



Investing in rural people

## **Montenegro**

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### **Country strategy note**

Main report and appendices

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## Weights and measures

1 kilogram	=	1000 g
1 000 kg	=	2.204 lb.
1 kilometre (km)	=	0.62 mile
1 metre	=	1.09 yards
1 square metre	=	10.76 square feet
1 acre	=	0.405 hectare
1 hectare	=	2.47 acres

## **Abbreviations and acronyms**

IPARD	Instrument for Pre-accession Assistance for Rural Development
MARD	Ministry of Agriculture and Rural Development
RCTP	Rural Clustering and Transformation Project
SO	Strategic objective

## Map of IFAD-funded operations in the country

### Montenegro

#### Map of IFAD-funded operations in the country

Country strategy note



## A. Country diagnosis

### Economy

1. Montenegro is an upper middle-income country (GDP/person : USD 7318, 2014). Since 2006<sup>1</sup>, the country has been intensifying efforts to promote competitiveness, and the government has just adopted a major growth initiative to boost economic development and connectivity, viewed as a vital complement to EU accession plans. Key growth drivers are the construction and service sector.
2. Montenegro is increasingly developing a dual economy with a thriving model in its costal and central parts, benefiting from robust growth in tourism, services sectors, construction and light manufacturing. The flip side is found in the northern mountainous region, increasingly disconnected from the growth drivers, and suffering from reduced investments, limited competitiveness, emigration and isolation, as infrastructure crumble. Montenegro is a net food importer and the deficit is widening. To reverse this, agriculture and rural development has been singled out as one of the priority economic sectors for inclusive development.

### Agricultural sector

3. Montenegro covers 13 812 square kilometers. Agricultural land resources account for 38% of the territory, the largest share of which consisting of pasture and grassland. Agriculture employs only 5.7% of the economic active population, but is the dominant activity of the rural population (60 000 households obtain their income partly or entirely from agriculture). Food production and agriculture represent around 7% of GDP. Farm sizes are small<sup>2</sup> and very few farms specialize (80% of all agricultural holding being mixed). Less than 1% are registered as business entities. Small agricultural producers and processors are disadvantaged in terms of access to markets as they are often located away from well-maintained roads. Key challenges are better connectivity and productivity.
4. With EU accession<sup>3</sup>, Montenegro will have unhindered access to export to the world's largest market, where demand for especially high-value agricultural products (including organic products) is soaring. On the other hand, accession will increase competitive pressures and require structural transformation.

### Rural development

5. One of the main ambitions of the Economy Reform Programme 2016 - 2018 is to reduce rural – urban migration and migration from municipalities of the North to the Central and Costal area, through increased competitiveness and by linking rural areas to better commercial opportunities. In the agricultural sector, governance has been comparatively robust, with consistent progress toward complying with the EU's Instrument for Pre-accession Assistance for Rural Development (IPARD) requirements.
6. The Strategy for the Development of the Agriculture and Rural Areas 2015-2020 particularly emphasizes the need to overcome widespread fragmentation, poor connectivity and increased climate vulnerability. A new law on cooperatives has recently been passed, providing improved corporate governance safeguards, and which will allow for the creation of new cooperative enterprises, and the transformation of the old cooperatives currently operating under the law for non-governmental organizations.

### Poverty

7. Poverty rate is of 8.6% (2013)<sup>4</sup>, 9.7% of the rural population is living below the national poverty line, and the Gini coefficient (24.3 in 2010 against 26.2 in 2013) indicates a rise in inequality. Rural poverty is significantly higher than urban, the gap now being 23%. Poverty is concentrated in the northern mountainous region. Montenegro has limited under-nutrition and the rate of under 5 mortality is also low. But under-5 stunting has been rising from 8% (2005) to 9% (2013)<sup>5</sup>.

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1 Separation from Serbia

2 Average of 4.6 ha, but with more than half under 1 ha. Often mixed : crop, poultry, pig, and cow.

3 Information on EU pre-accession assistance process is summarized in Appendix.

4 Minorities (Bosnians, Albanians and Roma) being particularly vulnerable.



8. The vulnerable rural poor with an economic potential live in the mountainous areas. A key constraint to producers is the poor connectivity to input markets and outlets. Moreover they are often producing small quantities and with variable quality, limiting their attractiveness. For rural service providers (agro-tourism, trekking, etc.) cumbersome long transport routes diminish demand and hinder the development of a rural service sector, which however has strong potential. The lack of connectivity and scale of primary producers also limits their capacity to benefit from the growth.

### **Environment**

9. Montenegro has one of the European's richest flora and fauna and diverse ecosystems. Hydropower is the most important energy resource. The climate is Mediterranean in the southern coastal region (warm and dry summers, mild and humid winters) and a continental in the northern mountainous region (hot summers, severely cold and humid winters). Montenegro experiences high river discharge levels (average total of 40 l/s/km<sup>2</sup>) and is in the top 4% of the world's territory in terms of average outflow.

10. An increase in temperature of up to 1.3°C can be expected by 2030, while changes in precipitation regime will range from + 5% to - 20%. Annual rainfalls vary noticeably (July has 50mm precipitation and December has 235mm). Climate volatility is increasing generating both more floods and more droughts. If global emissions grow more intensely, it will lead to reduced flows and water resources scarcity. For agriculture, both droughts and stress on livestock would increase, whereas road infrastructure (especially gravel roads) would become more susceptible to extreme rainfalls.

## **B. Rationale and time frame**

### **Economy**

11. Montenegro became a Member of IFAD in 2015 and subsequently requested financing for a project. The timing could not be more pertinent as the gap between the growing coastal/central region and the poor northern mountainous region is widening.

12. EU/IPARD assistance in the coming years will focus on investments in physical assets to modernize medium size agricultural holdings, while the enabling environment for rural development (particularly the development of rural infrastructure and the diversification of economic activities) would only be tackled from 2018 or 2019<sup>5</sup>. In the Ministry of Agriculture and Rural Development (MARD)'s perspective, delaying rural development strategies could lead to further migration, and combining the EU priority measures with immediate support to rural development is necessary to make transformative investments, enhance shared prosperity, and reduce the poverty gap.

13. Therefore, in alignment with the MARD strategy and complementing the EU/IPARD assistance, IFAD will support the government's endeavor to reducing rural poverty through accelerated inclusive rural economic growth. This CSN has been prepared instead of a COSOP as IFAD has insufficient country knowledge and the 2016-2018 PBAS allocation is below US\$ 5 million. This CSN will provide directions for assisting Montenegro (i) in reinvigorating rural growth in the mountainous and adjacent areas in the coming two years, and (ii) in transforming these rural economies away from their current stagnation. The Fund will focus on key challenges of better connectivity and higher productivity by: (i) fostering the graduation of micro and small agricultural holdings from the current non-viable subsistence-type agriculture toward semi-commercial and commercial agriculture, through investments in pro-poor rural infrastructure, and (ii) promoting the aggregation of smallholders into more structured farmers' associations.

## **C. Strategic objectives**

14. IFAD's overall objective will be to improve the economic and climatic resilience of poor rural communities in northern mountainous areas. IFAD is favourably positioned (i) to provide

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5 Children in the poorest quintile are more than 10 times more likely to be stunted compared to peers in wealthiest quintile (IFPRI 2015).

6 Information related to EU assistance and pre-accession process (timing, priorities, etc) is summarized in Appendix.

transformative knowledge brokering and leveraging additional finance, and (ii) to respond to increased demand for various knowledge products, while accelerating harmonization and alignment efforts with on-going engagements. The strategic objectives (SO) are: (i) in the short term, to broaden the evidence base on drivers for shared rural prosperity and how these can best be supported; and (ii) in the medium term (within 24 months), through two interconnected objectives, to contribute to transforming the rural economy into a dynamic sector, based on competitive farms, and efficient producer associations.

15. **SO1 is thus to improve climate resilience of the rural sector.** Climate resilience and market participation is closely linked, as especially rural infrastructure has both become more critical and vulnerable to accelerating CC. Thus rural roads are increasingly susceptible to extreme rainfalls rendering them hard-to-impossible to negotiate. Secondly, with increases in temperatures and heat waves, water supply is becoming more critical. Therefore, climate resilient rural infrastructure will be a key and immediate priority, while other climate resilient measures<sup>7</sup> will also be promoted. The expected outcome will be that farmers are more climate resilient in terms of having infrastructure that is adapted to more extreme weather events.

16. **SO2 will be to promote inclusive and competitive value chains that can integrate poor smallholders in commercial markets with higher profitability.** There is a need for increasing the productivity of the rural economy, especially in the more remote areas. IFAD will assist in overcoming structural barriers to inclusive rural transformation that relate to increasing production quality and quantity, through e.g. land consolidation, forming more competitive producer/processor groups with scale, and promoting diversification into high-value activities. The outcome is expected to be more productive and profitable farmers, rural processors and service providers.

## D. Planned IFAD engagement

17. IFAD will commence its first development engagement in 2017. An investment project “Rural Clustering and Transformation Project (RCTP)” is expected to deliver on the ambition of creating resilient employment opportunities in deprived rural areas. RCTP will have two interrelated outcomes, the first being the creation of climate resilient connectivity through rural infrastructure upgrading, the second being aimed at reducing fragmentation and promoting transformative diversification and commercialization. RCTP costs are expected to amount to US\$ 9 to 10 million, of which an IFAD loan of USD 3 million<sup>8</sup> and an Adaptation for Smallholder Agriculture Programme grant of USD 2 million. ASAP funding is needed to address imbalances that CC are exacerbating, as the poorer mountainous areas will suffer disproportionately from accelerating weather events<sup>9</sup>. Government and beneficiaries are expected to contribute with approximately USD 4 to 5 million in co-financing.

18. **Lessons learnt.** IFAD having no country experience yet, learning from others will be key and will be carefully looked at during RCTP design. However, a few lessons learnt are already presented in Appendix. Experience shows that most opportunities for smallholders lie in developing small niche markets. In terms of institutional capacities of the MARD, despite undeniable institutional progress, support is still necessary to ensure adequate targeting, while a robust monitoring system will need to be put in place, helping to monitor both disbursement and physical progress. RCTP design will also carefully look at the way to ensure a smooth cooperation and coordination between line ministries to avert implementation bottlenecks. In terms of targeting and gender inclusion, IFAD experience in the CEN region demonstrated that a targeting differentiated approach is needed for gender equality and funding, according to the poverty level of the direct beneficiaries, and that such an approach requires a robust understanding of the characteristics of the poor and of how these can and will benefit from a project. Finally, achievement of gender equality being constrained by socio-cultural stereotypes, IFAD will (i) draw on UNDP’s experience which has been championing the gender and youth cause in

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<sup>7</sup> Conservation agriculture, drip-irrigation, drought resistant crops, etc.

<sup>8</sup> 2016-2018 allocation, ordinary terms.

<sup>9</sup> ASAP funding will be used (i) to support the incremental cost for climate proofing rural infrastructure, and (ii) to contribute to the “National Climate Change Strategy by 2030”. Also, Montenegro having very low adaptation capacity, ASAP funding will help identifying capacity development priorities.

Montenegro, and (ii) leverage knowledge of the Ministries of Labour and Social Welfare, and of Minorities and Human Rights<sup>10</sup>.

19. **Partnerships.** IFAD intends to engage (i) with the WB and the EU, drawing on their expertise in establishing concrete project modalities, learning from the MIDAS project, and tapping in to their databases; (ii) with the European Investment Bank, for water management (area in which the Bank invested EUR 10 million); (iii) with EBRD, for activities related to agribusiness SME development; or (iv) with GIZ, for its knowledge of non-costal tourism (hiking, bicycling, etc.).

## E. Risk management framework

20. This risk management framework will be further revised during RCTP design.

Risk	Management and mitigation
No institutional memory to guide cooperation	IFAD will ensure frequent support/supervisions in the start phase, with close interaction with Government, providing directions for engagement and full transparency on requirements and procedures.
Weak fiduciary management (which could lead to leakages and possibly elite capture)	IFAD will support on-going efforts to improve governance (capacity development on procurement, close supervision of beneficiary selection, etc.), and a solid project implementation manual will be developed.
Environmental and climate risk associated with extreme heat waves and rainfalls	IFAD will work on (i) mapping these challenges, (ii) awareness creation and (iii) investments mitigating this risk (in the first instance through more climate resilient infrastructure, but other measures will also be utilised).
Lack of experience of farmers in working together in groups/associations	RCTP will ensure that (i) the process is demand driven and only involves truly committed farmers, and (ii) beneficiary contribution is enough to reflect binding participation. It will also use recently passed law on cooperative to enforce proper governance.

10 Which host the Department for Gender Equality

## Appendix 1: Country strategy note : Institutional quick overview

Montenegro and the EU. EU accession negotiations started in mid-2012 and Montenegro is among the beneficiaries of the Instrument for EU Pre-accession Assistance (IPA). Montenegro is now benefiting, for the period 2014-2020, from the IPA second phase (IPA II), which sets a new framework for providing pre-accession assistance. Though advanced compared to some other countries, Montenegro is currently assessed moderately prepared, for instance, with regards to public administration system and judicial system. At the current trend and under the best case scenario, accession might be in 2021.

EU/IPARD. For agriculture and rural development (one of the priority sector), the indicative amount of financial assistance is of EURO 52.4 million. With the Rural Development component of IPA, Montenegro will be assisted through a particular instrument called IPARD - Instrument for Pre-Accession Assistance in Rural Development. The objective of IPARD is two-fold: (1) to provide assistance for the implementation of the “acquis” concerning the Common Agricultural Policy; and (2) to contribute to the sustainable adaptation of the agricultural sector and rural areas. These objectives are to be met by implementation of 9 different measures under 3 priority axes:

<b>Axis 1- Improving Market Efficiency and Implementing Community Standards:</b>
1. Investments in agricultural holdings to restructure and upgrade to the EU standards
2. Investments in processing and marketing of agriculture and fishery products
3. Supporting the setting up of producer groups
<b>Axis 2- Preparatory actions for implementation of agri-environmental measures and Leader</b>
4. Preparation for implementation of actions relating to environment and the countryside
5. Preparation and implementation of local rural development strategies
<b>Axis 3- Development of the Rural Economy</b>
6. Improvement and development of rural infrastructure
7. Development and diversification of rural economic activities
8. Training
9. Technical assistance

In November 2014, MARD, the EU and the WB launched the “IPARD-like” programme, aimed at supporting Montenegro’s agriculture. The project is worth 4.5 million, of which EUR 4.1 million will be available to agricultural producers in form of grant support. IPARD-like especially addresses the above 2 first measures (under axis 1). The project is being implemented by MARD, in cooperation with the WB. Its implementation is expected to contribute to gradual achievement of EU standards, creating new jobs in agriculture (around 500, of which 300 in the northern part of Montenegro), boosting the value of primary production and partly that of processing, as well as to encourage the banking sector to finance agricultural projects. IPARD-like and IPARD primarily support medium rural agricultural holdings (i.e. viable agricultural holdings and enterprises having more than 25 employees and annual income of at least EUR 200 000). The average contracted investment per household amounts to €35,600. The IPARD-like Grant scheme requires (1) a contribution of 50% of the overall investment by the beneficiaries; and (2) a full pre-financing of the overall investment cost by the beneficiaries, of which 50% is then refunded by the IPARD-like (with a share of 75% from the EU and 25% from the MARD).

EU/WB Montenegro Institutional Development and Agricultural Strengthening project (MIDAS) and MARD’s capacities. MIDAS’ objective is to improve delivery of government assistance for sustainable agriculture and rural development in a manner consistent with the EU’s pre-accession requirements. It is using a methodology similar to the IPARD from agricultural holdings (farmers) to food establishments (agro-processors) and is thus a preparation for EU accession and for benefitting from EU’s generous subsidy schemes for agriculture. Experience from MIDAS implementation – where considerable capacity development support has been extended to MARD to build expertise to implement rural development policy and projects – demonstrated that significant institutional progress were made to implement IPARD (operating structure and implementation related procedures) but that support to the MARD is still necessary to make sure that beneficiaries systematically meet required project criteria. Experience also showed that extensive capacity development and information campaigns are necessary to ensure that farmers are eligible for support, due to the limited experience in complying with strict EU standards. Moreover, a robust monitoring system will need to be put in place, helping to monitor disbursement (monitoring of the absorption capacity) and MARD, as most ministries, still lack sufficient analytical staff often relying on external consultants). Finally, cooperation and coordination between line

ministries, as well as with stakeholders at all level of Government needs to be strengthened and monitored to avert implementation bottlenecks.

Lessons learnt from development partners. DANIDA – also a comparatively small development partner in terms of finance – has evaluated its completed project in support of organic agriculture. A key lesson is that any intervention aimed to support smallholders must take its point of departure in the fact that the limited degree of commercialisation is making it difficult for them to be competitive in the market. Opportunities therefore lie in developing small niche markets. Similar lessons have been learnt from EU pre-IPARD projects and the EU/WB Montenegro Institutional Development and Agricultural Strengthening project (MIDAS). Also, many smallholders continue to struggle to benefit from the EU/WB projects<sup>11</sup> and from their limited capacity to formulate reliable business plans. Clearly this is a niche that IFAD will focus on.

Organizations working in the agri-food value chain development. Cooperative Union of Montenegro coordinates the work of about 61 cooperatives and provides assistance to them, in the field of legal status and their assets, as well as in the field of development, and marketing. The Association of Agriculture, Food processing and Tobacco industry in the Economy Chamber of Montenegro is an umbrella organisation that protects the interests of all economy subjects in the Republic and the Association of Agricultural Producers, which is an umbrella organization uniting professional associations of agricultural producers in Montenegro. It includes about 40 other associations which, more or less, involve producers of the same sectors of agricultural production. There are a few specialized associations, like Union of Bee-keeping Associations (united in the Union of the Beekeeping Organizations), Association of Tobacco producers, Association of Protected areas producers, Association of Poultry producers, etc. There is one Association of the Veterinary in Montenegro, that unites veterinary workers on a voluntary basis, and is registered as a NGO. There are as well other associations functioning like NGOs which promote the production of healthy food, organic production, and protection of environment. There is a growing potential for small and medium-sized enterprises (SMEs) in agri-business. Financing under the EBRD's Local Enterprise Facility (LEF) of up to €405 million which also includes technical assistance, is focused on strengthening the private sector by providing long-term financing for SMEs in the Balkans.

Financial services. Financing the investments of farmers is available through the Investment Development Fund, commercial banks, and microfinance institutions. IDF can directly finance up to 50% of the total investment. The amount of the loan intended for investment in working capital can be up to 20% of the total loan amount. As a collateral loan IDF will accept bills of exchange, mortgage, bank guarantees, guarantees of local self-government units, the Government guarantee and other usual collaterals in the banking business in accordance with the policies of the collateral and the decisions of the competent authorities of the IDF. Financing through commercial banks is characterized by high interest rates and unfavourable conditions for farmers.

Extension Services. An Extension Service in support of crop production started working in 2003. Services are provided throughout the whole territory of Montenegro and are organized through five centres located at: Bar, Bijelo Polje, Berane, Niksic and Podgorica. The Extension Service is financed by the Ministry of Agriculture and Rural Development of the Republic of Montenegro. MARD has the following divisions: Agro-industry, Payments, Forestry, Water Management and Rural Development and units in: economy, law and veterinary. Livestock selection service and Extension Service in plant production are present in 7 municipalities. The objective of the service, defined by the MARD is to provide support for the improvement of plant production in yield and quality of products. To achieve this, the service provides technical expert advice, recommendations and directions to farmers at farm level. In addition, round tables with different kinds of plant production topics are organised. Despite MARD having made significant institutional improvements from the beginning of 2013, given the limited size and capacity of the service, the actual range of services and farmer contact is currently very limited. The cooperatives do provide some services but they need to be strengthened.

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11 EU's methodology favours larger farms.