Inception Report for the project
Strengthening mechanisms for public finance at the local level in Montenegro

February - April 2011
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1. Executive Summary

The project “Strengthening mechanisms for public finance at the local level in Montenegro” was initiated with the overall objective to facilitate socio-economic development at the local level through strengthening accountable, transparent and results oriented public finance mechanisms.

Specific objective of the project is to support development of capacities of the municipal stakeholders and stakeholders at the central level to introduce transparent, accountable, results oriented budgeting reflecting capital investments, local and national strategic priorities. Therefore, three results are envisaged: 

Result 1: Mechanism for transparent and accountable public finance at the local level established and operational; 

Result 2: Municipal bonds market in Montenegro is strengthened through better understanding of benefits and opportunities among municipalities and 

Result 3: Fiscal equalization mechanisms in Montenegro further strengthened.

The project is demand driven, prepared and agreed in close cooperation and partnership with the key national stakeholders; the Government of Montenegro endorsed and signed the project document in December 10, 2010. Implementation of the project “Strengthening mechanisms for public finance at the local level in Montenegro” began as of February 2011.

The original project document was designed at the end of 2009; however, there have been number of important changes on which the update is required; specifically, political changes (Montenegro’s progress in the EU accession process and the candidate status, changes in the Government, results of the local elections), socio-economic developments and changes (effects of the global economic crisis on the fragile Montenegro’s economy) and changes in the legal and policy framework related to functioning of local self-governments and financial sphere in Montenegro (changes in the Law on Local Self Government, the Law on Local Self Government Financing, adoption of the Strategy for Regional Development and the Law on Regional Development, adoption of the AURUM- Strategy for Public Administration Reform, work on Strategy for Inter-Municipal Cooperation, among other). In addition, the Inception phase revealed potential risks and assumptions on which update is required.

In terms of achievements during the inception phase, the main focus has been on getting an overview of the organizational structure and management system and collecting baseline data from the Government of Montenegro (the Ministry of Finance, the Ministry of Interior) and the national institutions (the Human Resource Management Authority, the State Audit Institution), from all municipalities in Montenegro, the Union of Municipalities and from other key development partners (European Union - Delegation to Montenegro; the Council of Europe, CHF Montenegro). The findings served as a basis to consider if the adjustments of the planned activities from the original project document are required and to which extent. In addition, the Project Team considered different approaches to ensure effective implementation of the project, at the same time to ensure coordination and cooperation with other activities of the Government and other partners in the area of public finance.

During the Inception phase, the Project Team carried out an in-depth analysis of municipal budgeting practices, performed assessment of capacities of municipal financial departments and prepared comprehensive report. This report highlights key challenges and provides recommendations to be addressed by the project (and possible in the follow up phases). Significant effort has been invested into preparing grounds for a substantive capacity development programme for improved public finance at the local level. In addition, the method for capital budgeting was designed, linking it with the regional development and strategic planning.

Meetings with municipalities and other key partners revealed the need to explore opportunities for financing of municipal infrastructure projects through issuing of municipal bonds. At the same time,
the issue of indebted municipalities emerged, highlighting the need to address capacities for debt management and public borrowing.

In terms of fiscal equalization, the Initial phase showed that the activities proposed in the original project document remained valid. In the upcoming period the project will work to improve capacities and increase transparency of the Commission for Monitoring Development of the System of Fiscal Equalization. Study tours and exchange of experience with the best international practices based on the specific interests and needs of the members of the Commission will be organized. Analysis from the Inception Phase showed the need to perform the analysis of local self-government budgets and perform the assessment of the actual relationship between the revenues and expenditures; in addition, the project will prepare an overview of the international best practices/ successful models for fiscal equalization. This will support the Ministry of Finance to implement criteria and indicators for assessment of fiscal capacities, in line with the legal requirements and actual needs of municipalities.

One of the main achievements in the period covered by this report, is project organizational and management structure; namely, core staff (the Project Team) have been selected and contracted. The Project Team has been composed in the way described in the project document. Project Board has been established in February and the first meeting would be organized by the end of May; therefore, the external management systems will be discussed in more detail during the first meeting of the Project Board.

In terms of implementation plans, overall project plan was prepared; a detail plan has been prepared for the first quarter of the project. The sustainability of the project results will be one of the highest priorities in the forthcoming period of the project; this issue will be consistently reinforced during internal meetings of the Project Team, meetings of the Project Board and during all meetings and activities with the Ministry of Finance, the Ministry of Interior, municipalities, municipal officials and municipal stakeholders. Furthermore it is important that in all communication the sustainability issue is highlighted.

During the project, the communication and public relations (PR) materials for the project will be continuously designed and distributed. At the same time the Project Team with support of UNDP Communication Unit will draft a detailed visibility and communication plan.
2. Update on Background

There are some main points of information on which an update is required; hence, it is important to highlight on the political changes (Montenegro’s progress in the EU accession process and the candidate status, changes in the Government, results of the local elections), socio-economic developments (effects of the global economic crisis on the fragile Montenegro’s economy) and changes in the legal and policy framework related to functioning of local self-governments in Montenegro (changes in the Law on Local Self Government, the Law on Local Self Government Financing, adoption of the Strategy for Regional Development and the Law on Regional Development, adoption of the AURUM- Strategy for Public Administration Reform, work on Strategy for Inter-Municipal Cooperation, among other).

2.1. Update on political developments in Montenegro

The Government of Montenegro (GoM) has prioritized the process of European integration as the basis of its principal strategic political and economic development framework. By the Declaration of Independence, the Montenegrin Parliament reconfirmed political will to accelerate integration into the European Union and adhere to the requirements of the Copenhagen criteria and the Stabilisation and Association Process/Agreement.

Progress in the EU integration process resulted in Candidate Country status for Montenegro (as of December 17, 2010). In the Opinion on the membership applications by Montenegro the EC concluded that Montenegro is ready to become a candidate country to the EU recognizing results and achievements. At the same time, the EC highlighted that further reforms are needed in a number of key areas (Political Criteria, Economic Criteria and EU Legislation) before the country is ready to start process of accession negotiations.

Almost at the same time, the Prime Minister Milo Đukanović resigned from the position. The current Government, led by Prime Minister Igor Lukšić, was elected on 29 December 2010 by the majority vote in the Parliament of Montenegro. The results of the local elections from May 2010 represent another key political milestone that had significant influence on the development of good local governance in Montenegro. The Coalition for European Montenegro, led by the ruling Democratic Party of Socialists (DPS), won majority in most municipalities; in some other the coalition with the Social Democratic Party (SDP) was established.

2. Main concerns are related to the following areas: effectiveness of anti-discrimination policies, freedom of expression and government relations with civil society as well as the situation of displaced persons from Croatia, Bosnia and Herzegovina and Kosovo. Furthermore, Montenegro needs to intensify its efforts to consolidate rule of law, in particular in the fight against corruption and organized crime, which remain serious problems. - Ref to EC Key findings of the Opinion on Montenegro
3. Montenegro needs to further address internal and external unbalances, as well as weaknesses in the financial sector and the functioning of labor markets. The country needs to continue implementing reforms and reducing structural weaknesses. - Ref to EC Key findings of the Opinion on Montenegro
4. Montenegro needs additional efforts to align with the EU legislation and to implement it as regards freedom of movement for workers, services and capital, public procurement, competition, financial services, information society and media, transport policy, energy, economic and monetary policy, consumer and Health Protection. - Ref to EC Key findings of the Opinion on Montenegro
5. The DPS CG holds an absolute majority in Bar, Berane, Bijelo Polje, Danilovgrad, Rožaje, Šavnik and Žabljak; the coalition with SDP CG is in Andrijevica, Podgorica and Ulcinj, and with smaller parties in Kolašin. The opposition won in Plužine, and Pljevlja. www.setimes.com/cocoon/setimes/xhtml/en_GB/features/setimes/features/2010/05/24/feature-01
2.2. Update on socio-economic development

In the aftermath of independence, the economy in Montenegro recorded significant growth, mainly due to large FDI inflows primarily into the tourism sector and associated real estate, and banking. Real estate sales to foreign investors have generated strong wealth effects, contributed to a sharp increase in bank deposits, and boosted domestic demand. Alongside, construction has boomed. Credit growth has soared, stimulated by surging deposits and keen competition in the largely foreign owned banking sector.

Table 1: Key macro-economic indicators for Montenegro (with projections for 2011 and 2012)

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
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</thead>
<tbody>
<tr>
<td><strong>Real sector</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Real GDP growth (%)</td>
<td>8.6</td>
<td>10.7</td>
<td>6.9</td>
<td>-5.7</td>
<td>0.3</td>
<td>2.9</td>
<td>3.7</td>
</tr>
<tr>
<td>Consumer prices (end-period, %)</td>
<td>3.0</td>
<td>7.7</td>
<td>7.2</td>
<td>1.5</td>
<td>0.8</td>
<td>1.2</td>
<td>2.2</td>
</tr>
<tr>
<td>Gross national savings</td>
<td>1.4</td>
<td>-5.6</td>
<td>-11.2</td>
<td>-3.1</td>
<td>-1.1</td>
<td>0.7</td>
<td>2.5</td>
</tr>
<tr>
<td>Gross investment</td>
<td>25.4</td>
<td>33.8</td>
<td>40.7</td>
<td>28.3</td>
<td>26.0</td>
<td>26.0</td>
<td>28.0</td>
</tr>
<tr>
<td><strong>Fiscal sector</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Revenues and grants</td>
<td>43.4</td>
<td>47.6</td>
<td>48.6</td>
<td>42.5</td>
<td>41.2</td>
<td>41.2</td>
<td>40.9</td>
</tr>
<tr>
<td>Expenditures</td>
<td>40.4</td>
<td>40.9</td>
<td>48.9</td>
<td>47.7</td>
<td>45.7</td>
<td>42.9</td>
<td>42.9</td>
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<tr>
<td>Overall balance</td>
<td>3.0</td>
<td>6.7</td>
<td>-0.3</td>
<td>-5.2</td>
<td>-4.5</td>
<td>-2.9</td>
<td>-2.2</td>
</tr>
<tr>
<td>Primary balance</td>
<td>4.2</td>
<td>7.4</td>
<td>1.3</td>
<td>-3.4</td>
<td>-4.1</td>
<td>-1.1</td>
<td>0.0</td>
</tr>
<tr>
<td>Public debt (gross)</td>
<td>33.2</td>
<td>27.5</td>
<td>29</td>
<td>38.2</td>
<td>48.4</td>
<td>48.1</td>
<td>47.8</td>
</tr>
<tr>
<td>External debt (public and private)</td>
<td>56.8</td>
<td>79.4</td>
<td>95.1</td>
<td>99.9</td>
<td>120.1</td>
<td>116.5</td>
<td>120.0</td>
</tr>
<tr>
<td>External debt - private sector</td>
<td>33.2</td>
<td>62.1</td>
<td>79.4</td>
<td>76.9</td>
<td>74.2</td>
<td>79.1</td>
<td>81.4</td>
</tr>
<tr>
<td><strong>External sector</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current account balance</td>
<td>-24.1</td>
<td>-39.5</td>
<td>-51.9</td>
<td>-30.3</td>
<td>-27.1</td>
<td>-25.3</td>
<td>-23.7</td>
</tr>
<tr>
<td>Foreign direct investment (net)</td>
<td>21.7</td>
<td>19.6</td>
<td>18.4</td>
<td>30.6</td>
<td>15.9</td>
<td>16.9</td>
<td>15.9</td>
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</table>

(Source: Statistical Office of Montenegro and the IMF data; 2011 and 2012 forecasts by IMF)

However, this initial economic boom was replaced with decline of all macroeconomic parameters. The first signs of the global economic crisis started in the beginning of 2009 due to decreased investments in (coastal) real estate and tourism. Economic situation was further affected by the fact that 85% of capital assets were already privatized and stock market is recording downfall trends for nearly a year and a half. Finally, while the existence of a low-tax, pro-business environment and a clearly defined European agenda has contributed to GDP growth, in the last two years a number of privatized companies encountered difficulties in functioning due to high energy prices and cash-flow problems.

In addition, the current Labour Law puts additional pressure on growth of business and employment opportunities.

The economic and financial challenges described above have different social effects, including the reduction of production and consequently layoff of employees. The Government has initiated a programme for stimulating employment through loans at favorable rates to citizens/businesses. This concentrates in the north as sharp regional disparities exist.

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6 The Law requires mandatory severance payments for redundant employees, in addition, the Law provided for temporary employment, which became preferred option for the employers. At the same time, it brings additional instability in sustaining business processes.

7 According to the national statistics, 45% of the poor live in the northern region and its poverty rate is almost twice as high as the national average. With a decile ratio of -7.0 and a Gini coefficient of -0.29, Montenegro is among the most unequal of countries in the Balkans while its poverty rate is estimated at 11.3% - 12.2%, concentrated amongst Roma, refugees and
2.3. Update on development of good local governance in Montenegro

Development of good local governance in Montenegro is an on-going process; hence, the update is required on several levels.

2.3.1. Update on the changes in the legal framework for local governance

The Law on Local Self Government (LoLSG)\(^8\) defines the framework for functioning of local self-government units in Montenegro. However, the Law was revised, with the changes taking effect as of the beginning of 2010; hence, an update on this is required.

The revision of the Law did not bring about significant changes in the functions of local self-governments. Namely, municipalities perform functions of direct and common interest to the local population, further divided in the original\(^9\) (affairs of primary jurisdiction) and delegated and entrusted functions\(^10\). Some of the functions are very explicitly defined; some others have quite a generic definition, which leaves room for flexibility and local self-initiative. In addition, there are some functions that could be shared between the local self-government units and the central level government, according to the Law on LSG, but unfortunately it is not the case in practice (e.g. in the area of education and primary health).

The Law defines municipal bodies, Municipal Council (representative body) and President of Municipality (executive body). With the latest changes, Municipal Council appoints and removes President of Municipality. This is, however, the major change as previously Mayors ( Presidents of Municipalities) were directly elected for a five-year term, while only qualified majority of voters from respective municipality was granted right for an early recall of a mayor. Still, the revised Law kept the provision for citizens to initiate recall of a mayor; the recall procedure may be initiated by at least 20% of voters of the municipality\(^11\).

The Mayor appoints the Chief Administrator, with the responsibility to manage and coordinate the work of local government/administrative bodies (secretariats, offices, directorates, etc.). Public services are established by the Municipal Council for the provision of communal services such as water supply, waste management, sewage, and public traffic. The Assembly can also establish public services if affairs are delegated or entrusted to the local self-government by the respective Ministry or national authority.

**Law on Local-self Government Financing (LoLSGF):** the Government of Montenegro made significant steps towards fiscal decentralization of the country with the adoption of the LoLSGF, which brought about major changes in intergovernmental fiscal relations. In 2010 major changes to the Law on Local Self Government Financing were introduced, on which update is required.

According to the Law on Local Self Government Financing\(^12\), budget revenues for local government consist of (Article 4): 1) Original revenues (municipal own resources); 2) Revenues transferred by the law; 3) Equalization Fund; and 4) State Budget.

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\(^{9}\) The LoLSG, Articles 29-37

\(^{10}\) The LoLSG, Articles 38 and 39- vested by law or delegated by means of the Government’s regulations

\(^{11}\) The LoLSG Article 61

The 2010 amendments to the Law abolished some of the existing municipal taxes; specifically, consumption tax; tax on company or title and tax on games of chance and entertainment games. The Law at the same time provided for the increase of the percentage of some of the taxes; e.g. amount belonging to the revenue from tax on real estate transfers, concessions and other fees for using natural resources (but not including marine coast in the natural resources).

The revised Law increased the total assets of the Equalization Fund. The resources, as defined in the Law, are earmarked to municipalities which average fiscal capacities per capita in three previous fiscal years are lower than an average fiscal capacity per year of all municipalities for the same period (Article 30). In order to monitor development of the system and especially in order to provide the equity, efficiency and transparency of the system of fiscal equalization of municipalities, the Law provides for the establishment of the Commission for Monitoring Development of the System of Fiscal Equalization of Municipalities. The role of the Commission hasn't been changed compared to the previous version of the Law.

The Law enabled provision of the Conditional grants from the state budget, as an opportunity for financing of local investment projects, which are of local self-governments’ special interest. This component has been slightly modified; however, it still remains that the Government on the basis of a proposal made by the Ministry of Finance decides on the allocation of the conditional grants.

More details on the system of functioning and financing of local self-governments in Montenegro is provided in the Annex 1 of the Inception report.

2.3.2. Update on professional development of municipal employees

In order to support development of capacities of municipal employees in a systematic manner, the Government of Montenegro has adopted the National Training Strategy for Local Governments of Montenegro (NTS), which defined the overall training system, delivery methods and capacity development priorities. The NTS highlighted the need to develop a wide range of managerial capacities such as strategic planning, public policy making, leadership and modern management, management of budgets and financial resources, human resource management, client orientation, citizen participation and overall municipal service delivery. Municipalities need better understanding of EU institutions, funds, integrations and practical aspects of EU accession process (especially project management and management of EU and other donor funding opportunities).

There are five strategic goals of the National Training Strategy: i) Build the capacities of local government for good local governance; ii) Build the capacities of the Union of Municipalities to support capacity-building in local government units (to supervise NTS implementation); iii) Develop a professional training environment; iv) Improve the legal and financial framework for local government and v) Build an institutional training framework.

The NTS has identified the main stakeholders13 for development of capacities at the local level and provided for the establishment of the National Training Council14, with the main role to oversee and coordinate local government training, agree Annual Report and Annual Programme, agree updated TNA / NTS, take legislative and fiscal initiatives.

Implementation of the NTS is one of the key national priorities (especially in light of reform of local governments in Montenegro). The European Commission and the Government of Montenegro

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13 The key stakeholders are a) local self government units; b) the Union of Municipalities; c) the Ministry of Interior and Public Administration; d) the Human Resources Management Authority, e) National Training Council

14 The Council was established in May 2009, by a decision from the governing board of the Union of Municipalities. It is composed of representatives of Ministry of Internal Affairs and Public Administration, Union of Municipalities and Human Resources Management Authority
together with UNDP are supporting implementation of the NTS and reform of the local governments\textsuperscript{15}. Initial step in this process will be a comprehensive functional review of municipal HR practices and policies.

\textbf{2.3.3. Update on Public Administration Reform}

The Government of Montenegro prepared the Public Administration Reform Strategy in Montenegro for the period 2011-2016; this is a comprehensive document adopted with an objective to set the framework for the establishment of an efficient, professional, and service oriented public administration serving the needs of citizens and other social and business entities. The Strategy strives to achieve the following specific goals: i) strengthening of rule of law by strengthening legality and predictability of administrative procedures and decisions; ii) improving efficiency and cost-effectiveness of public administration; iii) improving the business environment while improving the quality of public services and reducing the administrative burden; iv) raising the level of ethics in public administration; v) improving transparency and accountability of public administration and vi) integration of Montenegro’s public administration in the European Administrative Space.

The Strategy envisages areas with further reform needs, specifically: i) public administration, ii) local government and iii) public services and other organizations exercising public authority.

At the level of local governments, the Strategy focuses on number of priorities, such as: a higher level of functional and fiscal decentralization by adjusting financial and material resources, development of capacities of municipal employees, organizational development of local governments (including modernization of business processes and more transparency and accountability primarily through more active citizens participation), improvement of delivery of public services (including public utility companies and municipal enterprises).

\textbf{2.3.4. Update on the national framework for regional development}

\textbf{Regional Development Strategy:} Montenegro recognized that regional development is vital to the country’s prosperity and that balanced regional development is a prerequisite for social cohesion and stability. Therefore, the Government of Montenegro adopted the Regional Development Strategy of Montenegro, with the overall objective to achieve even socio-economic development of the country following the principles of sustainable development, at the same time creating conditions for increasing competitiveness in all part of the country and achieving their development potentials.

The key strategic goals of the Strategy are defined, based on segmented economic analysis and principles of new regionalism and territorial capital, as follows: Strategic goal 1- Balanced development of all local government units and regions; Strategic goal 2- Rapid development of less developed local government units and regions and Strategic goal 3- Regional development and environmental protection.

The Strategy recognized the need to remove institutional incapacities for coordinated and continual implementation of regional policy and achievement of stated objectives, but did not provide basis for institutional framework for regional development. As stated in the Strategy, the institutional framework doesn’t include establishment of new institutions, but rather suggests reliance on the existing structures. However, the Strategy highlighted that the Law on Regional Development should regulate institutional relationships and further details in the area of regional development.

\textbf{The Law on Regional Development}\textsuperscript{16}: In order to regulate the system of coordination activities and regional development policy, hence, to ensure implementation of regional development priorities,

\textsuperscript{15} This support is provided through the IPA 2010 funds to development of local governments in Montenegro

\textsuperscript{16} The Law on Regional Development (“Official Gazette of Montenegro”, No. 20/11, April 2011)
the Law on Regional Development was prepared and adopted. The proclaimed goals of the Law derived from the Strategy; so, the overall social-economic development, a reduction in regional disparities and the negative demographics trend, the growth of competitiveness and sustainable local economic development as well as the achievement of inter-municipal, inter-regional, cross-border and international cooperation.

The Law (Article 4) distinguishes between three (geographic) regions: the Costal, the Central and the Northern. Further to this, the Law classifies municipalities according to the index of development, in six different groups. The Law also provides strategic references for regional development, with the Strategy for Regional Development being the roof-document; at the same time it is envisaged that each municipality prepares and adopts Local Strategic Plan, as mandatory local development framework document.

The institutional structure for implementation of regional development policy remains work in progress; however, the Law envisages the establishment of Partnership Council for Regional Development, primarily with advisory and supervisory role.

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17 Municipalities: Bar, Budva, Herceg-Nov, Kotor, Tivat and Ulcinj
18 Podgorica, Cetinje, Danilovgrad and Nikšić.
19 Andrijevica, Berane, Bijelo Polje, Kolašin, Mojkovac, Plav, Pljevlja, Plužine, Rožaje, Šavnik and Žabljak.
20 Article 12, Paragraph 2 of the Law states that the development index represents the average of economic development indicators, structural adjustments and demographic conditions.
21 First group up to 30% of the national average; the second- between 30% and 50%, the third – between50% and 75%; the fourth- between 75% and 100%, the fifth - between 100 to 125% and the sixth above 125%.
3. Project Synopsis

3.1 Overall Objective
The overall project objective of the Project “Strengthening mechanisms for public finance at the local level in Montenegro” is to facilitate socio-economic development at the local level through strengthening accountable, transparent and results oriented public finance mechanisms.

3.2. Project purpose
The specific purpose of the project is to support development of capacities of the municipal stakeholders and stakeholders at the central level to introduce transparent, accountable, results oriented budgeting, which will reflect local and national strategic priorities at the same time address municipal capital investment needs.

3.3. Planned Results
The following chapter will focus on the planned results and on the activities performed during the inception period:

*Update on Result 1: Mechanism for transparent and accountable public finance at the local level established and operational*

During the Inception Period, a comprehensive review of current practices in municipal budgeting, including the assessment of capacities of municipal finance departments, was performed and a report on findings was produced (reference to the Annex 1: Report on Assessment of Capacities for Budgeting at the Local Level in Montenegro).

Specifically, the assessment focused on few dimensions:

- review and analysis of all the segments of the budgeting process, including budget preparation, budget execution and financial reporting;
- assessment of capacities to introduce programme budgets at the local level in Montenegro;
- review and analysis of the capacities for preparation and implementation of capital budgets, including assessment of municipal capacities for strategic planning and identification, priority setting and preparation of capital investment projects;
- citizen participation in local budgets preparation and execution.

It is important to highlight that the majority of activities proposed within the original project document remained relevant. At the same time, the assessment enabled to revise and focus and after careful appraisal discard some of the originally proposed activities. In addition, new activities were suggested to address some of the burning issues and identified challenges within the context of local governments financing in Montenegro.

The original project document provided detailed description of the specific methodology for trainings (as part of a broader capacity development support to municipalities). This included the generic content of training curricula and structure of training materials, delivery methods, evaluation scheme and system for monitoring impact of trainings.

During the Inception Phase, the overall approach to capacity development, (well-balanced combination of trainings, on-the-job trainings and mentoring, exchange of experience through peer to peer support, study tours, on-line support, etc.) that was proposed and presented in the original
Project document was re-confirmed as the most effective (in terms of the actual impact) and most appropriate (in terms of the learning curve and satisfaction level of municipal employees).

The assessment from the Inception Phase provided insight into specific training topics, which will be organized as general (basic knowledge and skills essential for every municipal employee) or more specialized (specific needs of the municipal officials, senior managers and other specific target groups), depending on the target groups.

<table>
<thead>
<tr>
<th>Topic</th>
<th>Duration</th>
<th>Content (indicative list of subjects)</th>
</tr>
</thead>
</table>
| Curricula 1: Planning municipal budget (basic and specialized training) | Three days | ▪ Budget cycle management in Montenegro (including local governance legal framework)  
▪ Approaches to budget planning  
▪ Data collection and analysis (in the context of budget planning)  
▪ Coordination in getting inputs from other units/municipal services  
▪ Revenues forecasting (including revenues planning, tax management, etc.)  
▪ Expenditure planning  
▪ Municipal borrowing, municipal bonds and property management in the context of budget planning |
| Curricula 2: Implementation of a municipal budget (basic and advanced training) | Three days | ▪ Budget execution: theory and practice  
▪ Public procurement  
▪ Payments and functioning of municipal treasury departments  
▪ Internal control framework  
▪ Budget monitoring: involvement of citizens and municipal councils (best EU or regional practices)  
▪ Budget imbalances – how to react promptly?  
▪ Financial reporting |
| Curricula 3: Training for improvement of functioning of municipal treasury departments | Three days | ▪ Legal framework for local governments financing  
▪ Framework for functioning of municipal treasuries  
▪ Cash and debt management  
▪ Financial reporting and monitoring  
▪ Operational procedures  
▪ Experience- how to improve it? (best EU or regional practices) |

22 Project document envisaged well-balanced combination of trainings; on-the-job-trainings/ mentoring and horizontal peer-to-peer exchange of experience. There will be study tours organized in course of implementation of capacity development program.
The Project will organize **two workshops**, where theoretical and practical aspects of municipal finances will be presented and discussed. First workshop will address the issue of municipal finances in the time of crisis; the content of the second workshop will be determined as needs arise. During the second year, the project will organize a conference on municipal budgeting/municipal finances. This will be done in cooperation with the Government of Montenegro and the Union of Municipalities.

In addition, the project will work to promote more active involvement of citizens in local decision and policy making processes, by providing them with tools to participate more actively in budget preparation and budget monitoring; hence, innovative approaches will be explored such as web-based applications and SMS-based technologies. In addition, the project will work with municipalities to develop capacities of municipal councils for more effective budget monitoring. In this regard, Project Team will organize trainings for selected municipal councillors and municipal executives from all municipalities, in monitoring of budget execution following the Curricula 6:

<table>
<thead>
<tr>
<th><strong>Curricula 6:</strong> Monitoring of local budget execution</th>
<th><strong>Duration</strong></th>
<th><strong>Content</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Two days</td>
<td>Montenegrin legal framework for monitoring of local budget execution</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Benefits from day to day monitoring in budget execution</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Professionalization of local councillors and executives in decision making and monitoring</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Best EU practices in local budget execution monitoring</td>
</tr>
</tbody>
</table>

The Final Project Report will provide, among other, lessons learned from the implemented activities and based on experience and findings, propose recommendation for the future development of the municipal budgeting in Montenegro.
Assessment from the Inception Phase showed opportunities from *inter-municipal cooperation (IMC)* in addressing some of the identified challenges. Namely, IMC could focus on inter-municipal infrastructure projects, support to budget planning, shared administration of local taxes, establishment of inter-municipal development entities or alike. The Project will explore opportunities for inter-municipal cooperation in Montenegro and prepare practical suggestions.

The Project also performed the appraisal of the need for benchmark system/tool (as proposed in the original project document). Availability and access to relevant information is challenging; in addition, there is no single institution showing genuine commitment and interest to take over responsibility for implementation of the benchmark system. Therefore, lack of ownership and availability of data and the issue of sustainability suggested that this component of the original project document should be discarded.

**Capital budgeting at the local level:** The original project document suggested identifying two municipalities to introduce or/improve capital budgets. However, development of the policy and legal framework for regional development (as highlighted in the previous paragraphs) and results of the assessment during the Inception Phase, showed the need to broaden the originally proposed approach and support selected municipalities to prepare municipal strategic plans, based on which capital budgets will be designed.

Selection of municipalities will be carried out during the second quarter of the project. However, firm commitment of municipal officials and other stakeholders to embark on the strategic planning process will be certainly one of the key pre-conditions.

Technical assistance program for strategic planning will comprise of formal trainings and mentoring: the project will, in pilot municipalities, support establishment of the ad-hoc group (or review and use existing one) for strategic planning and provide the following support:

<table>
<thead>
<tr>
<th>Topic</th>
<th>Duration</th>
<th>Content</th>
</tr>
</thead>
<tbody>
<tr>
<td>Curricula 7: Preparation of Municipal Strategic Plan</td>
<td>Six days (2 roll-outs each training 3 days)</td>
<td>Indicative content of the training will follow the methodology adopted by the Ministry of Economy.</td>
</tr>
</tbody>
</table>

In parallel with preparation of municipal strategic plans, pilot municipalities will be supported to start working on Preparation of the capital budget requires a coordinated approach by various departments within the municipal administration as well as with other key governance actors.

<table>
<thead>
<tr>
<th>Topic</th>
<th>Duration</th>
<th>Content</th>
</tr>
</thead>
</table>
| Curricula 8: Preparation of the capital budget | At least three days per selected municipality | - Montenegrin legal framework for capital budgeting  
- Prioritization and evaluation of projects (static and dynamic evaluation)  
- Calculation of costs  
- Preparation of capital budget  
- Funding opportunities (International Financing Institutions, EC funding framework, etc.) |
Curricula 9: Implementation of a capital budget-development of project implementation skills

At least three days per selected municipality

- Preparation of (mature) projects
- Pre-feasibility and feasibility studies
- Environmental Impact Assessment
- Costs-Benefit Analysis
- EC Practical Guide (PRAG) and international procurement rules

Update on Result 2: Municipal bonds market in Montenegro is strengthened through better understanding of benefits and opportunities among municipalities.

The review during the Inception Phase confirmed the relevance on the second result as defined in the original project document: all municipalities in Montenegro need further development of capacities for issuing of municipal bonds. At the same time, it revealed that all municipalities are facing problems with debt management, public borrowings and management of (municipal) property. Therefore, the project will approach issuing of municipal bonds within a broader aspect of debt and property management.

The original project document planned to perform review of the implemented municipal bonds as the basis for eventual changes of the legal framework. The analysis of the situation from the Inception Phase showed that this activity is outside of the scope of the project and its internal coherence. Therefore, it is suggested to include recommendations for improvements of the overall framework for issuing of municipal bonds in the envisaged assessment for municipal bonds market in Montenegro.

As said, in the forthcoming period, the priority will be to prepare a comprehensive assessment of the municipal bond market in Montenegro and provide recommendations for its further development (including the context, conditions and constraints for such a market and operational details such as current and possible volume of debt, interested municipalities, etc.). Following results of the assessment, the project will prepare and implement two-day training program for issuing of municipal bonds. It will reflect on the legal context and present step-by-step approach and hands-on experiences for issuing of municipal bonds.

<table>
<thead>
<tr>
<th>Topic</th>
<th>Duration</th>
<th>Content</th>
</tr>
</thead>
</table>
| Curricula 10: Introduction to municipal bonds | Two days | - Municipal bonds: opportunities and benefits (general introduction)
- Legal framework for issuing municipal bonds in Montenegro
- Step by step guidelines for issuing municipal bonds
- EU and regional best practices on municipal bonds |

In parallel, the project will work on preparation of a how-to Manual for Issuing of Municipal Bonds: it will provide simple, step-by-step instructions to municipalities on issuing of municipal bonds.

The project will provide assistance for municipal borrowing/ debt management, which will concentrate on how to plan and pay the interest and principal payments on existing debt, and how to plan for incurrence of new debt (at a level which will optimize borrowing costs and not impair the financial position of the municipality). It is envisaged that the training program will include topics such as public borrowing and risk assessment for borrowings, management of municipal property.
The project will commit to prepare an overview of best practices and lessons learned in municipal borrowing from Montenegro compared to the selected European countries and prepare recommendations for improvement of the current borrowing system. External technical support will be required for this particular component.

### Update on Result 3: Fiscal equalization mechanisms in Montenegro further strengthened.

Activities for improvement of fiscal equalization system proposed under the Result 3 of the original project document proved “real time relevance”. However, in order to further support the Government and municipalities in Montenegro to increase its transparency and predictability of the fiscal equalization system, an assessment was carried out during the Inception Phase.

In the upcoming period the project will work to improve capacities and increase transparency in the work of the Commission for Monitoring Development of the System of Fiscal Equalization. Training program/ technical assistance support will include number of specific topics arising from the new equalization framework in Montenegro (e.g. selection and monitoring of key indicators and assessment of fiscal capacity, introduction of international best practices, etc.). The project will support transparency in the work of the Commission, by assisting to prepare and publicize reports from each of the meeting sessions. During the lifetime of the project, study tours and exchange of experience with the best international practices based on the specific interests and needs of the members of the Commission, Ministry of Finance and municipalities eligible to equalization funds, will be organized.

During the Inception Phase, the Ministry of Finance and municipalities highlighted additional needs for improvement of fiscal equalization system. Specifically, the project will support the Ministry of Finance to implement criteria and indicators for assessment of fiscal capacities, following legal provisions and addressing more appropriately current situation and financial needs of municipalities in Montenegro. In order to do this, the project will perform the analysis of local self-government expenses and perform the assessment of the actual relationship between the revenues and expenditures; in addition, the project will prepare an overview of the international best practices/ successful models for fiscal equalization.

Training for municipalities on fiscal decentralization will be designed and implemented; the idea of the training is to increase general knowledge and understanding about functioning of the fiscal equalization system in Montenegro, including equalization formula.
Curricula 13: Fiscal equalization in Montenegro

<table>
<thead>
<tr>
<th>Topic</th>
<th>Duration</th>
<th>Content and target groups</th>
</tr>
</thead>
</table>
| Fiscal equalization in Montenegro | One day | - Legal framework: Laws and by-laws  
- What is and how to calculate fiscal capacity of municipalities?  
- Distribution of the Equalization Funds: formula and predictability  
- EU and regional best practices in fiscal equalization |

In addition, the project will support the Ministry of Finance to organize a round-table at the national level, where the new elements of the legal framework for fiscal equalization (laws, by-laws, indicators for assessment of fiscal capacities, etc.) will be presented and discussed.

### 3.4 Beneficiaries

The key institutional stakeholders for this project are: municipalities in Montenegro; the Government of Montenegro (specifically the Ministry of Interior and the Ministry of Finance); Commission for Monitoring Development of the System of Fiscal Equalization; the Human Resources Management Authority (HRMA) and the Union of Municipalities.

The direct beneficiaries of the project will be: a) Local self-governments (municipal leaderships and administrations) in Montenegro; b) Commission for Monitoring Development of the System of Fiscal Equalization; c) The Government of Montenegro (the Ministry of Finance and the Ministry of Interior); d) The Union of Municipalities of Montenegro.
4. Detailed Plan of Operations

4.1 Project Operational Work Plan

For detailed Project Operational Work Plan refer to Annex 3 of this report.

4.2 Quarterly Work Plan

A narrative description of the preparatory work carried out by UNDP and the Project Team and upcoming activities to be implemented in the next quarter\(^2\) is explained below, broken down by results to be achieved in the following reporting period. For detailed Quarterly Work Plans refer to Annex 4 of this report.

Result 1: Mechanism for transparent and accountable public finance at the local level established and operational.

**Upcoming period:**

**Preparatory activities for development of training program on public finance:** this is certainly critical and complex element of the project, as it implies broad scope of work, different but interrelated topics and high involvement of national and international experts. Therefore, in order to ensure internal logic and consistency of the training/learning materials, at the same time to ensure efficiency and effectiveness in the actual management of the process, one of the options could be to select qualified company for preparation of training programs (which will be part of a broader capacity development support) or consider possibility to engage experts for more than one training curricula (logically connected). During the upcoming period, the Project Team will decide on the preferred approach and prepare detailed description of the assignment and publically advertised it. It is expected that the selection process will be finalized by the end of the second month of next quarter; hence, the work on the training materials and programs can start immediately afterwards.

**Preparatory activities for strategic planning and preparation of municipal capital budgets:** upon consultation with the key stakeholders, the Project Team will select pilot municipalities. Municipalities will be invited to submit expressions/commitment to participate in the strategic planning process; as the original project document envisaged, the project will work with two municipalities. It is anticipated that the selection of municipalities will be finalized by the end of this quarter.

**Preparation of methodology and training materials for strategic planning and capital budgeting:** In parallel to selection of municipalities, the Project Team will prepare and advertise Terms of Reference for national and international experts to work on preparation of training plan and materials for strategic planning, in line with the methodology adopted by the Ministry of Economy. It is expected that the experts will be selected by the second month of next quarter.

The Project Team expects to start with strategic planning in the selected municipalities in September.

\(^2\) NEXT QUARTER refers to the period of three months after the approval and adoption of the Inception Report.
In the upcoming period, the project will work on assessment of opportunities for project initiatives: UNDP is working closely with the Ministry of Interior on the national Inter-Municipal Cooperation Strategy.

Result 2: Municipal bonds market in Montenegro is strengthened through better understanding of benefits and opportunities among municipalities.

**Upcoming period:**

In the upcoming period, the Project Team will prepare Terms of References for experts in municipal bonds. In addition, the Project Team is planning to contact other UNDP offices from the region and collect experiences and practices in UNDP’s involvement in municipal bonds.

Result 3: Fiscal equalization mechanisms in Montenegro further strengthened.

**Upcoming period:**

**Support to the Ministry of Finance to improve system for fiscal equalization:** The Project Team will prepare job description/terms of reference for technical assistance to identify capacity development needs of the members of the Commission for Monitoring Development of the System of Fiscal Equalization and prepare trainings accordingly.

Also, the Project Team will in close cooperation with the Ministry of Finance prepare job description/terms of reference for technical assistance to the MoF to implement criteria and indicators for assessment of fiscal capacities, following legal provisions and addressing more appropriately current situation and financial needs of municipalities in Montenegro. The technical assistance team (national and international experts) is expected to be selected and operational by the end of the next quarter.

First part of the assignment will be to perform the analysis of local self-government expenses and perform the assessment of the actual relationship between the revenues and expenditures. It is expected that this work will start during the next quarter and continue during the project lifetime, in close communication with the Ministry of Finance.
5. Implementation Arrangements

All the elements are as described in the original project document:

5.1. Internal Organization

The overall implementation of the project would be the responsibility of the Project Team. Members of the Project Team are:

- Project Manager is responsible for the overall management of the project (including managing and leading the Project Team). Project Manager will report on project progress, challenges, problems and opportunities to the Project Board and provide an overview of the activities planned in the following quarter.
- Project Coordinators: there are two Project Coordinators, with the role to supervise and coordinate project activities in the area of responsibility.
- Core Technical Advisor is responsible for provision of detailed, in-depth and continuous technical and policy advice concerning the financing of local self-governments, capacity building issues and related activities during the lifetime of the Project.
- Finance/Administrative Assistant is in charge of the financial (financial planning, disbarment of funds, financial accountability and reporting) and administrative (project administrative and filing system, HR and operational issues) affairs of the project.

5.2. External Organization:

The UNDP Country Office in Montenegro will directly implement the Project; however, the Project Team will establish strong day-to-day cooperation with the key partners, the Ministry of Finance, the Ministry of Interior and the Union of Municipalities. All of the key partners have expressed strong commitment and support to the project overall objective and results and have been involved in the design of the project.

*Project Board (equal to the Project Steering Committee)*: the Project will be supervised by the Project Board, which comprises of representatives of the Government of Montenegro (the Ministry of Finance and the Ministry of Interior), representative of the Union of Municipalities, representative of UNDP and representative of donor.

The main role of the Project Board would be to oversee the implementation of the Project and authorize any significant changes to the results and overall objective as well as to the general character of the activity components. Furthermore, it will be the key mechanism for coordination between this Project and other related development initiatives in Montenegro. The secretary of the Project Board will be the Project Manager with the main responsibility to facilitate the organization of meetings and timely distribution of relevant information and materials, while the chair of the Project Board will be a representative of the Government of Montenegro.

During the inception period meetings with all key stakeholders/members of the Project Board were organized whereby they have expressed strong commitment to the project and project results and willingness to participate in. The Project Board would first meet at the end of the Inception Phase to approve the Inception Report and the first annual and quarterly work plans. The PB would then meet on regular quarterly basis in order to review the progress in the previous period and approve the following quarterly work plan. Finally it will meet close to the end of the project to review the overall progress, the report on the independent evaluation and the proposal for the follow up activities.
5.3. Visibility

Activities will be carried out in support of the objective of the Project “Strengthening mechanisms for public finance at the local level in Montenegro”. They will conform to the Government of Montenegro communication guidelines, the UNDP Communications Strategy Framework and the communication proscription of the Kingdom of Netherlands.

Furthermore, during the Inception phase, the Project Team started a sound communication strategy. It is anticipated that this work will be finalized within the next quarter of the project timeframe. However, this is an opportunity to highlight on the key elements of the Communication platform:

**Goals:**
- to keep the stakeholders and general public informed about the project and achievements of the project;
- to ensure better coordination of activities in the area of public finance and local governance and the overall socio-economic development through continuous, well-planned exchange of information;
- to raise awareness on good local governance, socio-economic sustainable development, active community participation, gender, and other relevant areas covered to the extent possible by the Project;

**Target audience:**
- Municipal officials and administration;
- The Government of Montenegro (the Ministry of Finance; the Ministry of Interior; the Ministry of Economy; the Ministry for Foreign Affairs and EU Integrations, the Directorate for Infrastructure, etc.);
- The Union of Municipalities of Montenegro;
- International financing institutions and commercial banks operating in Montenegro;
- Business community and civil society (especially NGOs working on issues relevant to project objectives);
- International development partners / development agencies;
- General public in Montenegro.

**Key themes and messages:**
- Information on project background;
- Key project details - overall objective, purpose and expected results;
- Key activities and achievements of the Project;
- Wider perspective (regional and national development and links; support to EU integrations).

**Tools and approaches**
- Professional and personal contacts - all contacts of Project Team members provide an opportunity to put across key messages;
- Working with media – the Project Team will cultivate relations with national and local media; support from the UNDP Communication Team will be ensured:
  - Press Conferences - launch of project, start of infrastructure projects, inter-municipal cooperation;
  - Press releases – media alerts and key project activities;
  - Annual media breakfast – leading journalists will be invited for a breakfast with Project Manager;
  - Interviews and articles;
Establishment of formal partnership with media to ensure regular reporting about project activities.

- Special Events
  - Trainings (study tour visits, seminars, conferences, round tables, workshops, lecturers etc.)
  - Information campaign will be organised to promote transparent and accountable financing at the local level;
  - Citizens participation – where appropriate these will be linked with communication activities;

- Website;

- Visibility and promotion material.

**Monitoring and evaluation**

- Biannually measuring of volume and tone of media coverage of project activities. The measuring will include tracking of how often the media pick up the key messages and activities from the project;

- Obtaining feedback from events as well as about project products. Where appropriate feedback will be asked in advance.

- Regular review and readjustment of the communications strategy approach, as necessary.

The first large media/ communication event will be official launching of the Project “Strengthening mechanisms for public finance at the local level in Montenegro”. Participants in this event will be high representatives of the Government of Montenegro, the Union of Municipalities and the donor. This is anticipated to be one of the main media events that will contribute to successful kick off of the Project. The Project Team is planning to organize official launching of the Project after the first Project Board Meeting.

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24 The project document predicts organisation of a number of events supporting the achievement of planned project results; UNDP Communication Team will be involved in the organisation of these and consider the organisation of media opportunities.
6. Monitoring & Evaluation

6.1 Monitoring and evaluation framework

Monitoring is understood as a continuing function that provides the management of the project and main stakeholders with early indications of progress, or any concerns or issues related to achievement of results. Evaluation is understood to be a systematic exercise carried out periodically that makes assessments of different scope and depth that generate knowledge, promote learning and guide action during the effort to achieve the results and objectives.

Therefore, the monitoring and evaluation functions are perceived as inter-related and synchronous so they form a joint part here of all data collection tools and processes.

The reason for monitoring the progress and evaluating the performance of the project is to enhance the effectiveness of this assistance and to extract information about the relevance of the development action as well as its objectives.

Therefore, the monitoring and evaluation activities shall:

- help keep the project on course towards the achievement of its results;
- provide transparent, objective, verifiable evidence of progress towards and achievement of objectives;
- enable insights to be drawn and shared about what worked well or what did not work well and why that was the case;
- enable reflection on the context in which the project is being implemented and how this affects programming;
- provide the basis for fine-tuning, reorienting and planning future development efforts in the same or related sectors in Montenegro.

For detailed monitoring plan refer to Annex 5 of this report.

Evaluation

An independent evaluation will take place in the Completion Phase. This evaluation will be based on the original Project document and the Inception Report (including its annexes). It will analyse the progress of the project towards its results and purpose, and identify areas for further development assistance.

6.2 Reporting

Apart from the present Inception Report, which reflects on the aims and objectives of the projects, identifies internal and external project organization, describes the first actions undertaken and points out any issue related to the project, UNDP will also submit

a) Quarterly progress reports, submitted 10 days before the end of the reporting period i.e. before the Project Board meeting, will summarize activities and events during the past period, activities and events planned for the next three months (the next Quarterly Work Plan). For indicative structure of the progress report refer to Annex 6 of this report.

The PT (through the Project Manager) will be submitting the following plans and documents:

b) Final project report: will cover the main experience acquired and conclusions to be drawn from the assignment. The format of the final report will be based on the standard reporting format. It will be used to inform UNDP, donors, the Government of Montenegro, the Union of Municipalities and other interested parties of issues that have arisen that may assist with the planning of similar projects.
The PT (through the Project Manager) will be submitting the following plans and documents:

**Project Activity Work Plan and Project Operational Work Plan:** will indicate the expected results and resources/budget required for the achievement of Project outputs. Those plans will not need to include all the details, but should provide a tentative plan for 12/24 months (years 2011 and 2012). The **Project Activity Work Plan and Project Operational Work Plan (including budget)** will be submitted to the Project Board attached to the Inception report.

**Quarterly Work Plans:** will be based on the Project Activity Work Plan and Project Operational Work Plan but will be more detailed and specific. They represent the commitment of the Project Team for delivery of concrete key activities in the following 3 months.
7. Update on Assumptions and Risks

7.1. Update on Assumptions

The original project document has identified number of assumptions, factors that are external to the project, but which represent conditions that must be met if the project is to succeed. These factors answer the question: “What external factors are not influenced by the project, but may affect its implementation and long-term sustainability.” Clearly, awareness of these factors is essential if the Project Team and the partners on this project intend to achieve the objectives of the project in a complex and rapidly changing environment.

Our assessment of these assumptions is that they will hold true. However, during the Inception Phase we have identified some other assumptions that are relevant for project implementation. These assumptions are partially outside the control of the Programme, but also partially within. Indeed, they can also be interpreted as objectives to be achieved during the implementation of the project, by contributing, together with other activities, to improved situation in the area of local finances.

In general, our approach is to separate assumptions into those within and outside of the scope of the project.

<table>
<thead>
<tr>
<th>Assumption</th>
<th>Commitment</th>
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<tbody>
<tr>
<td>Political and economic situation in Montenegro remains stable</td>
<td>Political stability, economic growth and advancing European integration is a stated priority of the Government of Montenegro, and major progress has been made as the country was granted a candidate status. Political tensions in the post-independence and post-electoral period have significantly decreased and the country is steadily developing its democratic institutions. Global economic crisis has severely affected Montenegrin economy, but the country’s economy is slowly recovering now. Nevertheless, the Project Team will monitor developments in the political and economic sphere and adjust intervention appropriately.</td>
</tr>
<tr>
<td>All stakeholders and beneficiaries will remain committed to the project and its objectives</td>
<td>This assumption will hold true, as during the Inception Phase the need and demand for this intervention became even more evident. All the key stakeholders expressed full commitment to the project and planned results and activities. Furthermore, the key stakeholders will be directly involved in the project implementation by participating in the Project Board and in specific project activities.</td>
</tr>
<tr>
<td>Efficient coordination between national and local structures is established and continues</td>
<td>This assumption bears certain risk: even when coordination between different layers of governance is an important (political) goal, it remains to be rather challenging task in practice (especially for countries in transition). The Project Team is aware of all the issues and needs for efficient and effective coordination. Therefore, efficient coordination between national and local</td>
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structures will be approached as one of the objectives that the project is aiming to achieve. The need and the benefits from the efficient coordination will be promoted in all the project activities; furthermore, the Project will work on strengthening of the coordination mechanisms through the Project Board, as well as through planned activities.

This assumption is one that carries with it a serious risk. Even large municipalities often lack the human resources needed for implementation of projects. When municipalities demonstrate human resource capacity difficulties we would try to address this challenge by trying to group capacity either between strong/weaker municipalities and/or project experts and municipalities.

Thus the assumption is significant but our strategy will assure it will hold true. We would also try to avoid demanding too much time from the municipalities, being aware of the fact that they may also need to participate in other projects and that time spent on a certain project translates into time away from their normal duties.

### 7.2. Update on risks

A risk mitigation strategy simply refers to the additional efforts, if any, that must be taken by the Project Team and the Project Manager to lower the likelihood of the risk occurring and/or to minimize the impact on the project if the risk did occur. Risk can never be totally eliminated, but risk can be managed and mitigated to lessen the likelihood and/or impact on the project.

A risk mitigation strategy should include:

- roles and responsibilities for developing, implementing and monitoring the strategy;
- timelines;
- conditions present in order for risk level to be acceptable;
- resources required to carry out the planned actions.

During the Inception phase, the Project Team has performed risk assessment and risk management strategy is presented in the table below. This will be updated on a quarterly basis and will provide the Project Board and other key stakeholders with a clear and simple tool for monitoring the effectiveness of the Project Team in tackling and mitigating these risks.

<table>
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<tr>
<th>Risk</th>
<th>Risk Possibility</th>
<th>Impact</th>
<th>Mitigation Strategy</th>
</tr>
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<tbody>
<tr>
<td>Municipal fixed expenses (caused by high number of employees) are affecting financial sustainability</td>
<td>L</td>
<td>H</td>
<td>Majority of municipalities in Montenegro are experiencing serious issues with overstaffed administrations and public utility companies, which is resulting in rather high fixed expenses. This will even in a short-term perspective become one of the main risks for local...</td>
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</tbody>
</table>
Governments in Montenegro. The project will not deal with the issue of staff reduction, but it will provide experience from other countries on desirable amount of fixed-expenses (vs. development budget).

The trend of using property sales, municipal deposits, loans and credits from domestic sources continues, resulting in even more indebted municipalities with fewer resources. This is a risk that will in a long run affect macroeconomic stability of the country.

In order to address this risk, the project will develop and implement comprehensive technical assistance program to alleviate municipal capacities for sound administration and utilization of property and for borrowing and debt management. Primary targets will be municipal officials and high level managers.

The Government of Montenegro is committed to further decentralization primarily in education, primary health care, social and child protection, employment and other areas of interest to local residents. However, if not planned properly decentralization can increase socio-economic differences among municipalities, causing negative impact on access and quality of public services provided to the citizens.

Therefore, in order to avoid this risk, it is necessary to perform a detailed analysis on possibilities and approaches for non-symmetric decentralization, allowing more developed and advanced municipalities to take over more responsibilities than other with less capacity.

One of the major risks for the future development of local self-governments in Montenegro is a deprived collection of tax revenue. This is due to limited capacities of municipal administration as much as due to short-term (populist) political agenda. In order

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25 According to estimates by the Ministry of Finance, the deficit of local government in the first quarter of 2011 amounted to 0.03% GDP (app. 860,000 E).

26 Currently, the debt of municipalities is 46.2 mil € or 1.5%GDP. Source: Fiscal Data as of March 2011.
Project “Strengthening mechanisms for public finance at the local level in Montenegro” - Inception Report (February - April 2011)

**Financial instability affects the functioning of the Equalization Fund**

- **L** - Low
- **M** - Medium
- **H** - High

To strengthen the collection of tax revenue by local governments, the project will work on strengthening of administrative capacities for tax collection, raise awareness amongst both, local administration policy makers and local civil servants, about the importance of respecting the rules of taxation and promote consistent tax policy at the local level.

Functioning of the equalization system in Montenegro is a major risk, due to unstable sources of funding as well as allocation of the resources. The project will provide support to the Ministry of Finance and the Commission, informing them about best EU and regional practices in this regard and providing guidelines for increase in transparency, predictability and motivate local governments to increase its own fiscal capacities. Eligible municipalities would be informed and acknowledged about proscribed procedures and formulas for funds allocations. In order to introduce stability in the funding of the equalization fund, the project will explore international best practices in introducing funds from a certain "stable" source of income, which will contribute to the levelling of revenues that are allocated for equalization.
8. Planning to Ensure Sustainability

8.1. Policy Support

The Project “Strengthening mechanisms for public finance at the local level in Montenegro” directly corresponds with the national policies and strategies. Public administration, financial management reforms and dealing with related governance issues are priorities for Montenegro in the forthcoming EU accession processes. This includes a decentralization of the public administration and services. The Project is in line with the administrative reform programme, and directly supports key objectives of the AURUM- Public Administration Reform Strategy 2011-2016 and the Strategy for Regional Development among other.

In addition, the Project is fully in line with the National Training Strategy for Local Governments in Montenegro.

The Project will work on introducing more accountability, transparency, professionalization and efficiency in the functioning of municipalities in Montenegro, at the same time contributing to socio-economic development.

Project will build on results of the previous and on-going projects that are operating in the area of reform of public finance/ municipal reform. The Project will directly support implementation of the national EU integration strategy.

8.2. Environmental Protection Measures

All the Project activities will reflect the principles of environmental protection and local sustainable development, taking into consideration environmental concerns affecting Montenegro in line with standard EU practices. Furthermore the Project will promote the awareness and the understanding of the environmental issues throughout the overall implementation; at the same time addressing environmental issues to higher instances on the level of the Government of Montenegro.

8.3. Social Aspects

The Project will contribute to open socio-cultural communication and non-discriminative and multi-ethnic exchanges of experience and cooperation between local governments, and local officials, civil society organizations and business community. At the same time, through the project and all activities that are to be carried out, promotion of tolerance, dialogue and communication between all the partners at the local and regional level, as well as with the central level government will be ensured.

The full participation of women is a prerequisite for long term socio-economic development and creation of good local governance. In Montenegro, women continue to be under-represented in formal decision-making structures. Although women are increasingly active in community support systems, gender disparities persist in public positions at all levels in Montenegro.

Therefore, the Project will mainstream gender policy and gender equality through all envisaged activities, based on the following elements: gender equality consolidates the work of combating poverty; gender equality is of fundamental importance for sustainable and democratic development; unequal power structures for women and men constitute an obstacle to economic growth and democratic development and equal opportunities for women and men to own land and assets, to access employment and exercise other human rights are essential for sustainable and democratic development.
There are differences in relations between women and men in different municipalities in Montenegro (and even within different communities) and Project Team should take this into consideration - but without abandoning any requirements in respect of human rights.

8.4. Institutional and Management Capacity

The Project is focused on organizational strengthening and capacity development of municipal budgeting/finance departments, development of capacities of the Commission for Monitoring Development of the System of Fiscal Equalization and enhancing performance of the overall public finance system in Montenegro. In addition, the Project will strive to codify and preserve all the knowledge relevant for local finances, as all knowledge products and training materials will be handed over to the Union of Municipalities, the Human Resources Management Authority and the Ministry of Finance/Government of Montenegro.

8.5. Economic and Financial Analysis

The Project represents viable long-term investment in so far as permanent capacities of local governments and to some degree of the Government/governance structures in Montenegro are to be developed. The Project will directly support development of enabling environment for municipal budgeting, establishment of results oriented budgets; provide for establishment of functional municipal bonds market, support equitable and transparent distribution of transferred funds and work on exchange of knowledge.
Project “Strengthening mechanisms for public finance at the local level in Montenegro” - Inception Report (February - April 2011)

Annexes

Annex 1: Report on Assessment of capacities for budgeting at the local level in Montenegro

Annex 2: Project Activity Work Plan

Annex 3: Project Operational Work Plan

Annex 4: Quarterly Work Plan

Annex 5: Monitoring and Evaluation Plan

Annex 6: Indicative structure of progress reports