail Infrastructure Emergency Project	Direct	30.0	15.0	15.0	0.0	Disbursing
<b>Total 2007</b>				<b>84.0</b>	<b>34.5</b>	<b>34.5</b>	<b>0.0</b>	
2008		ViaOne	Regional	10.0	0.5	0.0	0.5	Disbursing
2008		WBLEF: Franca Mesopromet	Direct	5.0	5.0	5.0	0.0	Disbursing
<b>Total 2008</b>				<b>15.0</b>	<b>5.5</b>	<b>5.0</b>	<b>0.5</b>	
2009	x	Montenegro Rail Infrastructure Emer Rehab Project II	Direct	17.9	15.0	15.0	0.0	Disbursing
2009		LEF: MPM doo	Direct	1.5	1.5	1.5	0.0	Disbursing
2009		European Fund for SouthEast Europe (EFSE) II	Regional	30.0	1.8	0.0	1.8	Signed
2009		LEF: Voli Trade doo	Direct	4.2	3.1	3.1	0.0	Signed
2009		Southeast Europe Energy Efficiency Fund (SE4F)	Regional	25.0	1.3	0.0	1.3	Signed
<b>Total 2009</b>				<b>78.6</b>	<b>22.7</b>	<b>19.6</b>	<b>3.1</b>	
<b>Overall 2007-2009</b>				<b>177.6</b>	<b>62.7</b>	<b>59.1</b>	<b>3.6</b>	

Sector	Total EUR Project Value	EBRD Finance
Industry, Commerce & Agribusiness	5.7	4.6
Financial Institutions	1.5	1.5
Infrastructure	100.4	48.0
Regional	65.0	3.6

## ANNEX 8: SELECTED ECONOMIC INDICATORS

### Montenegro

	2004	2005	2006	2007	2008	2009 <i>Estimate</i>	2010 <i>Projection</i>
<b>Output and expenditure</b>							
	<i>(Percentage change in real terms)</i>						
GDP	4.4	4.2	8.6	10.7	7.0	-5.3	0.1
Industrial gross output	13.8	-1.9	1.0	0.4	-2.0	-32.2	na
Agricultural gross output	na	na	na	na	na	na	na
<b>Employment</b>							
	<i>(Percentage change)</i>						
Labour force (end-year)	13.0	-3.6	-2.3	0.7	4.7	2.5	na
Employment (end-year)	29.9	2.0	3.7	5.5	3.8	3.0	na
	<i>(In per cent of labour force)</i>						
Unemployment (end-year)	29.3	25.2	20.6	16.8	17.5	17.1	na
<b>Prices and wages</b>							
	<i>(Percentage change)</i>						
Consumer prices (annual average)	2.4	2.3	3.0	4.2	7.4	3.4	2.0
Consumer prices (end-year)	1.5	2.4	2.8	7.7	7.0	1.5	1.9
Producer prices (annual average)	5.8	2.1	3.0	8.5	7.5	-3.4	na
Gross average monthly earnings in economy (annual average)	12.2	7.6	15.3	14.1	16.3	na	na
<b>Government sector</b>							
	<i>(In per cent of GDP)</i>						
General Government balance	-1.9	2.1	4.2	6.4	1.5	-3.0	-4.1
General Government expenditure	40.5	39.1	42.5	39.0	42.9	49.8	na
<b>Monetary sector</b>							
	<i>(Percentage change)</i>						
Broad money (M2, end-year)	16.3	49.6	87.9	72.9	28.5	29.9	na
Domestic credit (end-year)	42.4	10.6	142.3	175.5	25.8	-14.3	na
	<i>(In per cent of GDP)</i>						
Broad money (M2, end-year)	32.1	44.2	70.1	92.7	101.8	135.6	na
<b>Interest and exchange rates</b>							
	<i>(In per cent per annum, end-year)</i>						
Discount rate	na	na	na	na	na	na	na
Money market rate	na	na	na	na	na	na	na
Deposit rate	4.8	5.0	5.4	4.8	na	na	na
Lending rate (long-term)	na	12.1	9.9	9.2	na	na	na
	<i>(Euros per US dollar)</i>						
Exchange rate (official, end-year)	0.7	0.8	0.8	0.7	0.7	0.7	na
Exchange rate (official, annual average)	0.8	0.8	0.8	0.7	0.7	0.7	na
<b>External sector</b>							
	<i>(In millions of US dollars)</i>						
Current account	-149.0	-197.3	-667.0	-1,129.6	-1,617.3	-834.4	-915.8
Trade balance	-517.9	-650.1	-1,066.4	-1,836.0	-2,252.4	-1,586.0	-1,707.3
Merchandise exports	561.4	581.8	813.9	903.0	939.6	775.3	823
Merchandise imports	1,079.3	1,231.9	1,880.3	2,739.0	3,192.1	2,361	2,530
Foreign direct investment, net	63.3	481.9	585.3	717.4	805.0	648.9	715.3
Gross reserves, excluding gold (end-year)	82.0	204.0	432.7	732.4	478.4	na	na
External debt stock	488.8	524.5	939.0	1,841.0	2,541.0	na	na
	<i>(In months of imports of goods and services)</i>						
Gross reserves, excluding gold (end-year)	0.8	1.7	2.4	2.9	1.5	na	na
	<i>(In per cent of exports of goods and services)</i>						
Debt service	3.4	2.8	2.4	2.6	2.4	na	na
<b>Memorandum items</b>							
	<i>(Denominations as indicated)</i>						
Population (end-year, million)	0.7	0.7	0.7	0.7	0.7	0.7	na
GDP (in millions of euros)	1,670.0	1,815.0	2,149.0	2,810.0	3,292.0	3,207.2	3,274.6
GDP per capita (in US dollars)	3,142.8	3,478.3	4,084.2	5,827.2	7,300.1	6,656.9	na
Share of industry in GDP (in per cent)	na	na	na	na	na	na	na
Share of agriculture in GDP (in per cent)	na	na	na	na	na	na	na
Current account/GDP (in per cent)	-7.2	-8.6	-24.7	-29.4	-33.6	-18.7	-19.6
External debt - reserves (in US\$ million)	406.8	320.5	506.3	1,108.6	2,062.6	0.0	na
External debt/GDP (in per cent)	23.6	22.8	34.8	47.9	52.7	na	na
External debt/exports of goods and services (in per cent)	56.1	52.6	70.1	100.9	122.6	na	na

## ANNEX 9: BILATERAL ASSISTANCE

Commitment Name	Euro Committed	Euro Disbursed	Approved Date	Commit. Stage	Sector
Extension of TAM in CE & SEE 2001-2003	28,887	28,887	13/09/02	Closed	Manufacturing
Progas Legal Due Diligence	40,100	40,100	07/03/02	Closed	Finance, Business
Montenegro Airports: Strategy building and business planning	27,080	27,080	15/09/04	Closed	Transport, Storage
TAM - Crnagoracoop	60,522	60,522	15/12/05	Closed	Manufacturing
TAM -- Pantomarket	44,298	5,302	21/01/10	Committed	Manufacturing
TAM Programme in Montenegro	680,983	680,983	09/07/02	Closed	Manufacturing
BAS Programme in Montenegro - Framework	468,166	468,166	19/09/02	Closed	Manufacturing
EAR Funded Business Incubator in Montenegro	60,693	60,693	20/01/06	Closed	Manufacturing
Pljevlja District Heating - Feasibility Study	90,730	69,210	04/03/09	Committed	Energy
Montenegro Railways Emergency Rehabilitation Programme	425,000	0	19/08/09	Committed	Transport, Storage
Continuation of BAS Programme in Montenegro	642,469	642,469	29/11/04	Closed	Manufacturing
Continuation of TAM Programme in Montenegro	563,452	563,452	30/11/04	Closed	Manufacturing
TAM - SMEDA Export Development	30,619	30,619	17/02/06	Closed	Manufacturing
TAM - Fabrika Elektroda	6,271	6,271	17/02/06	Closed	Manufacturing
TAM - Fabrika Namjesta Mi-Rai II	11,387	11,387	17/02/06	Closed	Manufacturing
Continuation EAR BAS Programme for Montenegro EAR Phase III - framework	565,710	565,710	21/11/06	Closed	Manufacturing
TAM - Otrantkommerce	47,330	47,330	11/01/07	Closed	Manufacturing
TAM - Farma Franca	54,005	54,005	17/01/07	Closed	Manufacturing
TAM - Airports of Montenegro	50,313	50,313	17/01/07	Closed	Manufacturing
TAM - Bajo Pivljanin	3,588	3,588	17/01/07	Closed	Manufacturing
TAM - Martex	49,085	49,085	17/01/07	Closed	Manufacturing
TAM - BAST	49,847	49,847	26/04/07	Closed	Manufacturing
TAM - EKO Meduza	41,624	41,624	10/08/07	Closed	Manufacturing
TAM - Vektra Montenegro	45,551	45,551	16/08/07	Closed	Manufacturing
TAM - Gradina Company	72,300	72,300	21/08/07	Closed	Manufacturing
TAM - National Parks of Montenegro	31,491	31,491	13/09/07	Closed	Manufacturing
TAM - EAR Montenegro Phase III Follow up Incubator Project	62,550	62,550	14/01/08	Closed	Manufacturing
TAM - EAR Montenegro Phase III Visibility and Training	6,164	6,164	12/08/08	Closed	Manufacturing
Montenegro Airports Due Diligence	47,165	47,165	28/05/03	Closed	Transport, Storage
Montenegro Roads - Consultancy for Engineering Supervision	749,470	737,252	13/12/05	Disbursing	Construction
ZCG Infrastructure: Niksic - Podgorica Railway/ Assistance in Project Preparation	400,000	0	20/04/09	Committed	Transport, Storage
KAP Pre-Privatisation Loan - Legal Advisory for Privatisation Advisor	125,850	125,850	07/04/04	Closed	Manufacturing
TAM - National Tourism Organisation of Montenegro	50,000	7,386	16/10/09	Disbursing	Manufacturing
Montenegro: Euromarket Banka: Credit and Risk Management Advisor	260,462	260,462	04/07/03	Closed	Finance, Business
TAM - Crnagoraput	14,156	14,156	28/01/04	Closed	Manufacturing
KAP - Institution building in environmental authorities	185,166	185,166	08/02/05	Closed	Community/Social Services
KAP Health & Safety Base Line Audit	173,364	173,364	08/02/05	Closed	Manufacturing
TAM - UPCG	59,341	59,341	13/12/05	Closed	Manufacturing
TAM Programme - DAZ Bijela Aleksandrija d.o.o.	22,186	22,186	22/03/06	Closed	Manufacturing
TAM - Zitoprodukt	49,960	45,247	05/08/08	Committed	Manufacturing
TAM - Granit	49,960	22,273	05/08/08	Committed	Manufacturing
TAM - Hidromol	49,960	35,158	05/08/08	Committed	Manufacturing
TAM - Ening	68,917	68,917	09/03/06	Closed	Manufacturing
TAM - Solar Seminar in Montenegro	11,650	11,650	08/10/08	Closed	Manufacturing
TAM/BAS Crisis Response Programme - Fabrika Elektroda	30,000	12,856	30/09/09	Committed	Manufacturing
TAM/BAS Crisis Response Programme - Bast	30,000	16,621	30/09/09	Disbursing	Manufacturing

<b>Commitment Name</b>	<b>Euro Committed</b>	<b>Euro Disbursed</b>	<b>Approved Date</b>	<b>Commit. Stage</b>	<b>Sector</b>
Continuation of BAS Western Balkans - Montenegro for 4 years	1,630,373	588,792	07/12/07	Disbursing	Manufacturing
Montenegro Airports: Strategy building and business planning	227,350	227,350	15/09/04	Closed	Transport, Storage
EPCG Metering and Distribution Project - Project Preparation	95,000	0	22/05/09	Committed	Energy
TAM - Montenegro Association of Hoteliers and Restaurateurs	6,354	6,354	26/01/06	Closed	Community/Social Services
US EBRD SME Finance Facility - Assistance to Alter Modus	183,204	102,007	13/09/05	Disbursing	Finance, Business
Republic of Montenegro: Communications Sector - Interconnection and Costing	354,795	337,900	31/10/07	Disbursing	Community/Social Services
Montenegro Rail Infrastructure Asset Management Plan Assistance.	250,000	51,888	13/11/07	Disbursing	Transport, Storage
Montenegro Regional Water Supply System - Project Implementation Support	401,470	359,635	18/12/07	Disbursing	Local Authority Services
Under Sea HVDC Interconnection - Italy/Montenegro	49,890	0	17/03/08	Committed	Energy
Presentation to SEE Public Officials on Energy and Environment Law and Policy	80,000	76,514	28/03/08	Disbursing	Non-classifiable Establishments
Velika Plaza - Technical and Legal Assistance	250,000	186,039	30/06/08	Disbursing	Commerce, Tourism
Montenegro Rail Infrastructure (ZCG) / Assistance In Project Implementation	47,850	47,850	03/07/08	Closed	Transport, Storage
Montenegro Airlines: Feasibility Study	140,000	140,000	24/07/08	Closed	Transport, Storage
Montenegro Airlines Strategic Investor Identification	49,500	9,900	27/02/09	Committed	Transport, Storage
Pljevlja District Heating - Feasibility Study	90,730	69,210	05/03/09	Committed	Energy
Communications Law Revision Phase II: Development of Secondary Legislation	150,000	45,000	05/08/09	Disbursing	Community/Social Services
Regional Energy Efficiency Programme for Corporate Sector - WB/SSF - D'apponia Framework Agreement	32,186	0	11/03/10	Committed	Energy
<b>TOTAL</b>	<b>10,676,525</b>	<b>7,868,190</b>			
	<i>No of Commitments:</i>	<i>63</i>			

<b>Sector</b>	<b>Euro Committed</b>	<b>Euro Disbursed</b>
Commerce, Tourism	250,000	186,039
Community/Social Services	696,316	574,421
Construction	749,470	737,252
Energy	358,536	138,419
Finance, Business	483,766	402,569
Local Authority Services	401,470	359,635
Manufacturing	6,043,023	4,842,107
Non-classifiable Establishments	80,000	76,514
Transport, Storage	1,613,945	551,233
<b>Grand Total</b>	<b>10,676,525</b>	<b>7,868,190</b>

## **ANNEX 10: TAM/ BAS ACTIVITIES IN MONTENEGRO**

### **Previous TAM experience**

Since inception in 2002, TAM has received a total of almost €3 million in donor funding for projects in Montenegro. The largest donors to TAM have been the EU, Italy and Japan. Austria, Greece, Canada, Denmark, Luxembourg and Switzerland have also supported the TAM Programme in Montenegro. The Programme has carried out 68 projects throughout Montenegro of which seven are still in progress. Enterprises assisted have been mainly focussed on the Food Manufacturing and Tourism sectors. Geographically, there has been a good spread with two-thirds of enterprise assisted located outside the capital, Podgorica.

### **Previous BAS experience**

Since inception in February 2003, BAS Montenegro has received a total of €3.7 million in donor funding. The main donors have been the EU (through the EAR), and the Netherlands. The Programme has undertaken a total of 274 projects with MSMEs, engaging 112 consultants (98 per cent of which were local). Three-quarters of the projects were located in rural area; outside the capital, Podgorica. The industry spread of enterprises assisted has been wide, with Food and Beverages, Tourism and Construction the most common sectors in the first three years of operations. Printing and Publishing as well as Health have become more common sectors in the last three years. In terms of cross-cutting issues, BAS Montenegro has mainly focused on facilitating rural development.

### **Linkages with Banking**

To date, four TAM/BAS-assisted companies in Montenegro have attracted investments from the EBRD or EBRD-related financial intermediaries, mobilising over €48 million of EBRD financing.

### **The Consultancy Market**

The consultancy market in Montenegro is concentrated in Podgorica and is still at a low level of maturity. The network of private consultancy agencies has expanded in recent years, though the quality of services requires further development. MSME demand for advisory services is low and limited to services directly related to financing such as business plans. However, following the Government's application for EU membership, greater demand for quality certification is expected to enable Montenegro to exploit export opportunities to EU countries.

### **TAM/BAS continuation in Montenegro**

**TAM:** In light of the low level of development of the local consultancy market, business advice from international experts is highly relevant in Montenegro. Based on the challenges of the Montenegrin economy, TAM will concentrate on the following types of projects:

- Trade and business partners : partner search, joint-ventures, export promotion;
- Restructuring, M&A, crisis response;

- Long term strategic planning; and
- New technologies, transfer of technologies to reach international standards.

**BAS:** Grant Guideline Matrix is proposed in Montenegro in order to prioritise intervention, avoid duplication of efforts from international donors and focus on the areas where Montenegro businesses have needs and no access to advisory services.

Depending on funding availability, higher grants will be allocated according to:

- Size of enterprise: Higher grants will be given to smaller enterprises
- Geographic location: Higher grants will be given to enterprises outside the capital city and particularly companies in the Northern parts of Montenegro
- Type of advisory service: Higher grants will be given to support projects involving consultancy services where market demand is less mature: particularly in the areas of energy efficiency/environment and Quality Management and Certification.

BAS assistance at the enterprise level will be complemented with the following Market Development Activities in order to maximise the Programme's transition impact in Montenegro :

- *Visibility and dissemination:* The BAS Programme will take steps to promote the use of business advisory services especially in more rural regions where consultancy is low in demand. BAS will organise more seminars related to best practices to demonstrate the potential benefits for MSMEs.
- *MSME and consultancy training:* Capacity building for consultants will be organised to help broaden the country's supply and quality of local advisory services. BAS will continue to address existing gaps in the supply of advisory services in order to stimulate demand for more sophisticated consultancy services.
- *Support to and development of existing local institutions:* BAS MDAs will continue supporting local institutions that contribute to the development of MSMEs and the business advisory services market.

## **Continuation of combined TAM/BAS activities**

### *Cross-cutting issues*

In order to address cross-cutting issues that are pertinent to Montenegro's MSME sector development, the TAM/BAS Programme will focus its effort on projects targeted in the northern region and the central region outside the capital Podgorica. Moreover, TAM/BAS will also devote efforts to supporting measures that increase energy efficiency and environmental management especially in those areas.

### *Contribution to EBRD policy dialogue*

By thoroughly analysing the business environment and clearly identifying the challenges faced by the MSME sector, TAM/BAS further strengthens the EBRD's policy dialogue toolkit. Future challenges for the Government (among others) are identified as improving efficiency of the tax administration, faster granting of business licenses and permits, upgrading the infrastructure and continuing to fight corruption. Access to credit for MSMEs remains a major issue of concern following the financial crisis. The TAM/BAS Programme will continue to engage in dialogue with Montenegrin authorities to encourage further economic diversification in particular by strengthening the tourism industry.