PROGRAMME

AN ADDITIONAL SUPPORT PROGRAMME FOR MONTENEGRO IN 2001

1. IDENTIFICATION

Beneficiary state:	**MONTENEGRO - The Federal Republic of Yugoslavia**
Programme:	**Council Regulation (EC) No.2666/2000**
Year:	**2001**
Cost:	**€ 3.0 million**
Expiry date:	**31.12.2003 contracting** **31.12.2004 disbursements**
Sector:	**AA**
Group:	**M**
Budget line:	**B7-541**
Implementing Body:	**European Agency for Reconstruction**

2. SUMMARY

The programme presented below has been designed to reinforce the Agency's initial 2001 programme. Care has been taken to ensure correlation with previous activities in earlier programmes, which are now under implementation. The proposed additional investments in transport and vocational education/training will further strengthen economic and institutional development in Montenegro.

This proposal consists of:

- ***Transport (Road Safety) - € 2 million (+/- 20%).*** Further improve safety on the Podgorica to Budva (via Cetinje) road and the Petrovac Croatian border coastal road through selected anti-skid surface treatments, crash barriers, etc. (See annex 1).
- ***Vocational Education and Training - €1.0 million (+/- 20%).*** Provide support (technical assistance, some equipment, etc.) to modernise vocational education and training for the two most promising economic development sectors: tourism, and wood processing. (See annex 2).

Maximum Available: € 3.0 Million

3. GENERAL BACKGROUND

3.1. Past EC Funding

A total of € 135.8 million has been committed thus far. It consists of:

PROGRAMME	SUM	DESCRIPTION
OBNOVA 1998 Economic reform	€ 5 m	*Agriculture: provision cattle for breeding, Transport: financing of 12 ambulances and 3 city busses. TA package: provision or technical assistance for support to the tax administration reforms, organic budget law, treasury system and Bank supervision. Education: to assist the Ministry of Education in reforming the existing education system at "elementary" level while developing a more comprehensive "master-plan" for future reforms in the higher and university sectors.*
OBNOVA 1999 Internally displaced (IDPs) Economic reform Energy supplies	€ 22.5 m	*Assistance to the national budget in support to "Internally Displaced Persons" from Kosovo for health and accommodations, National Aid Co-ordination office, public administration reform and private sector development and assistance to the National Budget in directing subsidies to EPIM, the electricity authority, which provides power to some industries and households at reduced prices*
OBNOVA 2000 Infrastructure, agriculture, fiscal and financial sector	€ 19 m	*Reconstruction road Podgorica-airport, construction of the Union bridge in Podgorica on river Maraca, construction of the Slatica school, critical road maintenance, agricultural supplies mainly machinery & equipments in milk sector, restructuring of the Ministry of Finance.*
Macro - financial assistance 2000	€ 20 m	*Exceptional Community financial assistance in favour of Montenegro's budget. In parallel, the Ministry of Finance on behalf of the Government has agreed to undertake measures to strengthen: revenue collection, budget transparency and efficiency in public spending.*
ECHO 1999 – 2001 Humanitarian assistance	€ 34 m	*Assistance to refugees, internally displaced people and "social cases"*
Food Security Programme 1999 - 2000	€ 21 m	*Assistance to the National Budget under certain conditions: a) liberalisation or the prices or bread and milk, b) Agriculture market reforms, c) Social sector reforms and d) Public Finance reforms.*
Media – NGOs 1998- 1999	€ 1 m	*Assistance to RTV Montenegro and independent media*
2001 Support Programme (Tranche 1)	€ 13.3	*Development of Municipal infrastructure, Transport (road rehabilitation), Institution building, the ATA facility (short term TA)*

3.2 Socio-economic issues

The break up of the former Yugoslavia, the ensuing armed conflicts and economic mismanagement resulted in hyperinflation and a ruined economy. Established markets were lost, traditional production relations were disrupted and the international community imposed sanctions. Household foreign exchange banking assets were frozen, a number of private banks collapsed and in early 1994 there was hyperinflation resulting in a virtual collapse of industrial output. By 1994 GDP in the Federal Republic of Yugoslavia (FRY) had dropped to 44% of its 1990 level.

Montenegro suffered a further severe economic set back as a result of the Kosovo crisis in 1999. GDP dropped by a further 10% in 1999 alone to 58% of the 1990 level. Foreign exchange shortages resulted in steadily increasing gaps between the official and parallel market exchange rates. Inevitably public finances were badly affected.

Today, the macro-economic environment remains fragile. In 2001 inflation in Montenegro reached 21,8 percent, despite the use of the DEM. There has been some recovery in output following the end of the Kosovo conflict. Nevertheless it is still estimated to be just about half of the 1990 level.

In 2000, the consolidated cash deficit of the budget and major extra-budgetary funds reached about DEM 136 million and arrears probably rose by some DEM 64 million (to a total accumulation of some DEM 120 million over 1999-2000). To compensate for the periods of high inflation the minimum wage increased from DEM 50 to 80 per month during 2000 and to DEM 90 per month in October 2001. This wage increase further aggravated the fiscal burden by increasing both public sector pay and benefit levels.

Faced with this difficult situation, the government adopted ambitious plans. They include cutting expenditure on a range of budget items, liberalising the prices of some key staples, better targeting of social benefits, accelerating restructuring and privatisation and now, freezing the minimum wage. To improve revenue, a comprehensive tax reform is also being implemented with donor assistance.

In the meantime Montenegro's budget for 2001 is somewhat off track. Tax revenues have been disappointing in some areas but have been compensated for by an increase in revenue generated by the campaign against the grey economy initiated during Summer of 2001 and by transit taxes due to increasing traffic from the port of Bar to Kosovo. However expenditure discipline will be necessary for the remainder of the year if the government is to honour its undertaking to the IMF to avoid new domestic arrears or borrowings.

Finally, the Federal, Serbian and Montenegrin governments have recently embarked on a reform agenda for 2001 backed by an IMF Stand-By Arrangement. This programme includes many measures, which would address macroeconomic imbalances through restrictive budgets and sustained tightening of monetary conditions. It also includes numerous elements of a deeper structural reform agenda, including public finances and the restructuring of enterprises and banks.

However, consensus between the Federal, Serbian and Montenegrin governments will be needed to create a well functioning single economic entity regardless of the ultimate political arrangements.

3.3 Socio-Political issues

The Federal Republic of Yugoslavia (FRY) was established in 1992, as a federation of the republics of Serbia and Montenegro after the four other republics of the Socialist Federal Republic of Yugoslavia became independent states. The current population of the Federal Republic is approximately 10.5 million. Montenegro's population is about 650,000.

FRY's federal structure is highly decentralised and fluid. In some areas, the reality differs from its legal form. The federal Constitution gives the republics the responsibility for most economic and social functions. The main federal responsibilities are defence, foreign policy, monetary and trade policy

Economic and political mismanagement during the 1990s resulted in increased tensions between Montenegro and Serbia especially after the election of Milo Djukanovic as President of Montenegro in October 1997. Djukanovic openly opposed the policies of Federal President Milosevic and proclaimed neutrality during the Kosovo crisis in 1999. Djukanovic began to detach Montenegro politically and economically from the Federal government, for example replacing the Yugoslav Dinar with the DEM in November 1999. Montenegro has also de facto established a separate customs regime and a Montenegrin Central Bank. As a consequence, the Republic of Montenegro has in practice taken over responsibility for much of its monetary and trade policy although some practical co-operation with the Federal authorities continues (e.g. on the IMF stand by arrangement).

At the end of last year, the Montenegrin Government presented a revised platform on the future of the Yugoslav Federation. It proposed a Union of independent Montenegro and Serbia (with each having a seat in the UN). The ruling coalition (Democratic Party of Socialist (DPS), Socio-Democratic Party (SDP) and the Peoples Party (NS)), split and the NS Party, which had been out-voted in the adoption of the new platform, moved into opposition. A general election was held on22 April 2001 with Montenegrin independence the main issue. Two main coalitions were formed: "Victory for Montenegro" (pro independence) and "Together for Yugoslavia" (pro Yugoslavia). The Liberal Alliance (more strongly pro independence) stood under their own banner, unable to strike a deal with the coalition "Victory for Montenegro".

The election produced a tiny majority in favour of independence but falling short of a mandate to press forward with an independence referendum. The results also failed to give the new government a strong mandate and a secure foundation on which to begin negotiations with Serbia. "Victory for Montenegro" emerged as the largest block but were three seats short of a governing majority. Negotiations with the Liberal Alliance to form a government were unsuccessful.

After 4 months, the minority government is showing signs of instability due to the question of the future structure of the FRY. Disagreements between the Liberal Alliance supporting the minority government in Parliament and the largest ruling party in the coalition DPS (President Djukanovic's party) "Victory for Montenegro" have become very evident. The Liberal Alliance believes they should press further in the preparations for a referendum on independence, while the DPS party has announced their preparedness to create a new coalition government with all parliamentary parties including the opposing pro-federation parties to work together in preparing a transparent, democratic and fair referendum. The opposing pro-federation parties have accepted this offer under the condition that "fair and democratic" negotiations with Serbia and the Federal government take place - dialogue for which the EU has repeatedly called. Only if these negotiations were unsuccessful would the pro-federation parties be prepared to enter a new Montenegrin government that will pave the way for a democratic referendum on independence.

Currently, the negotiations between the Montenegrin, Serbian and Federal governments are stalled due to disagreements on who should participate on behalf of the Federation. As part of their refusal to accept the Federal government, the Montenegrin government refuses to negotiate with the Federal Prime Minister or his Deputy, though accepts the participation of the Federal President. At the same time, the minority government continues to work with the Liberal Alliance in preparing a new legal framework for a referendum (a framework on which an OSCE opinion - probably negative - is expected shortly). The pro-Yugoslav parties are not taking part in these parliamentary committee discussions and have stated that they would refuse to support any legal framework in parliament without their previous participation.

4. PROGRAMMING CONTEXT

The main criteria are:

- To concentrate resources on a limited number of fields crucial to providing sustainable solutions in key areas of economic and social infrastructure.
- To ensure a sense of local "ownership" by supporting the Federal and Republican level Governments' priorities.
- To support sectors where practical assistance can be absorbed quickly.
- To support the process of economic and institutional reform.
- To work closely with other donors.

The two sectors in which the Agency proposes to intervene were selected following detailed consultations with the (republican government. The Agency also took into account the past and existing EC programmes in Montenegro, especially those in which implementation are about to get underway.

5. IMPLEMENTATION

This programme will be implemented under the responsibility of the European Agency for Reconstruction, which will sign all necessary contracts with service providers and suppliers. Selection of contractors will be carried out in conformity with the Agency and CARDS Regulations with maximum emphasis placed on local tendering to the extent permitted by the regulations.

Implementation of projects will be carried out in close co-ordination and consultation with the FRY and Montenegrin authorities and those international agencies and donors that are active in the various fields of the programme.

6. INDICATIVE DISBURSEMENT SCHEDULE (M€ ACCUMULATED)

Sector	**June 2002**	**Dec 2002**	**June 2003**	**Dec 2003**	**Dec 2004**
Transport	0.3	1.5	1.7	1.9	2.0
Vocational Training and Education	0.1	0.4	0.7	0.9	1.0
TOTAL	0.4	1.9	2.4	2.8	3.0

7. MONITORING, EVALUATION AND AUDIT

This programme will be monitored and supervised by the European Agency for Reconstruction, which shall:

a) monitor the implementation of the programme on the basis of regular reports;

b) carry out regular monitoring and evaluations to follow the progress of the programme and its components as well as ex-post evaluations after the completion of the programme.

The accounts and operations of the programme components will be checked at intervals by an outside auditor contracted by the Commission without prejudice to the responsibilities of the European Commission, including the European Antifraud Office (OLAF), and the European Union's Court of Auditors.