Government of Montenegro

MONTENEGRO ECONOMIC REFORM PROGRAMME 2019–2021

Podgorica, January 2019

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LIST OF ABBREVIATIONS

GVA – Gross Value Added
CEFTA – Central European Free Trade Agreement
CGES - Crnogorski elektroprenosni sistem AD (Montenegrin Electricity Transmission System JSC)
COSME – EU programme for Competitiveness of Small and Medium-Sized Enterprises
EBRD – European bank for Reconstruction and Development
EIB – European Investment Bank
EIF – European Investment Fund
EEN – European Enterprise Network
EFP – Economic and Fiscal Programme
EC – European Commission
EPCG – Elektroprivreda Crne Gore (Montenegro Electrical Power Company)
GPA – Government Procurement Agreement under WTO
IPA – Instrument for Pre-Accession Assistance
IPARD – IPA Rural Development
IRFCG – Investiciono-razvojni fond Crne Gore (Investment and Development Fund of Montenegro)
PE – Public Services Enterprise
PPP – Public-private partnership
KfW – German Development Bank
SME – Small and medium-sized enterprises
ERP – Economic Reform Programme
NATO – North-Atlantic Treaty Organisation
NQF – National Qualifications Framework
OECD – Organisation for Economic Cooperation and Development
PEP – Pre-Accession Economic Programme
ERP – Economic Reform Programme
MDD 2018-2021 – Montenegro Development Directions 2018-2021
RCC – Regional Cooperation Council
RUP – Rudnik uglja Pljevlja (Pljevlja Coal Mine)
SEETO – South East Europe Transport Observatory
FDI – Foreign Direct Investments
SEE 2020 Strategy – South-East Europe 2020 Strategy
WTO – World Trade Organisation
TEP – Termo-elektrana Pljevlja (Pljevlja Thermoelectric Power Plant

1. OVERALL POLICY FRAMEWORK AND OBJECTIVES

The Economic Reform Programme (hereinafter referred to as ERP) is Montenegro's most important document in its economic dialogue with the European Union and is a key national strategic document for medium-term macroeconomic and fiscal programming, which also contains a related agenda of structural reforms important for reducing or eliminating barriers to economic growth and for strengthening the country's overall competitiveness.

The topics covered by the 2019–2021 Economic Reform Programme have been the subject of a wide consultative process with the most important stakeholders in the society, as well as the work of the inter-sector working group established for its drafting by the Government of Montenegro.

Montenegro's economic policy and Euro-Atlantic integration processes

Montenegro is a NATO member and is well advanced in negotiations on EU membership. So far, 32 negotiating chapters have been opened and three have been closed.

Montenegro is playing a very active role in strengthening regional cooperation, which is reflected in the Berlin Process, as an important extension of the negotiation process for EU membership. A new method of communication between the region's leaders has been promoted through intensive dialogue at the highest level, taking place not only in Brussels and European capitals, but also, for the first time, in the countries of the region, with the aim of strengthening regional economic cooperation and implementation of the Connectivity Agenda and the Multi-Annual Action Plan for a Regional Economic Area of the six countries of the Western Balkans within the CEFTA legal framework.

Moreover, as a member of the World Trade Organization (WTO), Montenegro is regularly fulfilling its obligations that result from the multilateral trading system and WTO agreements, all aimed at simplifying trade and increasing overall competitiveness.

The strategic development objective for Montenegro in the next medium-term period and economic policy directions for achieving the objective

Montenegro's strategic development objective, defined in the Economic Reform Programme, is sustainable and inclusive economic growth that will contribute to reducing the country's development gap relative to the EU average and increasing the quality of life of all its citizens. GDP per capita in current price terms for 2018 is estimated at around €7,397, while in terms of purchasing power parity it is currently at the level of 46 percent of the EU average. After strong real economic growth in 2017 of 4.7 percent and a projected growth rate for 2018 of 4.1 percent, it is expected that economic growth will continue, thus contributing to an acceleration of the convergence of the standard of living in Montenegro with the standard of living of developed countries.

As described in the Economic Reform Programme for 2018, in order to achieve the above-stated strategic development objective, the Government of Montenegro is combining two sets of economic policy measures over the medium term. The first set of measures refers to strengthening the macroeconomic stability of the country, both fiscally and financially. The second set of economic policy measures is aimed at implementing structural reforms, precisely eliminating the key obstacles to improving the country's competitiveness and increasing the potential of real economic growth over the medium and long terms.

Alignment of the EU recommendations and priorities of the Government of Montenegro

The Economic Reform Programme is a document fully consistent with the annual Budget Law and Medium-Term Budgetary Framework, as well as with Montenegro's strategic development documents. The European Commission annually assesses the reform measures and policies contained in this document, and to that end, based on the Economic Reform Programme for 2018, the Ministerial Dialogue in May 2018 set out recommendations for its preparation for the period 2019–2021. The six recommendations in the question presented in Table 1.1 of this chapter coincide with Montenegro's key development priorities defined in the following strategic documents: Montenegro Development Directions; the South-East Europe 2020 Development Strategy; as well as in the sector development strategies and policies.

Table 1.1 presents the reform measures planned for 2019, as a response to these recommendations.

Table 1.1: Recommendations of the Ministerial Meeting from May 2018 and implementation thereof (already carried out or envisaged for 2019)

Recommendation to Montenegro	*Measures carried out by the end of 2018 and measures foreseen for 2019*
1. *Fully implement the July 2017 fiscal strategy. Take additional fiscal measures if necessary to achieve the debt and deficit targets as outlined in the 2018 ERP. Establish an adequate budget allocation to accommodate contingent liabilities related to unfavourable court cases. Prepare an options paper on the establishment of an independent body for fiscal oversight for further consultation with stakeholders, including the EU.*	*Pursuant to the Fiscal Strategy for the period 2017–2020, implementation of the fiscal consolidation measures continued in 2018, which resulted in a further reduction of the budget deficit. The fiscal consolidation measure introduced in 2018 which has the biggest impact is the increase in the standard VAT rate from 19 percent to 21 percent. Furthermore, excise taxes on tobacco products and alcohol were increased and an excise tax on carbonated water with added sugar was introduced. As a consequence of the expansion of the informal economy resulting from the increased excise tax on tobacco and the risk of the revenue levels projected under the Fiscal Strategy being downplayed, in July 2018 the Government redefined its excise policy by reinstating the excise tax to the levels from 2017. This has contributed to the recovery of the market for tobacco products and to bringing revenues from the excise tax on tobacco products in 2018 closer to those from the year before. In order to reduce current spending, or rather to establish a more stringent control of it, the Government adopted the Public Administration Optimisation Plan in July 2018, in order to rationalise the number of public-sector employees and consequently reduce its wage bill over the medium term. All the above-stated serves to generate a general government surplus and reduce public debt over the medium term.* *In line with Recommendation No. 1 of the Ministerial Meeting of May 2018, the Ministry of Finance has taken measures of planning contingent liabilities related to the costs of court rulings to become part of expenditures and deficit. Pursuant to the preliminary data on the central budget outturn, the central government budget deficit, including the liabilities from the previous period, is around 3.5 percent of GDP, which is in line with the most recent estimates of the Ministry of Finance. Based on the estimates, the general government deficit for 2018 is 2.7 percent of GDP. The trend of an increase in direct public revenues and a reduction in public spending as a percentage of GDP will be the same in 2019, bringing the general government deficit forecast to 2.2 percent of GDP.* *In line with Recommendation No. 1, the Government of Montenegro has begun to look into an optimal model for establishing a Fiscal Council, as an independent body for fiscal oversight. To that end, the Ministry of Finance has approached the EU Delegation in Montenegro, through the National IPA Coordinator office, to provide EU technical assistance through the European integration instrument for the detailed preparation of an option document for establishing an independent body for fiscal oversight and legal framework for its functioning. The request will be assessed by the Steering Committee for this instrument, which is composed of representatives of the National IPA Coordinator and the EU Delegation to Montenegro.*
2.	

2.. Grad ually reduce public spending on wages and pensions as a share of GDP. To this end, implement the new optimisation plan of the public administration reform, including local self-government and public institutions, and prepare pension reforms that would change the valorisation and indexation of pensions and tighten the eligibility for early retirements.	*Pursuant to Recommendation No. 2 of the Ministerial Meeting of May 2018, in July 2018 the Government adopted the Public Administration Optimisation Plan, which has as its objective the reduction of the number of employees at the public administration level, and by doing so, the reduction of wage bills at the central and local levels. Furthermore, it also commenced amendments to the Law on Pension and Disability Insurance in order to increase the adequacy of the calculation of pensions, valuation and indexation, and to narrow the possibilities for early retirement. However, the proposed changes to the law were subject to severe objections from the trade unions during the public consultations, which influenced the need to postpone amendments to the law in question, in order to be able to address successfully Recommendation No. 2 and to create the conditions for successful reform.*
3. Continue efforts aimed at NPL resolution and corporate debt restructuring, focusing also on loans held outside the banking sector and underlying obstacles outside the remit of the central bank. Establish a framework for the recovery and resolution of credit institutions. Consider conducting asset quality reviews in the banking sector and options for enhancing the emergency liquidity assistance framework. Enhance the accountability and transparency of macroprudential policy by publishing a document outlining the Central Bank's competences, objectives and instruments in this area.	*As a response to this recommendation, the following was done:* *Priority Reform Measure No. 7: Strengthening prudential supervision and the bank resolution framework*
4. Based on a mapping of the infrastructure and analysis of market interests, develop a comprehensive action plan on broadband roll out and coverage, and implement the broadband cost reduction measure in line with EU Directive 2014/61. Ensure the collection and delivery of statistical data on research and development, and innovation. Develop a model for the introduction of fiscal incentives for the research and innovation sector in line with EU state aid rules.	*As a response to this recommendation, the following was done:* *Priority Reform Measure No. 12: Improving the legislative regulatory framework in order to reduce the costs of deploying high-speed electronic communication networks*
5.Adopt legislation on concessions and public private partnerships in line with EU rules and best practices accompanied by an action plan for institutional capacity building in this area. Ensure effective, efficient and independent rail regulatory and safety authorities to implement the full opening up of the rail market.	*As a response to this recommendation, the following was proposed:* *Priority Reform Measure No. 3: Creating efficient and independent rail transport regulatory and safety authorities;* *Priority Reform Measure No. 8: Implementing the new regulatory framework for public–private partnership policies and amending the Law on Concessions*
6. Review the active labour market policies in order to improve their coverage and effectiveness, in particular for youth, women and the long-term unemployed. Ensure better coordination between employment activation measures and social benefit schemes. Increase enrolment in vocational and higher education corresponding to the labour market needs.	*In accordance with this recommendation, reform measures in the area of education and skills, employment and labour market were proposed, as follows:* *Priority Reform Measure No. 15: Development of qualification and education curricula in accordance with the labour market needs;* *Priority Reform Measure No. 16: Implementation of apprenticeships with employers; Priority Reform Measure No. 17: Support for self-employment and strengthening local employment initiatives*

Macroeconomic projections for the period 2019–2021

Montenegro's economic growth model in the period 2019–2021 continues to be under the strong influence of the investment cycle, which will have a dominant impact on economic flows. Public finance consolidation measures will also influence the development of economic activities, as well as measures aimed at the optimisation of the state administration. A lack of diversification in the Montenegrin economy is an important factor limiting multiplying effects resulting from investments. The value of investments and imports is at a historically high level, and the baseline scenario has the assumption that investments will remain at such a level, but will not experience more sizeable growth given the limited options for the state to borrow further and the low availability of domestic savings for such a purpose.

Starting from the above-stated and in line with the Montenegro's baseline scenario contained in this year's Economic Reform Programme, the annual real economic growth rate will be 2.8 percent in 2019, 2.3 percent in 2020 and 2.4 percent in 2021. According to the low-growth scenario, the average annual real economic growth rate in the period 2019–2021 will be 1.73 percent.

Fiscal framework in the period 2019–2021

The **core** objective of fiscal policy for the following medium-term period is to preserve the sustainability of public finances, which should guarantee the intensification of the growth of the economy, along with appropriate structural reforms and a favourable investment climate.

Pursuant to the set medium-term framework, the main objectives of the strategy in the area of public finances in the period 2019–2021 are:

- A projected reduction of the deficit in 2019, after which public finances will move into the surplus zone, which will take place in the period 2020–2021;
- A gradual reduction of public debt, returning it to a level below 60 percent in 2022.

The 2019–2021 Economic Reform Programme contains the continuation of the fiscal consolidation measures contained in the Montenegro Budget Deficit and Public Debt Recovery Plan for the period 2017–2021 and the medium-term fiscal strategy, based on the assumption of financing current spending from direct budget revenues and the projected surplus for the current budget. In line with the fiscal consolidation measures contained in these documents, the 2019–2021 Economic Reform Programme envisages in the baseline scenario a public finance deficit of 2.2 percent of GDP in 2019 and moving it into the surplus zone of 0.9 percent of GDP in 2020.

Table *1.2 (also contained in Chapter 3 of this document)* presents the projection of Montenegro's public finances in the period 2019–2021 for the baseline scenario and low-growth scenario.

Table 1.2: Summary of Montenegro's macroeconomic fiscal projections for the period 2019–2021 (baseline and low-growth scenario)

Macroeconomic framework		Outturn	Estimate	Baseline scenario			Low-growth scenario		
		2017	2018	2019	2020	2021	2019	2020	2021
Macroeconomic indicators	Nominal GDP (in € millions)	4,299.1	4,604.5	4,788.6	4,956.8	5,138.3	4,737.7	4,888.8	5,041.5
	GDP, nominal growth	8.7	7.1	4.0	3.5	3.7	2.9	3.2	3.1
	GDP, real growth	4.7	4.1	2.8	2.3	2.4	1.4	1.9	1.9
	Inflation (end of year)	2.4	2.9	1.8	1.8	1.9	2.2	1.8	1.6
	Employment growth (%)	2.1	2.2	1.0	0.9	0.5	−1.5	−1.0	0.0
	Current account deficit (as % of GDP)	16.1	18.1	17.0	15.9	12.5	12.6	8.5	5.2

Fiscal framework (as % of GDP)		Outturn	Estimate	Baseline scenario			Low-growth scenario		
		2017	2018	2019	2020	2021	2019	2020	2021
Fiscal indicators	Public revenues	41.5	42.6	43.0	42.6	41.7	42.6	41.6	40.5
	Public spending	46.8	45.3	45.2	41.7	38.8	45.6	42.3	39.6
	Deficit/surplus	−5.3	−2.7	−2.2	0.9	2.9	−3.0	−0.7	0.9
	Interest	2.4	2.0	2.1	1.8	1.7	2.1	1.9	1.8
	Primary deficit/surplus[1]	−3.2	−0.6	−0.1	2.8	4.6	−0.9	1.2	2.7
	Public debt (% of GDP)	63.2	70.0	67.0	64.6	60.4	68.6	67.0	63.6

Source: Ministry of Finance

At the same time, a downward trend for public debt as a share of GDP is envisaged starting from 2019, from the projected 70 percent of GDP in 2018 to 67 percent of GDP in 2019, 64.6 percent of GDP in 2020 and 60.4 percent of GDP in 2021.

Structural reforms in the period 2019–2021

Starting from the reform priorities defined in key national development documents, the obstacles to competitiveness and economic growth identified in Chapter 4 of this document, the Law on Budget for 2019, the adopted Budget Deficit and Public Debt Recovery Plan and Montenegro Fiscal Strategy for the period 2018–2020, as well as the Ministerial Dialogue recommendations from May 2018, the priority reform measures are defined in Chapter 4 of the Economic Reform Programme for the period 2019–2021. These measures are closely related to measures in Chapter 3, as well as to Chapter 2 of this document, and jointly should have a positive macroeconomic effect and improve the competitiveness of the country over the medium term. Thus, in the Economic Reform Programme for 2019 the key development priorities of the Government have been elaborated through eight structural reform areas defined in the European Commission's Guidance[2] for the Economic Reform Programmes 2019–2021, which define 19 priority reform measures.

Implementation of the reform measures from the Economic Reform Programme is also monitored through regular reports by the Competitiveness Council, established by the Government in 2017 in accordance with the recommendations of the European Commission.

[1] The primary budget deficit/surplus is the budget deficit/surplus less expenditure on interest.

[2] Energy market and transport market reform; sector development; business environment and reduction of the informal economy; research, development and innovation (RDI) and the digital economy; trade-related reforms; education and skills; employment and the labour market; social inclusion, poverty reduction; equal opportunities.

2. MACROECONOMIC FRAMEWORK

The positive factors that influenced the synchronised growth of the global economy in 2017 are weakening gradually, thus the latest EC autumn forecasts envisage lower growth rates for the global economies, along with diverging growth by regions and clusters, and the deceleration will be particularly pronounced in emerging market economies. The global economy is in a state where financing conditions could deteriorate significantly over a very short period. Unstable international cooperation policies are being spurred by an increase in inequality, along with rising populist tendencies. It is estimated that the combined effect of trade barriers and introduction of import tariffs between two largest global economies could reduce US growth over the long term by one percent and reduce the growth rates of the global economy by a half of one percent. An important feature of the growth dynamic during the previous period is that the majority of developed economies have had growth above their potential, and that is one of the reasons for growth rates going back to the potential level (lower) in the forthcoming period.

The growth rate of the global economy for 2018 is estimated at 3.7 percent, then declining to 3.5 percent in both 2019 and 2020 due to expected weaker growth in the USA, the euro area, the United Kingdom and emerging economies. Even though the US economy forecast real GDP growth of 2.9 percent in 2018, the growth forecast for 2019 is 2.6 percent, which reflects the negative impact of introducing trade tariffs. For 2020, growth is forecast to be even lower due to a decline in real growth rates to the potential growth level. Lower growth will be also impacted by the negative consequences of trade tariffs, the impact of the phasing out of fiscal reliefs, as well as an increase in interest rates.

The estimated growth of the euro-area economies in 2018 is 2.1 percent, while the forecast growth for 2019 is 1.9 percent, since recent confidence indicators (survey of businesses and official data from production sectors) indicate weaker growth and the same trend is recorded in the case of exports. The forecast growth for 2020 is 1.8 percent.

The commodities market in 2018 was under the influence of a strong growth in energy sources (11.1 percent) relative to the previous year (October), while the prices of food and metals have declined (6.4 percent and 11.7 percent respectively). Forecasts for the growth in the prices of energy sources are quite uncertain due to the embargo on the export of Iranian oil and the uncertainty surrounding the schedule for an increase in production by OPEC countries and the USA, which offsets the supply gap, as well as the impact on an overall lowering of demand in the global economy.

The increase in the headline inflation rate in 2018 was spurred by price dynamics in the energy sources sector, both in developed and in developing and emerging economies. The base inflation rate was below the target values. The headline inflation rate has had a mild increase in recent months, and thus it is expected that it will reach the level of 2 percent in the EU and 2.5 percent in the USA.

Unemployment was under the influence of the dynamics of economic activity and it was at a historical low level in developed economies with a further decline forecast (the USA, the EU and Japan). Thus, the unemployment rate in the USA was 3.9 percent, in the EU 6.3 percent and 2.7 percent in Japan.

In the autumn forecast, the European Commission revised the real growth for European emerging and developing economies. Such expectations are primarily a consequence of lowered optimism in Turkey which, as the largest economy in this group, has driven this decline. Political instability, aggravated relations with its important trade partners – the USA and the EU – and devaluation of the Turkish currency have impacted a forecast negative growth rate in 2019 of 1.5 percent.

Table 2.1: Forecast of the real GDP growth of the EC for European emerging economies

Economies of the region – GDP growth in percentage	2018	2019	2020
Bulgaria	3.5	3.7	3.6
Hungary	4.3	3.4	2.6
Romania	3.6	3.8	3.6
Croatia	2.8	2.8	2.6
Turkey	3.8	-1.5	3.0

Source: Autumn macroeconomic forecast of the European Commission

The economies of the Western Balkans will continue their stable growth in 2018 and 2019. The GDP growth forecasts for the countries of the Western Balkans are presented in the following table.

Table 2.2: Forecast of the regal GDP growth of the EC for the countries of the Western Balkans

Economies of the region – GDP growth in %	2018	2019	2020
Serbia	4.1	3.8	3.8
FYR Macedonia	2.1	2.8	3.1
Albania	4.1	3.9	3.9
Montenegro	3.9	2.8	3.1

Source: Autumn macroeconomic forecast of the European Commission

The technical assumptions on the EUR–USD exchange rate, commodity prices, growth of the global economy, global trade growth and real growth in EU trends were taken from the European Commission's Autumn Macroeconomic Forecast.

2.1. Recent economic developments

2.1.1. Gross domestic product

Acceleration of economic activities under the strong influence of the investment "boom" which started in 2017 led to stronger growth than expected. Final MONSTAT data indicates that the Montenegrin economy generated real GDP growth of 4.7 percent in 2017, whereby the estimated economic developments were revised upwards on three occasions during the year. The strong growth also continued in 2018. According to MONSTAT's preliminary data, the real growth of the economy in 2018 was 4.5 percent in Q1, 4.9 percent in Q2 and 5.0 percent in Q3, thus, according to those indicators, the growth of the economy for these nine months was 4.9 percent. When observed by activity, the strongest growth was recorded in the construction sector, with an increase in the completed construction works of 31.5 percent and in the effective hours worked of 14.9 percent. Industrial production increased by 24.4 percent, primarily due to growth of 84.8 percent in the production of electricity. A rise in turnover in the retail sector had a real increase of 3.0 percent, while the number of tourist overnight stays in collective accommodation was 7.5 percent higher.

GDP components on the spending side show that that the real spending of households for nine months was 4.4 percent, driven by an increase in household lending and revenues from tourism, while fixed capital formation recorded growth of 21.5 percent, as a result of the completion of infrastructure projects and projects in the areas of energy and tourism.

The total estimated share of gross investments and goods exports in 2018 is estimated at 73.4 percent of GDP, in comparison to 62.2 percent in 2015. This indicates that the economic policy objectives directed towards an increase in investment and the export of goods and services are being implemented. Real growth in the export of goods and services was 8.6 percent and the growth in imports of goods and services was 10.0 percent.

The most important positive contribution to the growth of the economy for these nine months came from gross fixed capital formation (5.3 p.p.) and exports of goods and services (3.9 p.p.), while imports of goods and services took away 6.3 percentage points from this growth. According to preliminary data from the Central Bank, revenues from tourism (foreign tourists) for the first nine months of 2018 were €930.0 million, which is 8.3 percent higher than for the same period of the previous year. The effects of fiscal consolidation on private consumption are short-term and are mitigated by growth in employment in the private sector and a higher volume of newly approved loans.

The available indicators for the fourth quarter show that the economic growth trend continued. Turnover in tourism (only collective accommodation) for these eleven months recorded a growth in tourist arrivals and overnight stays of 13.0 percent and 8.4 percent respectively. Continuous investment in the tourist sector resulted in an increase in the quality and quantity of accommodation capacities. In 2017, 33 hotels were opened with 1,738 beds, in 2018, 21 hotels with 1,570 beds, whereby more than 70 percent of the new accommodation capacities was made up of high-end hotels. Industrial production for those eleven months recorded growth of 22.8 percent, predominantly as a result of increased electricity generation (70.2 percent), benefiting from favourable weather conditions and new electricity generation capacities (wind turbines at Krnovo). Retail turnover followed the total economic growth and for those eleven months was 3.3 percent higher in real terms. Starting from the updated and preliminary MONSTAST data for the previous year and Q3 2018, as well as the available indicators for Q4 of the 2018, the estimate is that the growth of the economy for 2018 was at least 4.1 percent.

The difference between last year's projections presented in the 2018–2020 ERP and the updated GDP projections by component is presented in the following table.

Table 2.3: Difference between the projections and estimates for 2018

	2018 projection (real growth in %)	2018 estimate (real growth in %)	Difference (in p.p.)
Real GDP growth	3.0	4.1	1.1
Domestic demand	3.0	5.4	2.4
Households consumption	2.9	1.6	−1.3
Gross fixed capital formation	7.0	20.7	13.7
Government consumption	−1.2	0.3	1.5
Exports of goods and services	4.0	6.9	2.9
Imports of goods and services	3.6	8.6	5.0

Source: Ministry of Finance

When compared to the projections from the previous ERP, significant divergences are evident. The most significant divergence is evident in the gross fixed capital formation, due to intensified investment activities and imports of equipment and machinery required for carrying out investments. Connected with that, exports of goods were underestimated, while the divergence in the exports of goods and services is a result of the diversification of the export-oriented sectors and higher revenues from tourism.

Consequently, the negative contribution of net exports towards GDP growth is lower. According to the estimate, household consumption will be lower than earlier projected due to keeping wage levels at the same level as the previous year, while government consumption is slightly positive in spite of the consolidation.

International financial institutions revised their growth estimates for the Montenegrin economy for 2018 and the latest forecasts are presented in the following table.

Table 2.4: Forecasts of international financial institutions for 2018

Real GDP growth forecast for Montenegro, in %	2018
European Commission	3.9
IMF	3.7
World Bank	3.8
Ministry of Finance of Montenegro	4.1

The growth projections for 2018 by the Ministry of Finance of Montenegro do not differ too much from the projections of international financial institutions, whereby all forecasts agree about the main drivers of economic growth, those being investment activity and the tourist sector.

2.1.2. Inflation

Consumer prices grew in 2018, with positive annual growth rates in all months. The increase in oil prices at the global level had the largest impact on inflation during that period, which, along with the weakening of the euro against the US dollar, spilled over continuously from external markets onto the increase in fuel prices in Montenegro. The second factor that affected the price increase was an increase in the general VAT rate from 19 to 21 percent and in the excise tax on tobacco and alcoholic and carbonated beverages on the domestic market.

The average rate for the period January–November was 2.7 percent. The lower excise tax rates on tobacco applied from September (they returned to the level of August in the previous year), which partially caused the lower annual inflation rate in the following months. Export prices were 1.6 percent higher, while import prices grew by 1.7 percent. Given the development of factors driving inflation until the end of the year, the estimate is that the average inflation for 2018 was 2.9 percent.

2.1.3. Employment and wages

The improvements in the labour market continued in 2018, which is primarily a consequence of the growth in economic activity and the related increase in labour force demand, but also a result of incentives for self-employment and active employment policies. During the first nine months of 2018, the labour market recorded an increase in employment and a reduction in the number of unemployed. According to data from the Labour Force Survey (LFS), employment grew by 2.5 percent, the average number of employed was 237,500, while the average number of unemployed was 41,500, which is 4.3 percent lower than in previous years. The unemployment rate in Q3 was 14.1 percent, and the activity rate was 57.6 percent – 1.2 p.p. higher than the same quarter of the previous year. Such a dynamic is, first of all, a result of increased employment in the construction sector, which according to the administrative data, was 11.3 percent for those eleven months.

According to administrative data, the number of employees for the period January–November increased by 3.8 percent, and the registered unemployment rate at the end of November was 18.4 percent, which is 4.2 p.p. lower than the same period of the previous year. High employment growth was recorded in Q3 2018 (4.5 percent).

The data on the number of employed by manufacturing sector shows an important increase in employment in construction, the manufacturing industry, transport and the tourist sector. The increase in employment is a result of strong investment activity and a rise in tourist turnover. Based on recorded positive developments in the labour market, as well as continued economic growth in the second half of the year, it is estimated that employment will record an annual growth of 2.2 percent driven primarily by an increase in employment in the private sector.

The average gross and net monthly wages (wages without taxes and contributions) in the period January–November 2018 were €766 and €510 respectively, which is approximately the same level as in the comparative period of 2017. As a result of the dynamics of prices and nominal wages, it is estimated that real wages declined by 3.0 percent in 2018.

2.1.4. Lending activity of banks

Banks in majority foreign ownership are dominant in Montenegro's banking system, making up 74 percent of the assets of the banking sector. This concentration is declining in the banking market due to increased competition, driven by new market entries by banks, which resulted in the re-grouping of banks in the market. Five large banks control 61.9 percent of total assets and approved 63.2 percent of the total loans in the system as of the end of September 2018. Relative to the end of 2013, the share of the top five banks in terms of total assets reduced by 8.4 p.p. and in terms of total loans by 8.6 p.p.

The total assets of banks were €4,405.8 million as of the end of November 2018 and yielded growth of 6.9 percent when compared to the same period of the previous year. Loans and receivables from clients and banks (67.8 percent) make up the largest part of the assets. Most of the lending was directed towards households (41.5 percent) and the corporate sector (34.6 percent).

The total loans of banks amounted to €2,986.9 million at the end of November 2018 and recorded an annual increase of 9.9 percent. A recovery in lending is also evident from the data that all banks in the system registered an increase in lending in the current year, while 11 banks recorded positive annual growth.

The total debt of the household sector resulting from loans taken out from banks was €1,238 million and recorded an annual increase of 10.9 percent. The indebtedness of the non-financial sector resulting from loans was €1,032 million and recorded an increase of 8.2 percent.

During the first eleven months of 2018, the total of newly approved loans was €1,039.7 million and recorded a growth of 9.7 percent relative to the same period of the previous year. Of this amount, the corporate sector accounted for €442.1 million, an increase of 3.7 percent. At the same time, newly approved loans to natural persons amounted to €450.5 million, recording an increase of 2.9 percent.

The positive trend in the reduction of non-performing loans at the aggregate level continued, which has particular importance, given the application of international financial reporting standards (IFRS 9) starting from 1 January 2018. Non-performing loans and receivables at the end of November were €207 million or 7 percent of total loans and receivables. This indicator recorded a decline relative to December 2017.

Deposits are stable and the dominant source of financing of the banking activity and its share in liabilities and capital is 78.4 percent. The total deposits of banks are growing continuously, thus at the end of November 2018 they reached a historical high of €3.45 billion and recorded growth of 8.3 percent year-on-year. Household deposits were €1.32 billion and grew at a rate of 8.8 percent, while the deposits of the non-financial sector were €1.03 billion, recording growth of 8.2 percent year-on-year. The maturity structure of deposits is not satisfactory, given that a-vista deposits make up 66 percent of total deposits and term deposits make up 33.5 percent. As far as the available long-term sources of financing are concerned, the situation is unfavourable given the fact that short-term deposits (up to one year) make up 83.9 percent of total deposits, and term deposits over three years make up only 3.0 percent of total deposits.

The end of 2018 marked the introduction of forced administration by the Central Bank in two banks in Montenegro which account for about 6 percent of the total assets of the banking sector. In one of two banks bankruptcy was introduced. This situation did not affect the stability of the entire banking sector, which continues to be characterised by a growth in deposits.

2.1.5. External sector

Current account

The current account deficit in the period January–September 2018 was €416.6 million, which represents an increase of 32.2 percent relative to the first nine months of 2017. The negative trends of the current account deficit are a result of the deterioration of the balance of exports and imports in goods and services, in spite of the double-digit growth rate of exports of goods and positive results on the side of revenues from transport and tourism. The goods account deficit for the period January–September 2018 was €1.5 billion, or 12.6 percent more due to an increase in imports, which was to be expected because of the implementation of large infrastructure projects. Total exports of goods were €312.7 million, which represents an increase of 11.3 percent, due to higher exports of electricity, steel and iron, medical products and aluminium. Total imports of goods amounted to €1.8 billion and were 12.4 percent higher as a consequence of imports of machinery and means of transport, oil and oil derivatives, ferrous and non-ferrous products and various finished goods. For the first nine months of 2018, the surplus on the services account was €897.3 million and increased by 11.2 percent. A sizeable contribution comes from increased revenues from transport of 19.1 percent and from tourism of 8.3 percent. Expenditure on services was 14.9 percent higher, which went on construction, transport and other business services. In spite of an increase in net revenues on the primary income account for the first nine months of 2018 of 6.8 percent (€14.0 million higher), expenditure grew faster by a rate of 41.0 percent due to higher outflows for payouts of compensation to employees, dividends payments and the payment of income from interest. The secondary income account recorded a surplus of €184.5 million, which is 13.0 percent higher, due to the higher use of EU funds and an increase in the inflow of remittances from abroad.

Table 2.5: Current account balance of payments in € millions

	2017	January–September 2017	January–September 2018	Change in %
Current account	−691.7	−315.2	−416.6	32.2
Balance of goods and services	−1,007.9	−548.8	−629.8	14.8
Goods	−1,860.1	−1,355.9	−1,527.1	12.6
Export, f.o.b.	382.4	280.9	312.7	11.3
Import, f.o.b.	2,242.5	1,636.8	1,839.8	12.4
Services	852.2	807.1	897.3	11.2
Revenues	1,382.6	1,184.5	1,331.0	12.4
Expenditures	530.4	377.3	433.7	14.9
3. Primary income	87.8	70.3	28.8	−59.1
3.1. Revenues	273.9	205.4	219.3	6.8
3.2. Expenditures	186.1	135.1	190.5	41.0
4. Secondary income	228.4	163.3	184.5	13.0
4.1. Revenues	303.8	217.1	238.3	9.7
4.2. Expenditures	75.4	53.9	53.8	−0.1

Based on the available indicators for these nine months and the expected developments until the end of the year, it is estimated that the current account deficit in 2018 will reach 18.1 percent of GDP, which is 2.0 p.p. higher that in 2017. The high increase in revenues on the services account and the increase in the secondary income surplus were not able to offset the high growth of imports of goods, which was the main driver for the current account deficit in 2018.

2.1.6. Capital and financial account

The current account deficit for the period January–September 2018 of €416.7 million was mainly covered by the net inflows of foreign direct investments, which made up 52.4 percent, while the rest was covered by net inflows of portfolio and other investments and reserve funds. The recorded net inflow of foreign direct investments during the observed period was €218.4 million, which was 29.9 percent lower when compared to 2017. Reduced net inflows were driven by high outflows which were €370.4 million in the period January–September 2018, which was three and half times more than in 2017 (€98.1 million).

Total inflows of foreign direct investments in the period January–October 2018 were €638.2 million, which was 27.7 percent higher than in 2017. The growth of total inflows is a result of equity investments (investments in companies and banks and investments in immovable property were 61.7 percent higher), whereby investments in companies and banks increased by 71.4 percent, while investments in immovable property increased by 22.2 percent. Likewise, investments in form of the intercompany debt as a result of loans between companies linked by ownership increased by 11.2 percent. Net inflows of foreign direct investments in the period January–October 2018 were €253.2 million, which was 33.5 percent lower than the comparative period of 2017, due to increased outflows of €385.0 million (dominantly due to the purchase of the Power Company of Montenegro-EPCG shares from Italian company A2a).

In the period January–September 2018, the portfolio investment account recorded a net inflow of €102.8 million, due to borrowing by the state through the issuing of bonds on the international capital markets. The account of other investments recorded a net inflow of €173.4 million. The main drivers of developments on this account were an increase in liabilities from loans taken out, with higher borrowing by the state, banks and other sectors, as well as an increase in the deposits of banks abroad.

2.2. Medium-term macroeconomic scenario

Based on the current economic indicators and the outlook for Montenegro and the international environment, while taking into account the need to preserve fiscal stability and planned sector policies, the received Policy-Based Guarantee of the World Bank, the successful issuing of Eurobonds and the visible improvement of the economic environment, the baseline macroeconomic aggregates and indicators were projected for the period 2018-2021.

During preparation of the projections for the 2019–2021 ERP, a new macroeconomic model was partially used, in line with the recommendations of experts who helped with the development of the model, while the full functionality of the model and its application are expected by 2024, as was stated by experts in the Final Report's recommendations. The project was financed by the European Union and is significantly improving the process of macroeconomic planning and programming.

The model of growth of Montenegro's economy during the observed period is based on a strong investment cycle, which will have a dominant influence on economic flows. Public finance consolidation measures will also have an impact on the development of economic activities, as well as measures aimed at the optimisation of the public administration. The lack of diversification in the Montenegrin economy is having a sizeable effect on limiting the multiplier effects of investments.

The values of investments and imports were at historically high levels, and the assumption in the baseline scenario is that the investments will remain at that level, but it will not record any sizeable increase given the limitations on the country borrowing further and the low availability of domestic savings for such a purpose.

The next part of this chapter presents two macroeconomic scenarios for the period 2019–2021, whereby both scenarios take into account the economic policy measures required for implementation of the Fiscal Strategy for the period 2017–2020, as well as measures aimed at optimisation of the public administration. The alternative scenario develops macroeconomic projections in the event that economic growth turns out to be lower than envisaged in the baseline scenario due to external and/or internal factors.

2.2.1. Baseline macroeconomic scenario 2019–2021 and related risks

Real sector

The baseline macroeconomic scenario for the period 2019–2021 projected a cumulative GDP growth rate of 7.7 percent, as a result of expected developments in economic activity caused by domestic and foreign factors, whereby the real GDP growth rate would range from 2.8 percent in 2019, 2.3 percent in 2020 and 2.4 percent in 2021. The baseline scenario relies on external assumptions, which envisage a slowdown in growth in the EU, stable oil prices and an increase in interest rates for sovereign borrowing in emerging and developing economies. The domestic drivers continue to be strong investment activity, at the high level of approximately €1.65 billion, stable growth in the tourist sector and related business activities, a mild recovery in industrial production and further implementation of the fiscal strategy measures and public administration optimisation. The medium-term scenario envisages moderate inflation and employment growth, with a maintaining of nominal wages levels. In the period 2019–2021, investment activity and hiring domestic resources in construction and transport sectors, as well as the multiplicative effects on the related sectors will trigger growth of the Montenegrin economy. The domestic construction industry has a significant participation in the construction of infrastructure, new tourist capacities and energy facilities. During the operational phase (supply effect) of the functioning of these projects, growth in the economy's potential is expected, with multiplicative effects on the entire economy. We expect that the measures for supporting the development and growth of the agriculture sector will have an effect over the next medium term, given the sizable investments in this sector, and this effect could be visible through food import substitution and an increase in exports. The average projected GDP growth rate for the period 2019–2021 will be 2.5 percent.

The somewhat moderate real growth of the economy over the medium term will be a consequence of the high basis for gross investment[3] from previous years. The average share of gross fixed capital formation in the period 2010–2015 was at a level of around 20 percent of GDP, or around €675 million, expected to reach an average value of around 33 percent of GDP, or around €1.65 billion in the period 2019–2021. The constraints resulting from a lack of domestic savings needed for investment and fiscal consolidation are compensated either by increased borrowing or by financing from foreign sources. Implementing fiscal consolidation measures with the constraints arising from the high level of debt and deficit compared to GDP limits the scope for further borrowing for investment projects. Potential for a growth in investments could be spurred by attracting investors as a result of an improved legislative framework for public–private partnerships.

[3] Gross investment are the sum of gross fixed capital formation and changes in inventories.

The dynamic of GDP components on the expenditure side for the period 2019–2021 is as follows:

- Domestic demand will remain at the same level, and household consumption will have a positive share with an average real growth rate of 1.2 percent and an average share in the real GDP growth rate of 0.8 percent. The projected growth rate for household spending is triggered by the expected growth in disposable income from increased employment, wages, growth in revenues from tourism, as well as by stable inflow from personal transfers and employee compensation from abroad. Final government consumption will record a decline of 0.5 percent with a share in the real rate of −0.1 percent, due to fiscal consolidation measures and measures aimed at the optimisation of the public administration. Gross investment will have negligible growth in 2019 and 2020, then recording a decline of 4.1 percent in 2021. Such an investment dynamic reflects the maintaining of a high share of gross investments at an average level of around 33 percent of GDP.
- The foreign demand dynamic (net exports) is driven by a growth in exports of goods and services at a real rate of 4.0 percent, whereby the projected real growth of revenues from tourism is 5.3 percent (a nominal annual growth rate of 7.0 percent). It is expected that with such growth rates the total revenues from tourism will be at a level of €1.23 billion in 2021. Even though exports of goods make up around 21 percent of total exports (of goods and services), it is expected that positive developments in this segment will contribute to a reduction in the foreign trade imbalance. The nominal growth rate for exports of goods in this period is 5.7 percent. Imports of goods and services in 2019 and 2020 will record mild growth, while a decline is expected in 2021 due to lower imports of goods for investment (imports of construction materials and equipment).

Table 2.6: Montenegro: Macroeconomic projections, 2018–2021

Montenegro: Macroeconomic projections, 2018–2021					
	2017	2018	2019	2020	2021
Nominal GDP in € millions	4,299.1	4,604.5	4,788.6	4,956.8	5,138.3
Nominal growth	8.7	7.1	4.0	3.5	3.7
Real growth	4.7	4.1	2.8	2.3	2.4
Inflation (average)	2.4	2.9	1.8	1.8	1.9
Core characteristics	(as % of GDP)				
Current account deficit	−16.1	−18.1	−17.0	−15.9	−12.5
Exports	41.1	42.4	43.0	43.7	44.4
Imports	64.5	67.5	67.2	66.8	64.2
Other	7.4	7.1	7.1	7.2	7.3
Household consumption	74.8	73.0	72.3	71.7	70.8
Gross investments	30.2	34.0	34.2	34.0	31.9
Gross fixed capital formation	26.9	31.0	31.3	31.1	29.1
Changes in inventories	3.3	3.1	3.0	2.9	2.8
Government consumption	18.4	18.0	17.7	17.4	17.1
GDP deflator	3.8	2.9	1.2	1.2	1.2
	(real growth rates in %)				
Real GDP growth	4.7	4.1	2.8	2.3	2.4
Domestic demand	7.6	5.4	1.6	1.0	−0.7
Household consumption	3.9	1.6	1.4	1.3	0.8
Gross investments	25.1	18.2	3.1	1.3	−4.1
Gross fixed capital formation	18.7	20.7	3.4	1.5	−4.4
Changes in inventories	141.3	−2.1	0.0	0.0	0.0
Government consumption	−1.4	0.3	−0.5	−0.5	−0.5
Export of goods and services	1.8	6.9	4.3	3.9	3.9
Import of goods and services	8.4	8.6	1.5	1.0	−2.4
	(share in real growth as % of GDP)				
Real GDP growth	4.7	4.1	2.8	2.3	2.4
Domestic demand	9.3	6.7	2.0	1.3	−0.9
Household consumption	3.0	1.2	1.1	0.9	0.6
Gross investments	6.6	5.5	1.1	0.5	−1.4
Gross fixed capital formation	4.6	5.6	1.1	0.5	−1.4
Changes in inventories	1.9	−0.1	0.0	0.0	0.0
Government consumption	−0.3	0.1	−0.1	−0.1	−0.1
Net export	−4.6	−2.7	0.8	1.0	3.3
Export of goods and services	0.7	2.8	1.8	1.7	1.7
Import of goods and services	−5.3	−5.5	−1.0	−0.6	1.6
Macroeconomic indicators	Growth in percent unless otherwise stated				
Employment growth	2.1	2.2[4]	1.0	0.9	0.5
Growth of wages	1.9	0.0	0.5	0.5	0.5
Unemployment rate	16.1	14.8	14.5	14.0	13.8
FDI as % of GDP	11.0	7.2	7.9	10.1	9.7
Domestic loans (corporate and household)	11.8	7.1	4.0	3.5	3.7

Source: Ministry of Finance projections

Macroeconomic indicators:

- The balance of payments current account deficit will be, on average, 15.1 percent of GDP, after which it will decrease to 12.5 percent of GDP with a decline in imports and an increase in exports at the end of the period;
- Estimates of foreign direct investments over the medium term continue to be accompanied by a high degree of uncertainty concerning the investment dynamic in companies, the financial sector and real estate. It is estimated that they will be at a level of around 9.3 percent of GDP annually. In 2018, an increased outflow was recorded resulting from the repayment of intercompany debt, as well as from the withdrawal of equity investments, and such a dynamic is also expected in 2019, according to the available information. Inflows

[4] The estimate in the table was obtained based on the available data for 7 months, while the latest available data for 11 months 2018 indicate an average employment growth of 3.8%

of investments continue to be at a high level, which corresponds with the strong investment activity.

- Loans to the corporate and household sectors will grow at an average rate of 3.4 percent in line with the nominal GDP growth rate;
- Employment will gradually increase during the entire period (at an average of 0.8 percent annually) as a consequence of a growth in economic activity, whereby the unemployment rate at the end of the period will fall to 13.8 percent;
- An increase in wages at an average of 0.5 percent (nominally) is expected in the period 2019–2021. The dynamic of projected inflation shows that real wages will decline by an additional 1.3 percent, while the estimated decline in real wages in 2018 was around 3 percent;
- An average increase in prices of 1.8 percent is expected in this period. The projection is based on projections of stable energy and food prices for the forthcoming period, euro-area inflation projections, the announced excise calendar (alcoholic beverages and coal) and historical data.

GDP growth contains the following components on the production side:

- Projected real growth in the agriculture sector in the period 2019–2021 will be on average 2.3 percent. Such growth is projected based on increased investment in agriculture and sizeable lending support to this sector in the period 2019–2021. The agriculture sector growth rate will also influence a reduction in food imports through substitution and/or an increase in exports;
- The mining and quarrying sector will grow at an average of 5.8 percent annually over the medium term, as a result of increased demand for materials required for the highway project (stone, various size classes of gravel and substrate materials), as well as growth in mining (exports of bauxite);
- The manufacturing industry will experience growth of 5.1 percent in the forthcoming period with the assumption that the measures proposed in the document ‘Montenegro Industrial Policy Strategy by 2020’ will yield results in terms of removing bottlenecks and revitalising the sector. A special contribution is expected from growth in the subsectors of food processing and meat processing, the wood industry, metals industry complex and the production of tobacco products;
- Construction will have an average growth of around 5 percent, driven by the projected investment dynamic;
- This scenario envisages growth of 5.3 percent in accommodation and food services, which partially covers the tourist sector. The phased completion of the started investments in tourism will increase the supply of higher-category facilities, which is a prerequisite for strengthening the contribution of this sector to GDP growth. Hotel capacities account for 20 percent of the accommodation supply and their contribution has a many-times-higher effect than the contribution of private accommodation to total revenues from tourism. Increasing supply in this segment will contribute to a faster growth in revenues.

The following table provides an overview of real growth rates, their contribution to growth and share in GVA in the medium term, by aggregated production sectors:

Table 2.7: Production sectors – real growth rates and share in GVA

	Real growth rates (%)				Share in GDP growth (%)				Share in gross value added (%)			
	2018	2019	2020	2021	2018	2019	2020	2021	2018	2019	2020	2021
Agriculture	2.0	3.0	2.0	2.0	0.1	0.2	0.1	0.1	8.2	8.2	8.2	8.2
Industrial production	7.3	4.7	3.5	3.6	0.7	0.5	0.4	0.4	12.0	12.2	12.3	12.5
Construction	23.0	6.0	5.0	4.0	1.5	0.5	0.4	0.3	9.3	9.6	9.9	10.0
Services	1.8	2.0	1.7	1.9	1.1	1.1	1.0	1.1	70.5	70.0	69.6	69.3
Of which accommodation and food services	4.1	5.0	5.5	5.5	0.3	0.4	0.4	0.4	8.8	9.0	9.2	9.5
GVA (gross value added)	4.1	2.8	2.6	2.6	3.4	2.3	1.9	1.9	100.0	100.0	100.0	100.0
Taxes less subsidies	4.1	2.8	2.6	2.6	0.7	0.5	0.4	0.4				
Real GDP growth rate	4.1	2.8	2.3	2.4	4.1	2.8	2.3	2.4				

Source: Ministry of Finance projections

The risks for the macroeconomic scenario relate to those effects that could have a negative impact on the main growth drivers over the medium term and those relating to fiscal and financial stability.

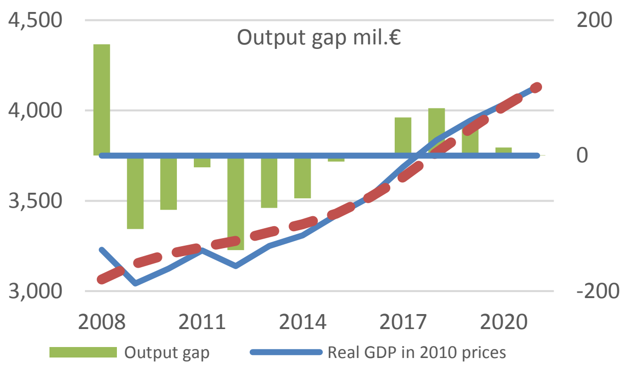
- Changes in the pace of investments and a possible unplanned increase if cost increases for the highway section pose a risk for this scenario materialising, with unavoidable negative multiplier effects on economic developments, as well as on fiscal indicators, revenues, deficit and debt. The multiplying effects of this risk materialising would impact a reduction in aggregate demand and lower household consumption, but would also reduce imports;
- The FED (US Federal Reserves in the role of a central monetary institution) increased the base interest rate to 2.25 percent, which caused currency crises in countries borrowing in US dollars (Turkey, Argentina and Indonesia) and increased the costs of debt financing. The FED announced new increases in the next period, which could worsen the situation for emerging and developing economies. Potential instability in the financial markets may increase interest rates for sovereign borrowing or make it difficult for Montenegro to make the borrowing needed to refinance the liabilities due in 2020 and later. The planned reduction of ECB financial support in the form of quantitative easing could also deteriorate borrowing conditions on the financial markets;
- The geopolitical risks from the immediate or wider environment are increasing security challenges which have an impact on the entire global economy through a reduction in investment, tourist turnover or a reduction in total economic activity, with the spill-over of potentially lower growth rates for all economies. This year the risks are more pronounced and relate to US–Chinese relations resulting from the introduction of trade barriers, the introduction of sanctions against Iran, Brexit, as well as other risks;
- A lack of implementation of fiscal consolidation measures and structural reforms would have a negative impact on fiscal stability and individually on the overall macroeconomic stability;
- Adverse weather conditions could have a significant effect on the sectors of tourism, agriculture and electricity generation.

Potential growth

This document comes up with an estimate of the potential growth and output gap using the CD[5] production function, which is part of the new macroeconomic model Unavailable data on the value of capital in the Montenegrin economy was substituted for by the estimated value of capital[6]. Estimates of labour-force developments were performed using estimates of population trends by applying the median fertility rate and assuming that the legislative reforms being implemented or intended to be implemented will increase the present activity rate by approximately 1 percent by 2020, thus contributing to an increase in the potential labour force.

The average potential growth from 2008 to 2017 was 2.3 percent, while it will grow to 3.3 percent in the period 2018–2021, because completed investment projects will increase the value of capital, as one of the components of growth, whereby the ongoing investments will be at a historically high level.

Figure 2.1: Output gap



Analysis of the share of production factors and related total factor productivity indicates that the share of capital in the real growth rate, during the period 2008–2017, was at an average of 2.7 percent, the share of the labour force was at 0.5 percent, while total factor productivity had a negative share of 1.1 percent. This indicates that the average potential for growth is caused primarily by the growth in physical capital, the weak contribution of the labour force and a negative contribution from total factor productivity. For the period 2018–2021, the contribution of productivity factors will change to a certain degree, thus for capital it is at an average of 2.9 percent, the labour force share will increase to 0.8 percent, while the total factor productivity as a residual is negative and is 0.8 percent. The following table provides a comparison of the share of productivity factors in the GDP growth for the period until 2018 and their share in the next medium-term period.

Table 2.8: Share of productivity factors in real GDP growth

Share of productivity factors in real GDP growth, in %	2008-2017	2018-2021
Capital	2.7	2.9
Labour force	0.5	0.8
Total factor productivity	−1.1	−0.8

Even though the drivers of growth in the Montenegrin economy are sectors without high technological growth (construction, tourism, agriculture and energy), they have the potential to increase total factor productivity. In agriculture, these are measures pertaining to investments in the education of agricultural producers, the adoption of production standards and the distribution of agricultural products in accordance with international standards. In construction, this refers to the use of new infrastructure building techniques – know-how (construction of the highway section). In the tourist sector, this refers to the strengthening of supply by constructing high-end facilities and the training of employees to work in such facilities.

[5] Cobb-Douglass production function.

[6] The calculation of capital for the opening year was done in line with methodology that takes into account the fact that the value of capital in the opening year is equal to the value of gross investments in that year, divided by the average growth of this item for the available period, then the value of capital amortisation is added. Source: Hall and Jones – Why do some countries produce much more output per worker than others.

The construction of new energy facilities linked with renewable sources (wind turbines and small hydroelectric power plants) requires new technological solutions that have raised total factor productivity.

Constant investment and the following of global standards in sectors with a high technological profile, primarily telecommunications and IT technologies, linked with this sector, provide them with high-level services which are a basis for strengthening productivity in the entire economy. Finalisation of large investments open up new possibilities for investments, thus we expect a rise in the quality of investment projects and their impact on strengthening of the potential of overall economy based on an increase in the quantity and quality of capital and an increased share of the active labour force. Even though this analysis makes many initial assumptions due to a lack of data, it is clear that the majority of the focus should be directed toward strengthening the dynamic of the total factor productivity. Investments in education, research and development have the biggest effects on the productivity side, thus strengthening the potential for growth.

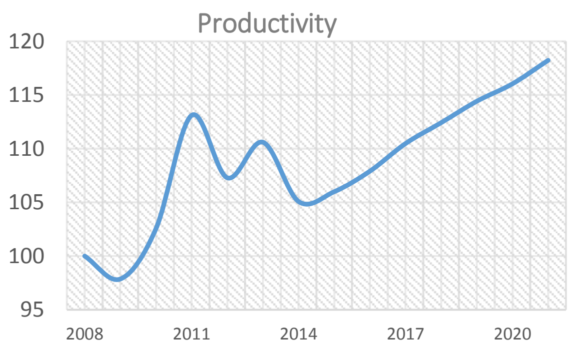
The external sector and its medium-term sustainability

The high level of the balance of payments current account deficit, which was estimated at 18.2 percent of GDP in 2018, indicates that the foreign trade imbalance continues to be high. The main negative contribution to the current account deficit relates to the balance of goods, which is estimated at 43 percent of GDP, but is partially offset by a surplus from the services account (21 percent of GDP) and the balance from the accounts of primary and

Secondary income of 3.9 percent of GDP. The current account deficit is partially covered by foreign direct investments and borrowing by the state on the international and domestic financial markets. The composition of the current account deficit and its financing represent a risk to the sustainability of the balance of payments position, since it relies on a high inflow of foreign investments.

During the next medium-term period we expect a decline in the current account deficit, given that continuous growth in exports of goods and services, and stagnant and declining imports of goods and services are projected, thus at the end of the period it will be around 12.5 percent of GDP. In the period 2019–2021, the expected FDI inflow is at an average of 10.3 percent, and it will make a significant contribution to financing the current account deficit.

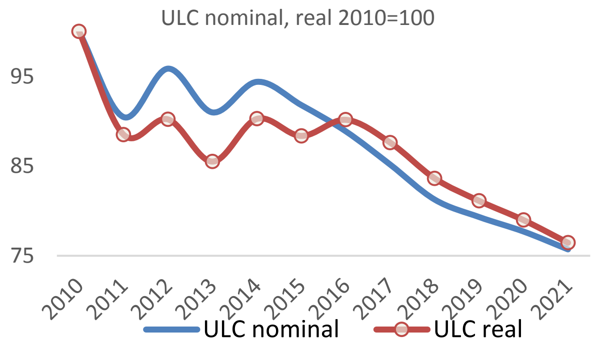
Analysis of productivity developments, stated as a percentage of the gross domestic product realised and the number of employed people (15+ years) at the level of the economy, indicates an upward trend in productivity, with an average rate of 1.2 percent in the period 2010–2017, which corresponds to an average growth in the overall economic activity during that period. According to the GDP and employment projections for the period 2018–2021, it is expected that productivity will increase, with an average annual growth of 1.9 percent.



The following figure presents the development of productivity as a ratio of real GDP and the number of employed people.

Analysis of competitiveness based on the unit labour cost (ULC)[7] shows that price competitiveness had sizeable growth in the period 2010–2017, as a consequence of the growth dynamic of wages, employment, inflation and GDP. The total growth of nominal wages was 6.9 percent, while inflation grew by 13.4 percent, resulting in real wages declining by 5.6 percent, which is a measure of internal devaluation during that period. The employment increase was 9.5 percent. At the same time, the cumulative rate of real GDP growth was 18 percent. The decline of ULC is shown by both real and nominal indicators, which correspond to a growth in productivity and an increase in competitiveness. By the end of the forecast period, we have estimated that there will be a further increase in competitiveness resulting from the wage, employment, inflation and GDP dynamics. Limitations of the analysis of the productivity in unit labour cost comes from the fact that the number of employed from the labour force survey does not cover the prominent number of foreign workers who participate in creating the gross value added. At the end of 2017, the Government set employment quotas of 18,000 foreign workers, but this quota was increased in 2018 by an additional 5,000, therefore 21,000 work permits were issued by the end of Q3 2018. This data also indicates a labour force supply–demand mismatch and significant limitations to the potential growth of the economy. Inclusion of this factor would reduce the positive results presented in the previous figures.

Figure 2.3: Unit labour costs (ULC)



Montenegro is a member of the WTO, CEFTA and EFTA and it has an incentivising investment environment. The high share of net foreign investments testifies to that fact, as does the intensified foreign trade exchange and cross-border cooperation being implemented from the EU's pre-accession funds.

It should be mentioned that, as far as Chapter 17 is concerned, regarding Economic and Monetary Union, the Montenegrin legal framework has a high degree of alignment with the EU principles and regulations in the area of monetary policy, dealing with the Central Bank's independence, its legal personality and the prohibition of monetary financing, while the legal framework in the area of fiscal policy and oversight is mostly aligned with the EU directive. Furthermore, the fourth closing benchmark, pertaining to the meeting of criteria for establishing a functioning market economy, which does not require legislative compliance, represents an important economic accession criterion. In the EC's spring report, the Montenegrin economy was assessed as being moderately ready in terms of the criterion of being a functioning market economy.

In terms of the regional view, all countries scored low in terms of competitiveness, with the main reasons adversely affecting the competitiveness of countries in the region being: an inadequate business environment, strong unfair competition coming from the informal economy, and limited and often expensive access to financing (in particular for small and medium-sized enterprises).

All the above-stated reasons, in addition to the public finances consolidation, give merit to continuing with activities to implement the economic policy measures addressing the solving of structural problems in the economy, namely removing key obstacles in order to improve the competitiveness of the country and increasing the potential economic growth over the medium and long term, which is presented in detail in Chapter 4 of this document.

[7] ULC values were calculated using the OECD methodology and official data from the statistical system.

Financial sector

The key performances of the financial sector are stability and pronounced bank-centricity. The banking sector has a dominant position and a growing share in financial sector assets, which made up 92.1 percent at the end of 2017. The capital market lost its systemic importance a long time ago and it will take time for it to recover from the consequences of the crises. The insurance market is under development and has a share of 4.6 percent in financial sector assets and for this reason does not have systemic importance. Therefore, the impact on the economic developments of financial sector intermediaries operating in the capital market and insurance market is still below expected, in spite of the invested efforts and achieved results.

The main features of the operations of banks for the first eleven months of 2018 were an increase in assets, loans and deposits and a mild decline in capital.. The downward trend of non-performing loans and interest rates has continued and is currently at a historical minimum.

High parameters for liquidity indicate that lending liquidity is lower than expected, even though economic growth is stronger and macroeconomic stability has been strengthened. The stability of the banking sector is supported with adequate capitalisation, given that the solvency ratio of 17.15 percent at the end of September 2018, exceeds the statutory minimum of 10 percent. The system has been operating at a profit at the system level, and it was €36.5 million at the end of November. These tendencies have contributed, amongst others, to improving or confirming the country's rating as recently released by the rating agencies Moody's and Standard & Poor's.

Non-performing loans and receivables at the end of November 2018 were 7 percent of total gross loans and receivables. Credit risk represents an increasing lower systemic challenge, which is more individual, and its resolution requires the implementation of activities to rationalise the operating costs of individual banks, which is additionally confirmed by the trend in interest rates.

The weighted average effective interest rate (WAEIR) for total approved loans continued its multi-annual downward trend (9.57 percent in September 2014), and it reached a historical minimum of 6.40 percent in November 2018. Compared to November 2017, this rate was 0.53 p.p. lower, WAEIR on loans granted to the corporate sector was 5.28 percent and dropped by 0.61 p.p. year-on-year, while WAEIR on loans granted to the household sector was 7.87 percent and recorded a decline of 0.35 p.p.

WAEIR on newly approved loans in November 2018 was 6.46 percent, which is a drop of 0.04 p.p. year-on-year. WAEIR on newly approved loans to the corporate sector was 5.63 percent and was on the same level as in November 2017, while WAEIR on newly approved loans to the household sector was 7.41 percent and recorded a decline of 0.68 p.p. year-on-year.

WAEIR on total deposits (deposit interest rate) was 0.58 percent in November 2018 and is 0.14 p.p. lower year-on-year. WAEIR on corporate deposits was 0.36 percent and recorded a decline of 0.11 p.p., while WAEIR on household deposits was 0.76 percent and was 0.19 p.p. lower year-on-year.

Positive results in the previous period were generated thanks to the presence of a legal framework for voluntary debt restructuring, resulting from amendments to the Law on Voluntary Financial Restructuring of Debts towards Financial Institutions and the *Decision on minimum standards for the management of credit risks in banks*. The total amount of restructured loans under this law was €36.7 million as of 30 September 2018, of which 95.7 percent were loans to the corporate sector.

Further positive effects from the application of this law are expected in 2019. The adoption of the Law on Resolution of Credit Institutions, which will implement Directive 2014/59/EU on Establishing a Framework for the Recovery and Resolution of Credit Institutions and Investment Firms (the so-called BRRD Directive), the adoption of the Law on Credit Institutions, which will implement the Directive 2013/36/EU on Access to the Activity of Credit Institutions and the Prudential Supervision of Credit

Institutions and Investment Firms and Regulation (EU) No. 575/2013 on Prudential Requirements for Credit Institutions and Investment firms, are planned for 2019, as well as the preparation of an entire set of part of the secondary legislation for implementation of these laws and the adoption of the Law Amending and Supplementing the Law on Bankruptcy and Liquidation of Banks.

All of the above is connected with the response to Recommendation No. 3 of the Ministerial Meeting of May 2018, stating that Montenegro should *"Continue efforts aimed at NPL resolution and corporate debt restructuring, focusing also on loans held outside the banking sector and underlying obstacles outside the remit of the Central Bank. Establish a framework for the recovery and resolution of credit institutions. Consider conducting asset quality reviews in the banking sector and options for enhancing the emergency liquidity assistance framework. Enhance the accountability and transparency of macro-prudential policy by publishing a document outlining the Central Bank's competences, objectives and instruments in this area"* (see Chapter 4 – Financial Services section).

2.3. Alternative scenario

2.3.1. Low-growth macroeconomic scenario 2019–2021

In the case of a small and non-diversified economy, such as the Montenegrin economy is, changes in the external environment can cause pronounced consequences in economic activity and in the macroeconomic stability. The baseline scenario is based on the assumption that the investment activity has peaked and reached historically high levels. The necessary fiscal consolidation and public administration optimisation measures are not questionable, while the trend of growth in the tourist sector continues and its share in total GDP is rising. Bearing in mind the possible risks, it is clear that activating any of them can jeopardise the projected growth rates to a greater or lesser degree. While acknowledging uncertain developments in investment activity, along with the high level of investment projects, the starting assumption for the low-growth scenario is based on a decline in investment activity during the observed period. This scenario could be a consequence of the business cycle dynamics (a boom followed by a contraction or bust), the fact that the space for new borrowing of the State for investment projects is very limited, and that there could be a disruption in the external environment in the form of any of the numerous geopolitical risks materialising, which could impact investors and thus postpone the planned investments. At the same time, the materialising of geopolitical risks reduces the oil supply on the global market, and thus affects an increase in prices.

The assumptions of the scenario are:

- Gross fixed capital formation in 2019 will decline sizeably and such a development will continue in 2020 and 2021, with rates of 10.3, 5.8 and 4.0 percent respectively;
- Inflation will grow under the influence of diverging factors: a reduction in aggregate demand on the one hand would cause deflationary tendencies, while an increase in oil prices could have the opposite effect.

This dynamic has strong multiplying effects on all macroeconomic indicators.

The GDP components (expenditure approach) are as follows:

- The real GDP growth rate would reach 1.4 percent in 2019, 1.9 percent in 2020 and 1.9 percent in 2021;
- A reduction in disposable income for household consumption caused by stagnant employment and real wages, would result in stagnant household consumption over the medium term;
- Given the reduction in aggregate demand of 2.1 percent, final consumption by the state could be negative, lower than in the baseline scenario. Lower aggregate demand would reduce state revenues and thus additional stabilisation measures would be required. Lower budget revenues, due to a decline in aggregate demand, and thus in the taxation base,

would require additional borrowing in order to finance the projected expenditure side. The level of the government debt as a share of GDP would increase because of the assumed increase in borrowing and the reduced amount of nominal GDP. The alternative would require a further reduction in government consumption in order to achieve the set fiscal objectives, with multiplicative effects on other sectors, which would lead to additional changes in the parameters in the low-growth scenario, with lower growth rates.

- Exports of goods and services would be the same as in the baseline scenario;
- Imports of goods and services would decline by an average of 4.0 percent due to these domestic and foreign demand developments. This decline would be pronounced during the first two years in particular. Changes in net exports, assuming that the other current account items remain unchanged, would lead to a decline in the deficit to the level of 5.2 percent of GDP at the end of the period.
- The materialisation of this scenario would result in a drop in employment and a rise in the unemployment rate with stagnant wages;
- A reduction in domestic demand would put pressure on a reduction of the general level of prices, while an increase in the prices of oil derivatives would sizeably push up inflation in 2019. Combining the effects of these two factors results in higher inflation in 2019 to a level of 2.2 percent, with it going on to be somewhat lower in the next two years, 1.8 percent and 1.6 percent respectively.

The following table presents the macroeconomic indicators for the low-growth scenario.

Table 2.9: Montenegro: Macroeconomic projections, 2018–2021, low-growth scenario

Montenegro: Macroeconomic projections, 2018–2021					
	2017	2018	2019	2020	2021
Nominal GDP in € millions	4,299.1	4,604.5	4,737.7	4,888.8	5,041.5
Nominal growth	8.7	7.1	2.9	3.2	3.1
Real growth	4.7	4.1	1.4	1.9	1.9
Inflation (average)	2.4	2.9	2.2	1.8	1.6
	(in %)				
GDP deflator	3.8	2.9	1.5	1.3	1.2
	(as % of GDP)				
Current account deficit	−16.1	−18.1	−12.6	−8.5	−5.2
	(real growth rates in %)				
Real GDP growth	4.7	4.1	1.4	1.9	1.9
Domestic demand	7.6	5.4	−3.2	−1.9	−1.3
Household consumption	3.9	1.6	−0.3	−0.4	−0.3
Gross investments	25.1	18.2	−10.3	−5.8	−4.0
Gross fixed capital formation	18.7	20.7	−11.3	−6.4	−4.4
Changes in inventories	141.3	−2.1	0.0	0.0	0.0
Government consumption	−1.4	0.3	−1.9	−1.0	−1.0
Exports of goods and services	1.8	6.9	4.3	3.9	3.9
Imports of goods and services	8.4	8.6	−5.4	−3.8	−2.7
Macroeconomic indicators	Growth in percentage unless otherwise stated				
Employment growth	2.1	1.3	−1.5	−1.0	0.0
Growth of wages	1.9	0.0	0.0	0.0	0.0
Unemployment rate	16.1	14.8	15.2	15.8	15.8
FDI as % of GDP	11.0	7.2	8.0	7.2	7.9
Domestic loans (corporate and household)	11.8	7.1	2.9	3.2	3.1

Source: Ministry of Finance projections

3. FISCAL FRAMEWORK

3.1 Policy strategy and medium-term objectives

The fiscal policy from the previous period is characterised by the creation of conditions for the strengthening of public finance stability. Accordingly, the fiscal consolidation measures outlined in the 2017–2021 Budget Deficit and Public Debt Recovery Plan and supplemented by the 2017–2020 Fiscal Strategy have been implemented.

The designed measures have produced positive effects and resulted in increased public revenues, which, together with the rationalisation of public spending, have facilitated a decreased deficit and discontinued the public debt growth trend, i.e. created the prerequisites for its gradual decrement in the medium term. The implementation of the measures directed towards strengthening public finance stability has been also accompanied by dynamic economic growth rates, which have not only contributed to the improvement of the country's credit outlook but have also resulted in the strengthening of the overall economic environment.

The main fiscal policy objective in the following medium-term period is to preserve public finance sustainability, which together with appropriate structural reforms and favourable investment environment should guarantee intensified growth of the economy.

According to the established medium-term framework, the main objectives of the public finance strategy for the period 2019–2021 are as follows:

- a projected reduction of the deficit in 2019, after which public finances will transit to the zone of surplus, which will be achieved in the period 2020–2021;
- a gradual decrement of public debt, and its return to below the limit of 60 percent in 2022.

In order to achieve the set objectives, the implementation of the fiscal consolidation measures contained in the Budget Deficit and Public Debt Recovery Plan for the period 2017–2021 and in the Fiscal Strategy for the period 2017–2020, directed towards the increased public revenues, will be continued, and the restrictive policy related to expenditures will also continue to be pursued in order to restrict their growth.

To that end, the fiscal policy measures to be implemented in the following medium-term period (detailed in Chapter 3.3 – Medium-term budgetary outlook) will facilitate:

- faster growth of revenues and a reduction in expenditures, which will ensure the achievement of a surplus in current public expenditure in all projected years;
- intensified investment activity of the country through increased investments in infrastructure projects;
- new debt solely for the purpose of capital budget funding, i.e. in the years of achieved surplus for the needs of repayment of the existing debt.

In addition to the measures focused on ensuring the stable growth of public revenues, activities will be implemented to contribute to expansion of the tax base and improvement of tax discipline. With regard to this, in 2018 the reform commenced with the focus on improving tax administration in order to enhance the effectiveness of the operational functions of the Tax Administration, which, together with the introduction of a system of electronic issuing of fiscal invoices, should ensure the efficient collection of tax revenues.

Significant positive effects in generating revenues, primarily through the attraction of new investments, are expected from implementation of the Economic Citizenship Programme which implies acquiring Montenegrin citizenship based on the implementation of an investment programme that contributes to Montenegro's economic and commercial development.

On the other hand, as regards public expenditure, the strategic commitment is related to the rationalisation of the current expenditure so as to create the conditions for increased investments for the needs of funding capital projects particularly for the purpose of achieving a balanced regional development. Restriction of the current expenditure growth is anticipated due to the planned effects of the implementation of the 2016–2020 Public Administration Reform Strategy aimed at creating an efficient public administration which can better respond to the needs of citizens and the private sector, with concurrent disburdening of the government and municipal budgets through optimisation of the aggregate number of employees. In addition, reforms will be implemented with a focus on restricting the growth of costs for the needs of funding reform of the healthcare and pension system, taking into account that such costs have the highest percentage share in overall spending.

In order to avoid risks and ensure efficient public debt management, the 2018–2020 Public Debt Management Strategy adopted in March 2018 will be implemented.

Stability of Montenegro's public finance system is also substantially determined by the local self-government units, and reform processes will be carried out in that segment. Namely, the adoption of the new Law on Local Self-Government Financing will create normative assumptions for the stable functioning of the local public finance system through an increase in the percentage of personal income tax being assigned to the municipalities in the northern region of Montenegro, for the purpose of providing support for balanced regional development.

As support for all reform measures, the implementation of the 2016–2020 Public Finance Management Reform Programme (a detailed explanation of the reforms is provided in Chapter 3.7) revised in June 2018 will be continued, as well as the achievement of the objectives within the European Union accession process, outlined in the relevant negotiation chapters.

At the Ministerial Meeting held on 25 May 2018, Montenegro was invited to implement the following recommendations in the area of fiscal policy:

To fully implement the July 2017 fiscal strategy. Take additional fiscal measures if necessary to achieve the debt and deficit targets as outlined in the 2018 ERP. Establish an adequate budget allocation to accommodate the contingent liabilities related to unfavourable court cases. Prepare an options paper on the establishment of an independent body for fiscal oversight for further consultation with stakeholders, including the EU.

As regards the mentioned recommendation, in the coming medium-term period the Government of Montenegro will continue with its consistent implementation of the fiscal consolidation measures outlined in the 2017–2020 Fiscal Strategy. Although the measures have contributed to the improvement of the collection of overall revenues in the previous period of their implementation, due to the deviations from the plan in the collection of excise on tobacco and unfavourable market trends of individual excise goods, the excise policy for tobacco and carbonated water with added sugar has been redefined, and it will not threaten the general image of public finances in the medium term.

Taking into account the macroeconomic outlook, and therefore the better collection of budget revenues, along with controlled growth of current expenditure, as well as the disburdened capital expenditure resulting from the completion of the construction of the first section of the highway, it is estimated that additional measures for achieving the targeted deficit and debt will not be necessary. The achieved growth of the public revenues and the reduction of public spending as a percentage of

GDP in 2018 contributed, according to preliminary data, to a decline in the general government deficit as apercentage of GDP in comparison to 2017.

Expenses for court decisions costs, as a part of the category *Repayment of liabilities from the previous period*, as of 2019 are planned as an integrated part of the overall expenses and thus are included in the calculation of the planned deficit, which is in line with the EC recommendation . In this way, the resolution of the issue of the differences in methodology that has existed until 2019 between the planned and the executed level of expenses, i.e. the deficit, has been accommodated.

As regards the strengthening of oversight over the implementation of fiscal policy, options are being considered for the identification of the most adequate model for establishing the Fiscal Council, and expert assistance has been sought from the European Union for this purpose.

Recommendation No. 2 – Montenegro is invited to gradually reduce public spending on wages and pensions as a share of GDP. To this end, implement the new optimisation plan of the public administration reform, including local self-government and public institutions, and prepare pension reforms that would change the valorisation and indexation of pensions and tighten the eligibility for early retirement.

As regards this recommendation, the medium-term projection contained in this programme indicates a gradual reduction of spending on wages and pensions as a share of GDP, and these two categories of expenditures, viewed cumulatively, range from 19.9 percent of GDP in 2019 to 18.9 percent of GDP in 2021. In projecting the aggregate gross wage bill in the public administration, the starting assumption was that the Public Administration Optimisation Plan would produce positive effects and result in the reduction of the aggregate gross wage bill through optimisation of the number of employees at both the central and local levels, and a conservative approach was applied, given that the optimisation plan effects have not been accomplished yet. To that end, the projected fiscal framework includes very "mild" effects from this reform, and therefore in the case of its implementation to the extent planned in the Optimisation Plan, significant savings can also be expected, and thus positive effects on the reduction of the public spending deficit. In 2018, for the purpose of restricting public sector employment, in addition to the established optimisation plan, the Government of Montenegro adopted a decision to discontinue employment with state administration authorities and public institutions until 1 July 2019, except in sectors of special public interest, where previous consent by the Government is required.

As a response to the recommendation related to pension reform, the Draft Law Amending the Law on Pension and Disability Insurance has been prepared in view of increasing the adequacy of pension benefits, preventing people leaving the labour market early and early retirement. Adoption of the Law Amending the Law on Pension and Disability Insurance is planed until the end of 2019.

3.2 Budget implementation in 2018

The Fiscal Policy for 2018 focused on the implementation of the fiscal consolidation measures, previously outlined in the 2017–2021 Budget Deficit and Public Debt Recovery Plan and the 2017–2020 Fiscal Strategy in order to prevent fiscal risks and reverse the public finance trend.

In 2018, the original budget plan was revised on two occasions, in March and July, where the main reasons were as follows[8]:

- the purchase of the shares of Elektroprivreda Crne Gore (Montenegro Electrical Power Company), where the state increased its equity in this company;
- the need to reformulate excise policy regarding the excise on tobacco and tobacco goods and the excise on carbonated drinks with added sugar in line with the amendments to the Excise Law;
- the increase of the current budget expenditure.

Public revenues in 2018 are estimated at the level of €1.963 billion, or 42.6 percent of estimated GDP. Estimated revenues are €25.2 million, or 1.3 percent, lower than the planned level, whereas in relation to the revenues generated in 2017 they are €177.6 million, or 9.9 percent, higher. It is estimated that in relation to the previous year, as a result of positive trends in the macroeconomic environment and the effects of fiscal consolidation measures, all categories of tax and non-tax revenues recorded growth. As regards tax revenues, the greatest deviation will be recorded in the collection of VAT by €68.2 million or 12.4 percent, as a result of the increased standard rate, and also increased economic activity. At the same time, taxes and contributions on wages will be €42.7 million, or 6,7 percent, higher due to the collection of tax arrears and strengthened tax discipline. Furthermore, revenues from the profit tax will increase by €18.9 million as a result of positive trends in the macroeconomic environment. As regards non-tax revenues, the greatest deviation is recorded in the collection of revenues from capital by €33.5 million, primarily due to the collection of dividends from Elektoprivreda Crne Gore, amounting to €35.0 million.

On the other side, in relation to the revenues planned in 2018, it is estimated that the generated revenues will be lower due to the collection of revenues from the excise on tobacco being below planned, caused by unfavourable market trends. With regard to this, in relation to the plan, the excise revenues were €11.5 million or 5.0 percent lower. Furthermore, local self-government revenues also recorded a lower outturn due to a lower outturn of expected revenues from the legalisation of informally constructed buildings.

Fiscal adjustment measures implemented on the revenue side in 2018 are as follows:

- The standard VAT rate was increased from 19 percent to 21 percent as of 1 January 2018;
- Excise policy continued to adjust to the Montenegro Fiscal Strategy, apart from the excise on cigarettes, where the excise calendar changed in line with the amended Excise Law. Accordingly, the specific excise on cigarettes in 2018 amounted to €30 per 1000 kg, and ad-valorem excise of 32 percent of the retail price;
- Tax arrears continued to be collected through the implementation of the Law on Rescheduling Tax Receivables;
- Personal income continued to be taxed at a rate of 11 percent (applicable to the portion of the wage above the national average) while wages below the average wage in Montenegro were subject to the application of a rate of 9 percent.

[8] The comparison of the current public revenues and public expenditures presented in this subchapter includes the comparison of revenues and expenditures specified in the Budget revision for 2018 from July and estimates of their execution in 2018.

Public spending in 2018 is estimated at €2.085 billion, which makes up 45.3 percent of GDP and is at the level of spending planned under the Budget revision adopted in July and as percent of GDP, less than in 2017. The need to revise expenditures, relative to the initial plans, was conditioned by the following:

- an increased aggregate gross wage bill due to the need for the HR strengthening of institutions carrying out affairs particularly significant from the aspect of the quality of provided public services, primarily in the areas of: education and health and social protection, as well as the need to strengthen capacities for meeting the EU integration requirements;
- contingent expenses in the area of health caused in one part by accumulated arrears from the previous period and in another part by additional costs incurred during the current year for the needs of treatment, procurement of medicine and medical supplies;
- changes in the treatment of *Expenses for the purchase of securities*, in line with internationally accepted methodology, according to which this category forms an integrated part of financing transactions.

The **public finance deficit** in 2018 is estimated at €122.1 million or 2.7 percent of GDP and in relation to the planned level is €24.1 million, or 24.5 percent, higher. The main reason for the mentioned deviation is lower executed public revenues. The primary deficit of public finances is estimated at €29.3 million or 0.6 percent of GDP.

Figure 3.2: Trend of fiscal parameters, in € millions

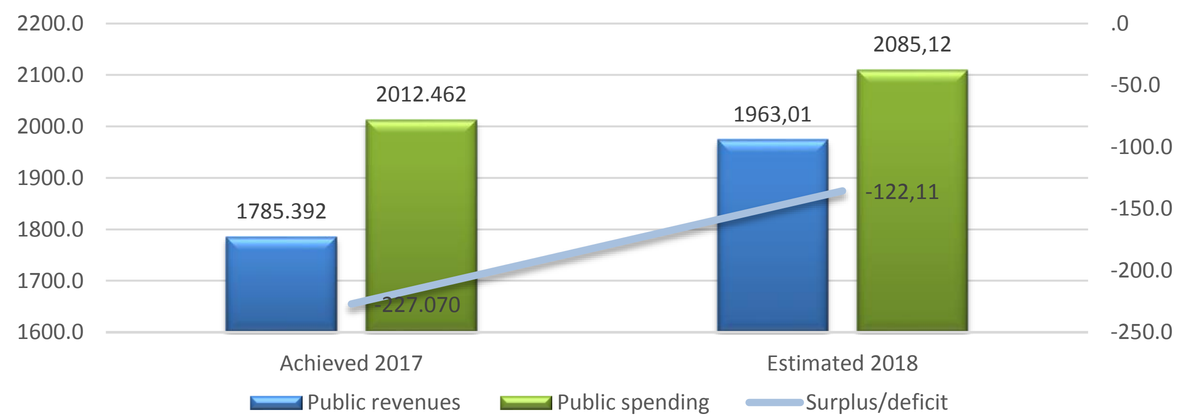


Table 3.2: Estimate of public finance outturn in 2018

Annual GDP (in € millions)	4,299.0		4,604.5				4,430.9			
Estimate of public finances for 2018	2017		2018 estimate		Deviation (2018/2017)		Plan 2018		Deviation (Estimate/Plan 2018)	
	€ millions	% of GDP	€ millions	% of GDP	€ millions	%	€ millions	% of GDP	€ millions	%
Public revenues, of which:	1,785.4	41.5	1,963.0	42.6	177.6	9.9	1,988.2	44.9	−25.2	−1.3
Income tax	145.6	3.4	158.8	3.4	13.2	9.1	155.6	3.5	3.2	2.1
Value added tax	548.7	12.8	616.9	13.4	68.2	12.4	624.4	14.1	−7.5	−1.2
Excise	225.1	5.2	221.2	4.8	−3.9	−1.7	232.7	5.3	−11.5	−5.0
Local taxes	85.9	2.0	87.6	1.9	1.7	2.0	87.6	2.0	0.0	0.0
Contributions	495.0	11.5	524,4	11.4	26.5	5.4	522.3	11.8	−0.8	−0.1
Public expenditure, of which:	2,012.5	46.8	2,085.1	45.3	72.7	3.6	2,086.2	47.1	−1.1	−.01
Gross earnings	492.1	11.4	507.5	11.0	15.4	3.1	510.0	11.5	−2.5	−0.5
Interest	102.5	2.4	92.8	2.0	−9.7	−9.4	91.33	2.1	1.5	1.7
Social care transfers	538.9	12.5	545.3	11.8	6.5	1.2	559.8	12.6	−14.4	−2.6
Capital budget	298.0	6.9	311.3	6.8	13.3	4.5	341.1	7.7	−29.8	−8.7
Transfers to institutions, individuals, NGO and public sector	212.8	4.9	255.1	5.5	42.3	19.9	253.5	5.7	1.6	0.6
Repayment of liabilities from the previous period	71.9	1.7	22.9	0.5	−49.0	−68.2	63.2	1.4	−40.4	−63.8
Surplus/deficit	−227.1	−5.3	−122.1	−2.7	105.0	−46.2	−98.1	−2.2	−24.1	24.5
Primary surplus/deficit	−124.6	−2.9	−29.3	−0.6	95.3	−76.5	−6.7	−0.2	−22.5	335.3
Debt repayment	371.8	8.6	753.3	16.4	381.5	102.6	591.4	13.3	161.9	27.4
Expenses for purchase of securities	0.0	0.0	69.2	1.5	69.2		70.0	1.6	−0.8	−1.1
Financing, of which:	−598.9	−13.9	−944.6	−20.5	−345.8	57.7	−759.5	−17.1	−185.2	24.4
Borrowings abroad	353.3	8.2	904.1	19.6	550.8	155.9	745.3	16.8	158.9	21.3
Borrowings in the country	264.4	6.1	218.6	4.7	−45.8	−17.3	10.0	0.2	208.6	2,086.0

3.3 Medium-term budgetary outlook

The 2019–2021 Fiscal Policy will be focused on the continuation of the implementation of the fiscal consolidation measures in order to ensure the achievement of a public spending surplus, starting as of 2020 and gradually reducing public debt to a level below 60 percent in 2022.

The overview of fiscal policy measures for the period 2019–2021 is as follows:

Measures aimed at increasing public revenues:

- Mitigation of the excise calendar by retaining excise on tobacco in 2019 at the same level as in 2018 (specific excise on cigarettes €30 per 1,000 pieces, and ad valorem 32 percent of the retail price of cigarettes), while as of 2020 the specific excise will annually increase by €3.50, and ad valorem will decrease by 1.5 percent;
- Excise taxes on carbonated water with added sugar or other sweeteners or aromatisation agents in 2019 will amount to €25 per hectolitre, while in 2020 excise will increase by €5 per hectolitre;
- Increased excise on ethyl alcohol in line with the calendar specified by the established 2017–2020 Fiscal Strategy;
- Introduction of coal excise as of 2019 of €0.15 per GJ, which will gradually increase to €0.30 per GJ in 2020;
- Reform of the Tax Administration and implementation of electronic monitoring of fiscal registers;
- Reduction of tax arrears through the implementation of the Law on Rescheduling Tax Receivables;
- The taxation of personal income will continue (applicable to the portion of wage exceeding the national average) at a rate of 11 percent until the end of 2019, while wages below the average in Montenegro will be subject to the application of a rate of 9 percent;
- Implementation of the new legislative framework in the area of organising games of chance will create the conditions for collecting additional revenues in this respect;
- The Economic Citizenship Project will ensure an increased inflow of foreign direct investments, generate new revenues and provide additional funds for investing in under-developed areas, so as to improve regional development;
- Implementation of the Law on Local Self-Government Financing and legalisation of informally constructed buildings will create the conditions for increased revenues collected by local self-governments and an increased level of fiscal and budgetary discipline.

Measures aimed at public spending optimisation:

- Implementation of the 2018–2020 Public Administration Optimisation Plan and a freeze on employment in the public sector until July 2019 will facilitate a reduction in the number of employees at the central and local levels and ensure a reduction in the aggregate gross wage bill for public-sector employees;
- Restricting the growth of public spending will create the conditions for increased investments in development projects;
- The medium-term budgetary framework does not include an increase in wages, pensions or social benefits, except for their regular adjustment in line with the law;
- Implementation of the new concept of “consolidated public procurement” will create the conditions for rationalisation of the “common” costs of the state authorities (office supplies and equipment, fuel, landline and mobile telephony and the like);

- Implementation of the Public Finance Management Reform Programme will strengthen fiscal discipline and increase the transparency of public finances.

Th fiscal policy measures for the following medium-term period are a continuation of the measures outlined in the 2017–2020 Fiscal Strategy aimed at strengthening fiscal stability and providing support for economic growth. All the above-mentioned measures are created in such as way as to accommodate the further growth of public revenues, which, concurrently with the controlled growth of current expenditure and disburdened capital expenditure resulting from the completion of the construction of the first section of the highway, will create the conditions for a reduction in the deficit in 2019, i.e. achieving a surplus in public finances in 2020 and 2021.

Table 3.3.1: Medium-term fiscal framework

Fiscal framework (in % of GDP)		Outturn	Estimate	Baseline scenario			Low-growth scenario		
		2017	2018	2019	2020	2021	2019	2020	2021
Fiscal indicators	Public revenues	41.5	42.6	43.0	42.6	41.7	42.6	41.6	40.5
	Public expenditure	46.8	45.3	45.2	41.7	38.8	45.6	42.3	39.6
	Deficit/Surplus	−5.3	−2.7	−2.2	0.9	2.9	−3.0	−0.7	0.9
	Interest	2.4	2.0	2.1	1.8	1.7	2.1	1.9	1.8
	Primary deficit/surplus[9]	−3.2	−0.6	−0.1	2.8	4.6	−0.9	1.2	2.7
	Public debt (% of GDP)	63.2	70.0	67.0	64.6	60.4	68.6	67.0	63.6

In 2019, the current budgetary spending surplus will be achieved, which indicates that a public finance deficit is recorded only in capital expenditure. Thus, even in a year of a recorded deficit, new debt serves solely for the funding of capital projects, the implementation of which encourages economic growth that is followed by achievement of the balanced public finances, i.e. a surplus.

Public spending, as regards current expenditure, is stable, given that its growth has been discontinued by the fiscal consolidation measures which opened up room for the increased capital budget. Given the fact that the works on the first section of the highway are to be completed in the time horizon covered by the 2019–2021 Economic Reform Programme, it may be concluded that in this period stability of public finances will be achieved and creation of the conditions for reduction of public debt will be facilitated, i.e. its returning to below the limit of 60 percent of GDP in 2022.

Concurrently with the mentioned measures, activities will be undertaken with the aim of expanding the tax base and reducing the level of the informal economy. To that end, tax administration reform is being implemented, which will result in the improved effectiveness of operational functions of the Tax Administration so as to accommodate the efficient collection of taxes and contributions from all sources of economic activities.

The medium-term public finance framework does not include the anticipated effects of the implementation of the Economic Citizenship Project, taking into account the conservative approach to revenue planning, whereas the effects of the implementation of the Public Administration Optimisation Plan are planned to be at a low percentage, and thus, in the case of the full operationalisation of the effects of these reforms, a positive impact on the projected public finance deficit is expected. The medium-term fiscal framework projection for the period 2019–2021 takes into account the reform measures contained in Chapter 4 of this document.

[9] The primary budget deficit/surplus is the budget deficit/surplus reduced by the expenses related to interest.

In spite of the achieved outcomes and positive expectations, it is necessary to continue with the measures aimed at the restriction of the current budget expenditure, particularly as regards mandatory expenses and, in accordance with that aim, the projected medium-term budgetary framework does not include an increase in wages, pensions or social benefits, apart from their regular adjustment in line with the law.

Public revenues in 2019 are planned to be €2.060 billion or 43.0 percent of the estimated GDP and in relation to the estimate for 2018 they are €96.8 million, or 4.9 percent, higher.

The greatest positive deviations in the main categories of revenues will be recorded with:

- Value added tax, by €35.9 million or 5.8 percent, as a result of growth in economic activity;
- Fees, by €15.1 million or 19.2 percent, primarily due to the expected effects of the new Law on Games of Chance;
- Excise, by €18.4 million or 8.3 percent, as a result of the fiscal consolidation measures;
- Contributions, by €6.6 million or 1.3 percent, as a result of strengthened fiscal discipline and the anticipated effects of the Law on Rescheduling Tax Receivables.

In the period 2019–2021, public revenues will nominally go up while, as a percentage share in GDP, they will have a falling trend, taking into account that nominal growth of GDP is faster than the growth of revenues. Such a trend is a consequence of the strong growth of gross investments which, in the construction phase, have no significant impact on revenues, whereas in the operational phase a greater effect on the collection of revenues is expected.

Public revenues have been projected based on the projections of the trend of macroeconomic indicators (GDP, wages, employment) and the estimated effects of the fiscal consolidation measures in the medium term.

The explanation of the trend of the main public revenue categories in the period 2019–2021 is as follows:

- **Value added tax** – projected based on the growth rate of household consumption, the standard rate increased from 19 percent to 21 percent as of 1 January 2018 and issuing of electronic fiscal invoices measure (the first effects on the revenue side will be visible as of 2020). The effects of issuing of electronic fiscal invoices in 2020 will amount to €6.0 million and in 2021 an additional €4.0 million. In line with the growth of household consumption and fiscal consolidation measures, the collection of VAT will grow by 4.2 percent on average, with a significant share of VAT in imports of about 66 percent of total revenues from VAT. Viewed as a percentage share in GDP, in the medium term, revenues will remain approximately at the level planned for 2018 (about 13.6 percent of GDP), which is the result of the anticipated trend in the categories of household consumption, employment and wages;
- **Taxes and contributions on wages** – in the coming period a slight nominal growth in employment and wages in the private sector is expected, whereas in the public sector, in line with the Public Administration Reform Strategy, the number of employees will be optimised and the wages will remain at the same level. As a result of these labour market trends it is projected that income tax and contributions in the medium term will nominally grow by about 1.1 percent on average. The projections have also taken into account the expected effects of the following:
    - The Law on Local Self-Government Financing (revenues from income tax of the central budget have reduced by €10.0 million in favour of the budgets of local self-governments);

- The Law on issuing of electronic fiscal invoices in the Turnover of Products and Services (in 2020 the estimated effect on income tax will amount to €4.0 million and in 2021 an additional €1.0 million);
- The Law on the Rescheduling of Tax Receivables (the annual effects in the period 2019–2021 will amount to about €15.0 million on average).

In accordance with the above-mentioned, together with the strengthened tax discipline, in the medium term taxes and contributions will record nominal growth, on an annual basis, at the rate of 1.9 percent on average, whereas as a percentage of GDP they will gradually fall taking into account, on one side, a slight growth in employment and wages and higher rates of economic growth encouraged by the investment cycle, on the other.

- **Excise** – excise will dominantly grow under the impact of the amended tax policy in this area, as well as the trend of the nominal rate of GDP. Namely, the Fiscal Strategy announced for 2019 an increase in excise on tobacco, excise on ethyl alcohol, excise on carbonated water with added sugar and the introduction of excise on coal. However, the measure related to the excise calendar was mitigated as regards tobacco goods as of September 2018 and carbonated drinks as of 1 January 2019. The mentioned measures envisage an annual increase in the revenues from excise by 5.2 percent on average.

- **Fees** – the position of fees will go up as a result of the implementation of the new legal provisions relating to local self-government financing, and also the new Law on Games of Chance that will regulate the market of games of chance in a comprehensive way, define new forms of games of chance, accommodate full and qualitative online oversight of the organisers, which will lead to the creation of a quality environment for the development of the market and an increase in revenues in that respect.

Public spending in 2019 is planned at €2.163 billion, or 45.2 percent of GDP, and in relation to the estimate for 2018 it is €77.7 million, or 3.7 percent, higher. The mentioned growth in public expenditure is a result of higher allocation for the Capital Budget, which in relation to the estimate for 2018 will be €61.2 million, or 20 percent, higher, whereas the current expenditure will be almost at the same level, given that it will increase only by 0.9 percent. The increase in capital expenditure is a result, dominantly, of the intensified works on the construction of the priority section of the highway, as well as the increased allocation for other capital projects.

On the other side, the current public expenditure will grow exclusively as a result of legal obligations, i.e. obligations under the process of EU accession, where a part of increase is substituted for by unproductive expenditures, such as: business trips, fuel, administrative material and the like. Positive effects on further rationalisation of expenditure are also expected from the implementation of the concept of consolidated public procurement, where the centralised authority carries out consolidated procurement of standardised goods and services required for the functioning of state authorities, such as: office supplies and equipment, fuel, services of landline and mobile telephony, and the like.

In the period 2019–2021, a decreasing trend will be established, given that public expenditure will range from €2.163 billion, or 45.2 percent of GDP, to €1.995 billion, or 38.8 percent of GDP. The main reason for the reduction in public expenditure is the disburdening of capital expenditure due to the completion of the construction of the first section of the highway, whereas the current expenditure will nominally grow, but as a share of GDP it will go down. According to the Joint Conclusions of the Economic and Financial Dialogue between the Western Balkans and Turkey, drawn up on the occasion of considering last year's Economic Reform Programme, the expected expenses for the finalisation of court cases are planned within the overall expenses, and therefore they are also included in the calculation of the deficit. In this way the issue of methodological differences, which existed in previous years between the planned and executed level of expenses, i.e. deficit, is also resolved.

The **public finance deficit** in 2019 is projected at €103.0 million, or 2.2 percent of GDP, after which it will transit to a positive balance, given that in 2020 a slight surplus is projected at €45.6 million, or 0.9 percent of GDP, whereas in 2021 the expected public finance surplus will amount to €148.8 million or 2.9 percent of GDP.

Considering the projected levels of public finances deficit and the funds required for the repayment of the debt, the shortfall of funds in 2019 will amount to €573.8 million and will be financed from accumulated deposits of €173.8 million, while the remaining amount of the funds will be provided from borrowings on the domestic and international markets. In 2020 and 2021, the shortfall of funds will decrease as a result of the achieved public finance surplus.

Figure 3.3: Trend of fiscal parameters in the medium term

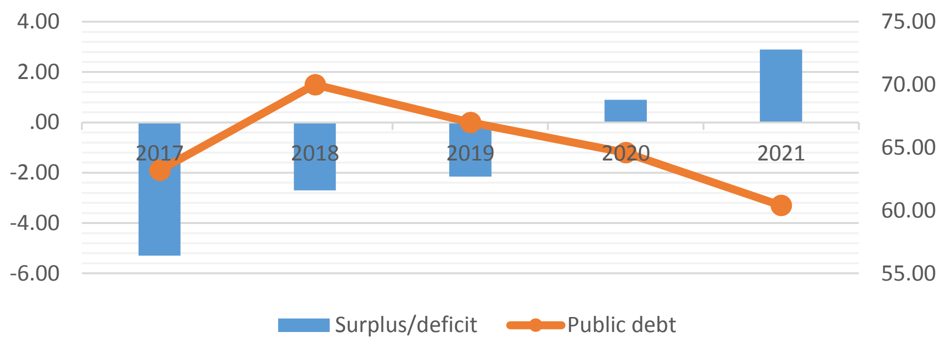


Table 3.3.2: Development of public finances in 2017 and 2018 and the projection of public finances for the period 2019–2021

Annual GDP (in € millions)	4,299.0		4,604.5		4,788.6		4,956.8		5,138.3	
	Outturn		Estimate		Baseline scenario					
Estimated public finances for 2019–2021	2017		2018		2019		2020		2021	
	€ millions	% of GDP	€ millions	% of GDP	€ millions	%	€ millions	% of GDP	€ millions	%
Public revenues, of which:	1,785.4	41.5	1,963.0	42.6	2,059.9	43.0	2,111.6	42.6	2,144.1	41.7
Income tax	145.6	3.4	158.8	3.5	154.4	3.2	158.8	3.2	161.5	3.1
Value added tax	548.7	12.8	616.9	13.4	652.9	13.6	678.1	13.7	698.2	13.6
Excise	225.1	5.2	221.2	4.8	239.6	5.0	251.2	5.1	257.1	5.0
Local taxes	85.9	2.0	87.6	1.9	88.9	1.9	89.8	1.8	90.7	1.8
Contributions	495.0	11.5	524.4	11.4	531.0	11.1	539.6	10.9	545.1	10.6
Public expenditure, of which:	2,012.5	46.8	2,085.1	45.3	2,162.9	45.2	2,066.1	41.7	1,995.3	38.8
Gross wages	492.1	11.4	507.5	11.0	523.7	11.0	522.7	10.5	519.4	10.1
Expenditures for goods and services	110.7	2.6	127.1	2.8	115.8	2.4	118.4	2.4	122.7	2.4
Social care transfers	538.9	12.5	545.3	11.8	555.3	11.6	572.1	11.5	583.8	11.4
Capital budget	298.0	6.9	311.3	6.8	372.5	7.8	273.5	5.5	177.7	3.5
Transfers to institutions, individuals, NGOs and the public sector	212.8	4.9	255.1	5.5	256.2	5.3	247.2	5.0	252.2	4.9
Surplus/deficit	−227.1	−5.3	−122.1	−2.7	−103.0	−2.2	45.6	0.9	148.8	2.9
Primary surplus/deficit	−124.6	−2.9	−29.3	−0.6	−2.8	−0.1	137.0	2.8	237.7	4.6
Debt repayment	371.8	8.6	753.3	16.4	430.6	9.0	573.3	11.6	463.7	9.0
Expenses for the purchase of securities	0.0	0.0	69.3	1.5	40.2	0.8	0.0	0.0	0.0	0.0
Financing, of which:	−598.9	−13.9	−944.6	−20.5	−573.8	−12.0	−527.7	−10.6	−314.9	−6.1
Borrowings abroad	353.3	8.2	904.1	19.6	196.0	4.1	494.2	10.0	248.7	4.8
Borrowings in the country	264.4	6.1	218.6	4.8	188.0	3.9	24.2	0.5	58.0	1.1
Use of deposits	−31.8	−0.7	-203.9	-4.4	173.8	3.6	−6.6	−0.1	−7.8	−0.2

3.4 Structural balance (cyclical component of the deficit, one-off and temporary measures, fiscal stance)

The cyclically-adjusted balance (structural balance) represents the actual public expenditure imbalances, and it is related to the actual surplus/deficit to GDP ratio, which will prevail if the economy grows at the level of its potential. It is calculated as the difference between surplus/deficit as a share of GDP and the estimated cyclical component.

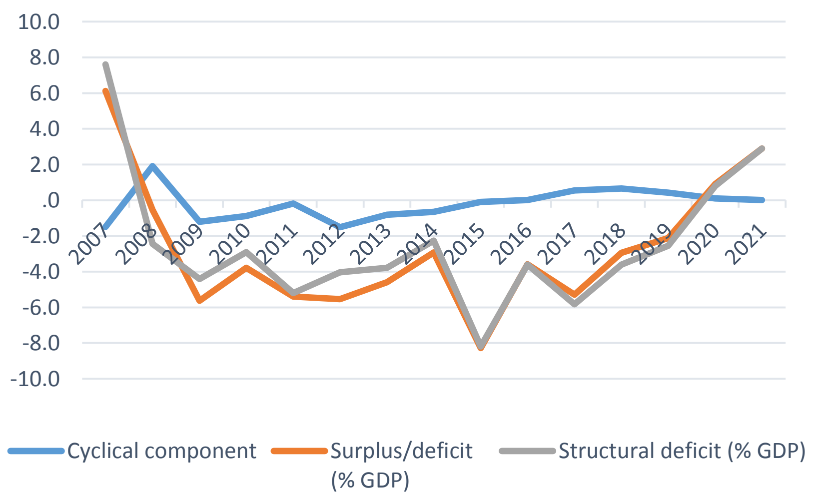
The cyclical component is calculated based on the method used by the European Commission, and it is carried out in two steps, as follows:

1. *Assessment of the output gap as an indicator of the economic cycle;*
2. *Estimation of the elasticity of public revenues and public expenditures in relation to the gap.*

The values of the potential growth rate and potential GDP and output gap required for the calculation are presented in Chapter 2 – Macroeconomic framework.

In step 2, the coefficients of elasticity are estimated for the following individual revenue categories: indirect taxes, income tax, profit tax and contributions. Each of the mentioned categories is firstly taken in relation to the relevant base, for example in the case of income tax where the category of wage and contributions of employees from the estimated GDP calculation (income approach) is taken as the base, then after multiplication by the weighting (the share of an individual revenue category in overall revenues) the elasticity of this revenue component is obtained in relation to the output gap.

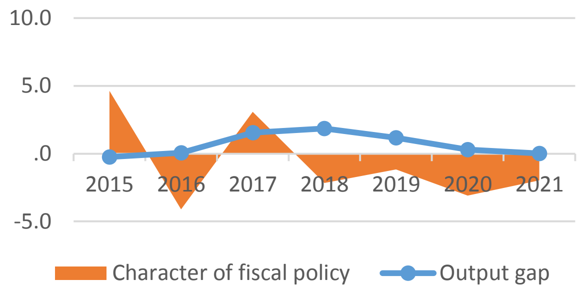
Figure 3.4 .1: Developments in surplus/deficit, the cyclical component and structural deficit



Multiplying the coefficient of elasticity of the mentioned revenue categories by the share of overall revenues in GDP results in the revenue-sensitivity parameter, and at the same time the parameter of sensitivity of the public finance balance, because the coefficient of elasticity of expenditures equals approximately zero. The category of expenditures that was the subject of the elasticity calculation is expenditure on the unemployed, but when the very low share of the mentioned expenditures in the total expenditures is taken into account, the obtained total sensitivity parameter of the expenditures side of the budget equals zero.

The sensitivity parameter of the surplus/deficit in relation to the output gap is estimated at 0.35. The results of the model are limited due to the country's specifics and the frequent changes in the fiscal policy measures, the length of the time series used in the elasticity assessment and the changes in methodology, but they reflect the core trends of the structural and cyclical components of the balance of public finances. Also, the cyclically adjusted primary balance (surplus/deficit excluding interest) has been calculated, which is additionally reduced by the one-off collection of revenues (e.g. in 2016 – collection of digital dividends) and one-off expenditures (subsidies, repayment of guarantees, redundancy funds and cost of court proceedings). The sign of the category of the annual change in the cyclically adjusted primary surplus/deficit indicates the fiscal position, and speaks of the nature of fiscal policy in a specific year. The positive values in Figure 3.4.2 represent an expanding fiscal policy, while negative values represent a restrictive fiscal policy. As can be seen, the figure indicates a restrictive policy nature in the period 2018–2021, with a positive output gap in the period 2018–2020, while in 2021 the economy is at the level of its potential and the output gap is equal to zero. This situation represents the nature of the stabilisation of the policy led by the Government of Montenegro aimed at getting the key fiscal indicators under control by setting the measures for fiscal consolidation.

Figure 3.4.2: Character of fiscal policy and output gap



3.5 Debt levels and developments, analysis of below-the-line operations and stock-flow adjustments

3.5.1 Government and public debt in 2018

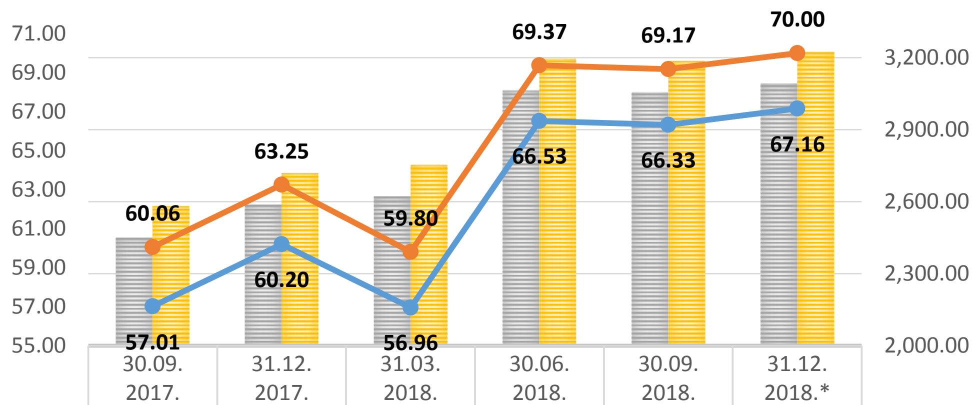
3.5.1.1. Government and public debt in 2018

Montenegro's public debt, as of 31 December 2017, amounted to €2,719.05 million, or 63.25 percent of GDP[10], and consisted of the government debt, which amounted to €2,588.08 million, or 60.20 percent of GDP, and local self-government debt at €130.97 million, or 3.05 percent of GDP.

The deposits of the Ministry of Finance, including 38,477 ounces of gold and the deposits of local self-government, at the end 2017 amounted to €97.83 million in total, of which the deposits of the Ministry of Finance amounted to €70.90 million, while the deposits of the local self-governments amounted to €26.93 million. Montenegro's net public debt, as of 31 December 2017, including the deposits of the Ministry of Finance and local self-governments, amounted to €2,621.22 million, or 60.97 percent of GDP.

[10] According to MONSTAT data, the value of GDP for 2017 amounted to €4,299.00 million.

Figure 3.5.1: Montenegro's government and public debt, in € millions [11]



	30.09. 2017.	31.12. 2017.	31.03. 2018.	30.06. 2018.	30.09. 2018.	31.12. 2018.*
Governmetn debt	2,450.88	2,588.08	2,622.68	3,063.18	3,054.09	3,092.38
Public debt	2,581.85	2,719.05	2,753.68	3,194.18	3,185.09	3,223.38
Government debt as % of GDP	57.01	60.20	56.96	66.53	66.33	67.16
Public debt as % of GDP	60.06	63.25	59.80	69.37	69.17	70.00

Governmetn debt   Public debt   Government debt as % of GDP   Public debt as % of GDP

**The debt stock, as of 31 December 2018, is according to the latest projections of the Ministry of Finance.*
***The amount of debt of local self-governments is according to the projections of the Ministry of Finance because the state does not produce quarterly reports on public debt.*
****The debt shown in the figure does not include the deposits of the Ministry of Finance or deposits of the local self-governments.*

Compared to the data from the previous year, the public debt will, according to the latest projections of the Ministry of Finance, in 2018 amount to 70.00 percent of estimated GDP[12].
Montenegro's government debt, as of 30 September 2018, amounted to €3,054.08 million, or 66.33 percent of estimated GDP for 2018.

According to the 2018 Budget Law, it is envisaged that in 2018 the Government is allowed to borrow up to €440.00 million as follows: for the financing needs of the budget, debt repayment and creating reserves of about €250.00 million; and for the needs of the construction of the Bar–Boljare highway amounting to €190 million. In addition, the law allows the possibility for the Government to additionally take borrowings for the needs of refinancing and/or redemption of debt through the issuing of bonds on the international market of up to €500.00 million, which was done in the second quarter of 2018.
The public debt stock in the first three quarters of 2018 went up primarily due to borrowing taken out on the international market through the issue of Eurobonds (in April 2018) of €500 million – which refinanced €362.35 million of bonds with a maturity date in 2019, 2020 and 2021 – and due to the disbursement of funds for development projects. The issued bonds are characterised by a seven-year maturity period and an interest rate of 3.375 percent, which achieved the effect of reducing the pressure related to the repayment of debt in the years when the refinanced bonds mature.

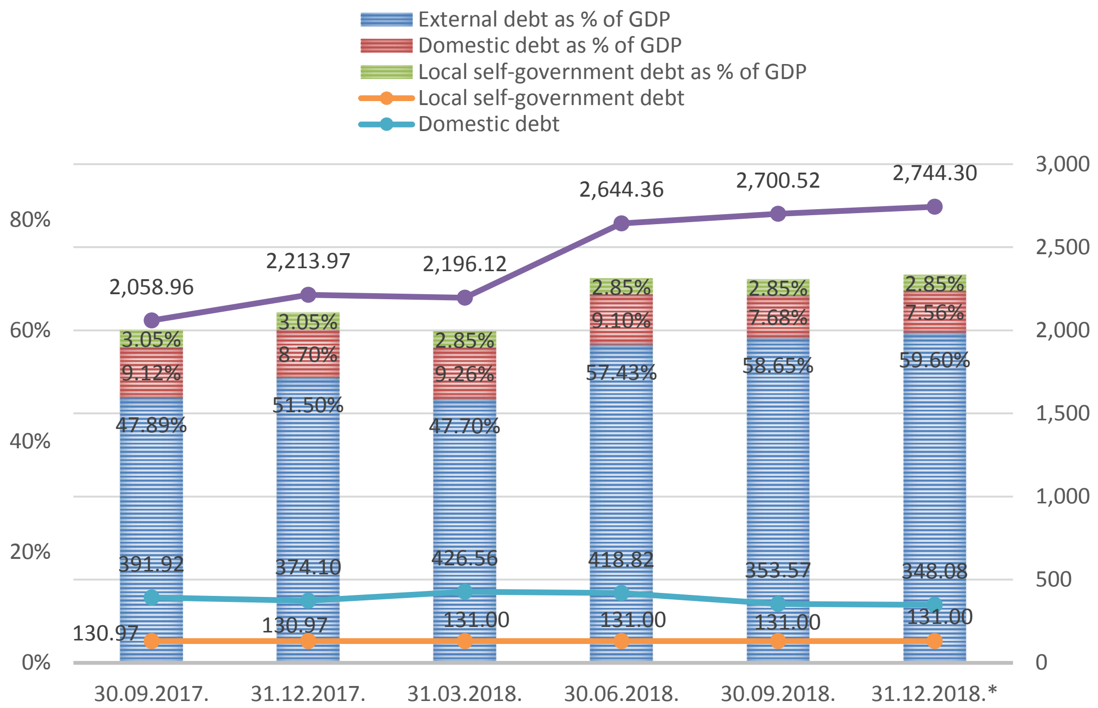
[11] The data is in accordance with EDP methodology. The presented balance excludes the railway debt and the debt for pension arrears, in line with EDP methodology.

[12] According to the projections of the Ministry of Finance, the value of GDP for 2018 will amount to €4,604.50 million.

In the same period, a commercial credit facility was signed, which was backed by a World Bank guarantee, for a total amount of €250.00 million, with a repayment period of 12 years, including a grace period of four years and an interest rate of EURIBOR + 2.95 percent. The funds obtained through the implementation of this arrangement will be used for the repayment of a part of the government debt, and the majority of the funds will be used for debt refinancing in 2019. The current estimate is that the deposits will be around €180.00 million in 2019.

Internal debt went up in 2018 due to the issuing of Treasury bills, for the purpose of maintaining current liquidity. However, at the end of the third quarter of 2018, internal debt decreased compared to the end of 2017, due to the repayment of Treasury bills, down to the level as of the end of 2017, and due to commercial loans taken from domestic banks, as well as the repayment of old FX savings.

Figure 3.5.1.1 Debt developments in € million and in % of GDP[13]



**The debt stock, as of 31 December 2018, is according to the latest projections of the Ministry of Finance.*
***The amount of debt of local self-governments is according to the projections of the Ministry of Finance because the state does not produce quarterly reports on public debt.*
****The debt shown in the figure does not include the deposits of the Ministry of Finance.*

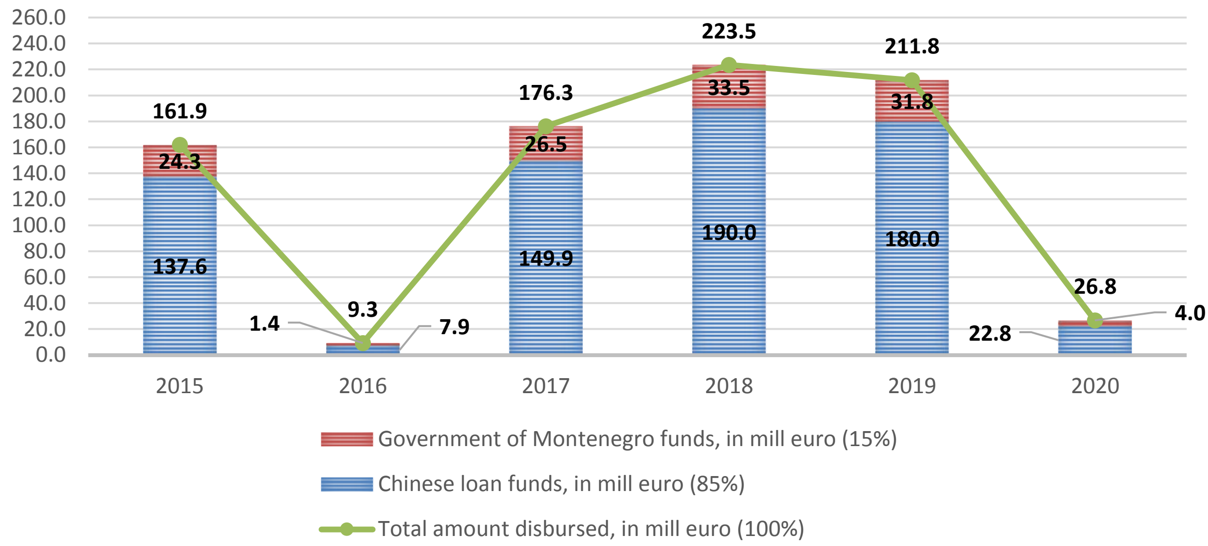
In addition to the described financial activities, the increase in the external debt in the first three quarters of 2018 was also largely impacted by the disbursement of credit funds for the needs of the execution of infrastructure projects, primarily the construction of the Smokovac–Uvač–Mateševo highway priority section, amounting to €105.79 million[14] (US$122.46 million), and by the end of 2018 an additional commitment of funds of about €84.21 million (US$97.48 million) is expected. It is important to note that the performance of construction works will be extended, which will result in the extension of the period for disbursement of credit funds under the credit with the China EXIM Bank. To

[13] The data is in accordance with EDP methodology. The presented balance excludes the railway debt and the debt for pension arrears, in line with EDP methodology.

[14] According to the exchange rate as of 30 September 2018.

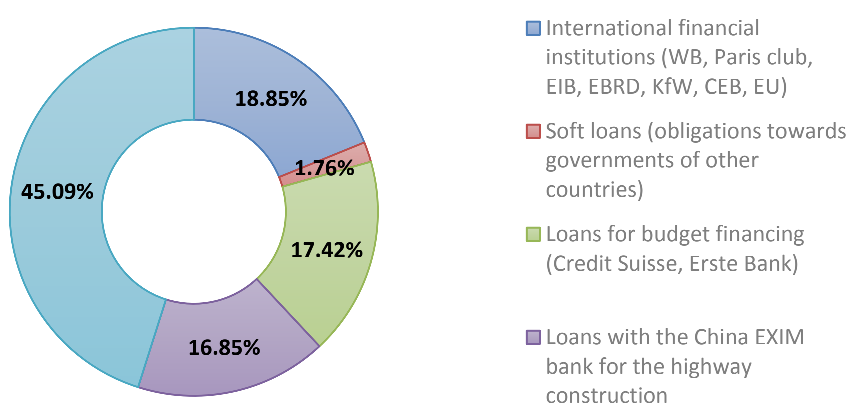
that end, it is expected that in the following year, 2019, around €180.00 million will be disbursed, while the remaining amount will be disbursed by the end of 2020.

Figure 3.5.1.2: Funds for the Highway Construction Project – Smokovac–Mateševo priority section, in € millions[15] (contracted funds)



In the same period, around €56.83 million of credit funds was disbursed for the implementation of infrastructure and other projects, such as World Bank projects for the improvement of agriculture, energy efficiency and education; then European Bank for Reconstruction and Development (EBRD) projects for the construction and reconstruction of road infrastructure and wastewater treatment plants; the German Development Bank (KfW) projects for the needs of construction of a water supply, system for the discharge and treatment of waste waters, and energy efficiency; the Council of Europe Development Bank (CEB) Project of Social Housing 1000+, the project of cluster development in agriculture, the project of procurement of helicopters for the needs of the Army of Montenegro and the like.

Figure 3.5.1.3: Structure of external debt towards creditors as of 30 September 2018



[15] According to the contracted fixed exchange rate EUR/USD of 1.3718.

As regards the structure of debt towards residents, the highest amount of debt is related to the liabilities towards commercial banks amounting to €97.19 million, while in the structure of external debt distinctive is the debt in respect of Eurobonds of €1,217.65 million.

Table 3.5.1: Highest debts as of 30 September 2018[16]

Debt to residents	Amount in € millions	Debt to non-residents	Amount in € millions
Loans with commercial banks	97.19	Eurobond	1,217.65
Liabilities in respect of restitution	85.98	China EXIM Bank	455.85
Treasury bills	77.00	Syndicated loan PBG	250.00
Domestic bonds from 2016	80.41	International Bank for Reconstruction and Development (IBRD)	192.56
Old FX savings	12.21	Credit Suisse Bank	126.33

Until 30 September 2018, the amount of debt repaid in respect of the principal, to residents and non-residents was €455.58 million and debt repaid from the previous period – old FX savings – was €1.53 million. Repayment in respect of interest, to residents and non-residents, amounted to a total of €70.51 million.

Table 3.5.2: Government debt servicing until 30 September 2018

Budget position	Paid by 30 Sep 2018, in € millions
4611 – Repayment of principal to residents[17]	15.40
4612 – Repayment of principal to non-residents[18]	440.18
4630 – Repayment of liabilities from previous years[19]	1.53
4161 – Repayment of interest to residents	3.28
4162 – Repayment of interest to non-residents	67.23
TOTAL	**527.62**

3.5.1.2 Currency and interest structure of government debt

As regards the current government debt stock, around 83 percent of the amount of debt is expressed in domestic currency, i.e. euros, so at this point currency risk effects that could have a material impact on developments of government debt are not expected. Taking into account future disbursements of loan funds for the needs of the highway construction from the China EXIM Bank loan, the funds expressed in dollars are expected to have a higher share in the debt stock. Due to the risk that may be attached to the trend of debt, until the beginning of repayment of liabilities in respect of the loan from the China EXIM Bank, a hedging arrangement will be applied, in order to ensure protection against the currency risk. As regards the risk of an interest rate change, it is evident that the debt with fixed interest rate prevails in the overall government debt, therefore the risk of increased liabilities in this respect is low, and it is not expected to be a significant burden for the budget in case of possible changes in the borrowing conditions in the market.

[16] According to the exchange rate as of 30 September 2018. In line with EDP methodology.

[17] The stated amount does not include Treasury bills that amount to around €214.13 million.

[18] In the stated amount calculated is the amount of €362.35 million in respect of refinancing bonds maturing in 2019, 2020 and 2021.

[19] Amount excludes court decisions.

Figure 3.5.1.4: Currency structure of government debt, as of 30 September 2018

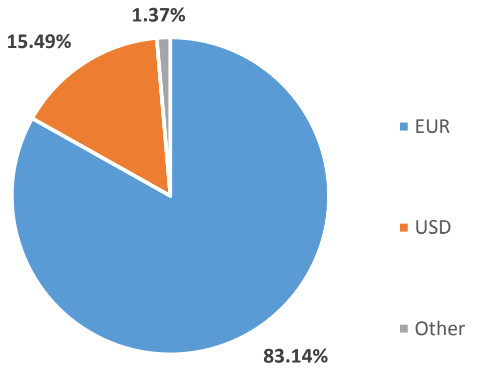
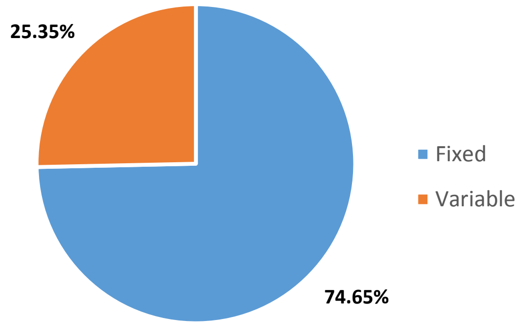


Figure 3.5.1.5: Interest structure of government debt, as of 30 September 2018



3.5.1.3 Debt management strategy

One of the very important debt management instruments is the 2018–2020 Medium-Term Debt Management Strategy, adopted by the Government of Montenegro in April 2018. The Debt Management Strategy has been prepared with a view to analysing the current debt and potential funding sources, analysing the costs and risks of potential borrowings, domestic market development, as well as defining guidelines for the further policy of borrowing and debt management. In addition to the Debt Management Strategy, the Market Relations Strategy has been produced, aimed at establishing greater coverage of credit investors, by facilitating better integration and communication with all stakeholders willing to invest in Montenegro.

The key guidelines on which the strategy is based are related to the following:
- equalisation of debt repayment by years and extension of maturity of commercial debt;
- management of the currency risk and interest rate risk;
- gradual development of the domestic securities market; and
- minimising borrowing costs.

Given that the debt analysis has shown that the refinancing risk is set as the most important indicator, this indicator has priority over the other debt portfolio risk indicators, such as average maturity, interest rate risk and currency risk.

Consequently, in the coming three-year period it is necessary to undertake activities to reduce the refinancing risk, which would thereby reduce the country's risk on the international market, and thus affect the borrowing cost. With regard to this, the Ministry of Finance, after the adoption of the Strategy, in 2018 carried out a liability management operation (LMO) through issuing bonds on the international market. On that occasion, Eurobonds were issued worth €500.00 million, with a seven-year maturity and an interest rate of 3.375 percent, which served to refinance part of the bonds maturing in 2019, 2020 and 2021. The refinanced value of bonds amounts to €362.35 million. In this way, the goal of reducing the pressure on public finances regarding debt repayment and repositioning bonds worth €500.00 million to 2025 was achieved.

In addition to the above, the Government intends to apply a hedging arrangement for the need of minimising the currency risk attached to the China EXIM Bank loan required for the construction of the

Bar–Boljare highway. The hedging arrangement would be applied in 2019, and certainly before the commencement of the loan repayment that is envisaged for 2021.

In 2019, the strategy is envisaged to be updated, which should include a new debt analysis and formulation of debt management strategies in the new three-year time horizon – 2019–2021.

It is important to note that the credit rating agency Moody's, in its new report published in September 2018, affirmed Montenegro's B1 rating, with a significant change of outlook from stable to positive. In addition, the credit rating agency Standard & Poor's affirmed Montenegro's rating outlook, which is indicated as stable, with preservation of a B+/B rating. This fact is a clear signal of trust by investors in Montenegro's economic progress, as well as support to the public finance stabilisation measures implemented by the Government of Montenegro and the Ministry of Finance.

3.5.2 Baseline scenario of government debt trend in the period 2019–2021

Based on the 2019 Budget Law it is estimated that the shortfall required for financing the debt repayment and liabilities from previous period, capital budget financing (including financing of the construction of the highway priority section up to the amount of the completed works), budget spending financing and creating reserves, will amount to about €556.0 million.

The mentioned amount of the shortfall will be provided from borrowings and loans from domestic and international sources of €370.0 million, as well as 2018 deposits of about €180.0 million. The mentioned financing will also be supported by expected receipts from privatisation of enterprises of €6.0 million.

The idea is that the funds from domestic sources are provided through the issuing of domestic bonds of up to €190.0 million. In case of a failure to reach the target value of €190.0 million, the remaining amount would be provided from borrowing facilities with commercial banks. If there is no possibility for borrowing on the domestic market, the shortfall may be provided on the international market. As regards borrowing facilities from external sources, it should be noted that the borrowing would be related to the withdrawals of the loan extended by the China EXIM Bank or other sources, for the needs of the construction of the Bar–Boljare highway. Namely, it is estimated that the financing needs of the construction of the Bar–Boljare highway in 2019 will amount to around €220.0 million, of which about €180.0 million will be provided through a borrowing facility with the China EXIM Bank.

Taking into account the borrowing for the needs of the highway construction of about €180.0 million, as well as deposits to be used in 2019, amounting to €180 million, as well as privatisation proceeds of around €6.0 million, it can be concluded that the actual needs for borrowing in the coming year, 2019, will amount to about €190.0 million.

For 2020, the amount of borrowing required for debt repayment will amount to about €510.0 million, of which the largest part is related to repayment of bonds issued in 2015, which mature in 2020 and amount to about €321.0 million, while the remaining amount will mostly relate to the provision of funds required for financing of the highway construction. At the same time, the projections for 2020 include additional contingent costs for the highway construction of €95.0 million.

The shortfall will be provided through borrowing on the international market. Namely, in addition to the credit facility already implemented with the World Bank Policy Based Guarantee (PBG) in 2018, there is a possibility for entering into a new facility of this kind for the budget financing needs in 2020. In 2018, the representatives of the World Bank and Montenegro commenced negotiations on the conclusion of this facility, as well as the fulfilment of the assumptions for its implementation contained in the matrix of public policy outcomes. To that end, there is a range of criteria facing Montenegro to be met in the coming period, and relating to structural reforms, such as: the introduction of accrual accounting and reporting in the public sector; qualitative specification of capital projects; improvements in the area of health; rationalisation of the number of employees in the public sector; improvement of the social and fiscal sustainability of the pension system; and regulation of employment relations through the improvement of the legislative framework. In addition to the aforementioned, the fulfilment of the conditions for granting the World Bank guarantee includes improvements in the area of public procurement through its centralisation, strengthening of regulations in the financial sector, primarily in the banking sector, and the like. The objective is, after the conditions have been met, to enter into a credit facility of the same or higher value in comparison to the first PBG, which amounted to €250 million, for which a €80 million World Bank guarantee was provided.

In addition to the above-mentioned, Montenegro will consider the possibility of issuing bonds on the international market, with the intention of achieving the most favourable borrowing conditions possible. In that respect it is expected that the same or better borrowing conditions will be achieved than was the case with the issuing of Eurobonds in 2018.

As regards the shortfall, Montenegro expects more favourable opportunities in 2021, taking into account that in that year a significant reduction of the shortfall is anticipated in comparison to 2020, which will amount to about €298.0 million.

The greatest impact on the developments of public debt in the period 2019–2021 will continue to come from the withdrawal of funds for implementation of construction of the Bar–Boljare highway. According to the projection, it is envisaged that the loan funds required for the implementation of infrastructure projects will be engaged annually amounting to €30.0 million on average.

Table 3.5.2: Developments of government and public debt in the period 2018–2021 – baseline scenario (in € millions)[20]

Year	2018	2019	2020	2021
GDP	4,604.50	4,788.60	4,956.80	5,138.30
Internal debt	347.30	498.80	539.80	542.80
External debt	2,744.30	2,582.30	2,539.30	2,445.27
Debt of state-owned enterprises and business organisations	0.78	0.78	0.78	0.78
Total government debt	3,092.38	3,081.88	3,079.88	2,988.85
Total government debt % of GDP	67.16%	64.36%	62.13%	58.17%
Local self-government debt	131.00	126.00	121.00	116.00
Total public debt	3,223.38	3,207.88	3,200.88	3,104.85
Total public debt % of GDP	70.00%	66.99%	64.58%	60.43%

**The amount of local self-government debt is according to the projections of the Ministry of Finance, for the reason that the state does not produce quarterly reports on public debt.*
***The debt presented in the figure excludes the deposits of the Ministry of Finance and the deposits of local self-governments.*

As can be seen in Table 3.5.2, at the end of 2018 government debt is expected to amount to 67.16 percent of GDP, while public debt will be at the level of 70.00 percent of the GDP estimated for 2018.

In 2019, a slight reduction of the debt is expected, primarily caused by the effects of the refinancing process implemented in 2018. Namely, the refinancing of Eurobonds issued in 2014 and maturing in 2019 led to the value of debt repayment in this respect decreasing by €110.9 million and currently it amounts to about €169.10 million, instead of the previously envisaged €280.00 million. However, given that the works on the Bar–Boljare highway have been extended in relation to the anticipated level in 2018, it is certain that the debt in respect of the highway it will continue to be a significant factor of debt development in 2019. Consequently, the government debt is expected to amount to 64.36 percent of GDP at the end of 2019, while public debt will amount to around 66.99 percent of GDP.

A gradual decrease in the government and public debt will also characterise 2020, which will result from debt refinancing in respect of the bonds maturing in that year. Namely, the bonds issued in 2015 (of

[20] The data is in accordance with EDP methodology. The presented overview excludes the railway debt or outstanding debt for pensions, in line with EDP methodology.

€500.0 million) will mature in 2020. The amount of debt related to this issuance decreased in 2018, through refinancing, by around €178.90 million, and currently it amounts to about €321.10 million. Therefore, the value of government debt for 2020 amounts to about €3,079.88 million or 62.13 percent of GDP, whereas the public debt is expected to reach the amount of €3,200.88 million or 64.58 percent of GDP.

As regards 2021, the decreasing trend of government debt is expected to continue, and thus it is estimated that at the end 2021 the value of government debt will reach the amount of €2,988.85 million or 58.17 percent of GDP, whereas the public debt will amount around €3,104.85 million or 60.43 percent of GDP estimated for 2021.

3.5.3 Low-growth scenario

If economic growth slows down and the level of revenue decreases according to the low-growth scenario, the mentioned changes will affect the public debt trend too. Revenue reduction and investment growth stagnation will lead to the need for additional borrowing in order to cover the shortfall for deficit financing.

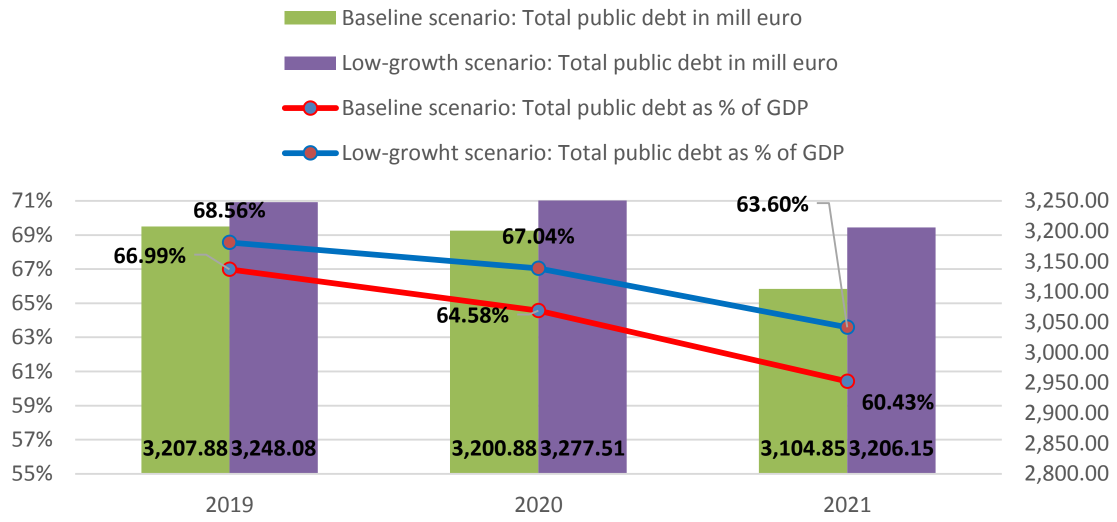
Table 3.5.3: Debt developments for the period 2018–2021 – low-growth scenario (in € millions)[21]

Year	2018	2019	2020	2021
GDP	4,604.50	4,737.70	4,888.80	5,041.50
Internal debt	347.30	498.80	539.80	542.80
External debt	2,744.30	2,622.50	2,615.93	2,546.57
Debt of state-owned enterprises and business organisations	0.78	0.78	0.78	0.78
Total government debt	3,092.38	3,122.08	3,156.51	3,090.15
Total government debt % of GDP	67.16%	65.90%	64.57%	61.29%
Local self-government debt	131.00	126.00	121.00	116.00
Total public debt	3,223.38	3,248.08	3,277.51	3,206.15
Total public debt % of GDP	70.00%	68.56%	67.04%	63.60%

**The amount of local self-government debt is according to the projections of the Ministry of Finance, for the reason that the state does not produce quarterly reports on public debt.*
***The debt presented in the figure excludes the deposits of the Ministry of Finance and the deposits of local self-governments.*

[21] The data is in accordance with EDP methodology. The presented overview excludes the railway debt, in line with EDP methodology.

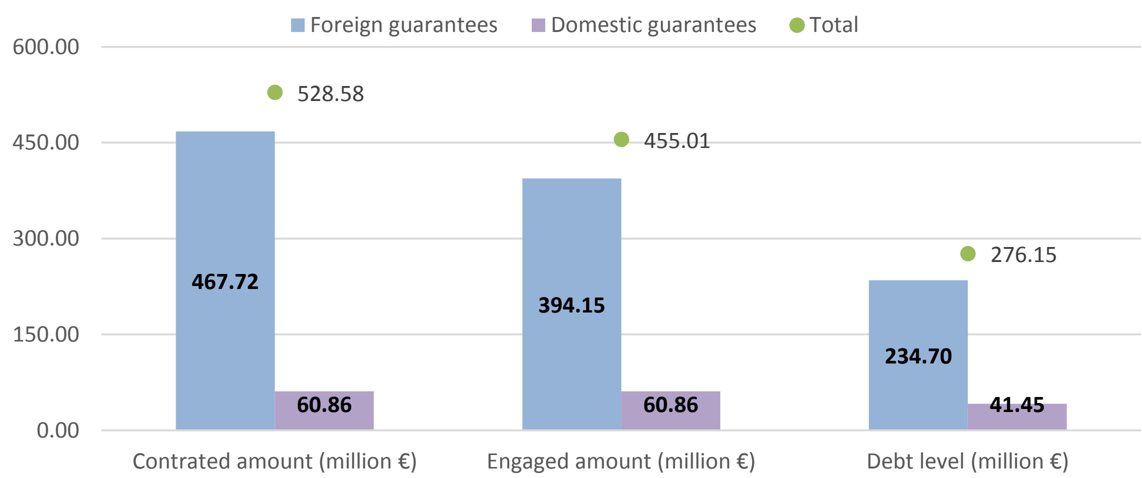
Figure 3.5.3: Comparative overview of public debt developments in the baseline scenario and low-growth scenario, in € millions and % GDP



3.5.4 State guarantees stock

The total contracted state guarantees as of 30 September 2018 amounted to €528.58 million or 11.48 percent of GDP. Out of the mentioned amount, external guarantees amounted to about €467.72 million (10.16 percent of GDP), while domestic guarantees amounted to €60.86 million (1.32 percent of GDP). In the first three quarters of 2018, there were no state guarantees called upon, and no new guarantees were concluded.

Figure 3.5.4: State guarantees, as of 30 September 2018



The amount of withdrawn funds in respect of contracted guarantees issued by the Government of Montenegro by the end of the third quarter of 2018 amounts to €455.01 million, while the debt stock at the end of the mentioned period, related to guarantees issued to domestic and international creditors, amounts to €276.15 million, which makes up 5.99 percent of GDP.

The committed amount of guarantees issued by the Government of Montenegro for the loans with international creditors amounts to about €394.15 million, whereas the debt stock in this respect amounts to €234.70 million, or 5.10 percent of GDP.

The 2018 Budget Law envisaged the issuing of a state guarantee to the Crnogorski Elekroprenosni Sistem (Montenegro Electricity Transmission System – CGES) of €20 million for the needs of the credit facility between CGES and the German Development Bank for the project "Montenegrin Coast: Luštica Region Development". The activities related to the implementation of the mentioned guarantee were finalised at the end of October 2018.

The guarantees issued in the previous few years are mostly related to the loans that served for implementation of various infrastructure projects, roads, railways, water supply and sewerage systems, electricity, support provided to the development of small and medium-sized enterprises or restructuring.

Also, the 2018 Budget Law envisaged the issuing of a guarantee of €7.0 million for a loan facility made in March 2017 between the Željeznička Infrastruktura Crne Gore (Montenegro Railway Infrastructure) and the European Investment Bank (EIB) for projects related to reconstruction and improvement of the railway infrastructure amounting to €20.0 million. However, this guarantee was not issued in 2018, but it is planned by the 2019 Budget Law.

3.6 Sensitivity analysis and comparison with the previous programme

3.6.1 Sensitivity of public finance projections to alternative risk scenarios

The main risks, whether political or economic, to the realisation of fiscal projections may have a negative impact on public finances. An overview of the risks associated with the realisation of the given fiscal projections is given in the following table:

Table 3.6: Overview of fiscal risks in the medium term

	Positive	Negative
Political	- NATO membership will increase the confidence of foreign investors and tourists, which will have a positive impact on the economic parameters of the domestic economy and will facilitate access to funding sources; - Progress in the EU accession process leads to an increase in investor confidence, an improved business environment and access to EU funds;	- Political instability at the global level and in South-East Europe can have a negative impact on the economy of Montenegro, especially in the tourist sector;
Economic	- Implementation of fiscal consolidation measures has a positive impact on the stability and sustainability of public finances in the medium term; - Implementation of the 2018–2020 Debt Management Strategy will improve Montenegro's credit position and reduce the costs of financing public debt; - The completion of the Highway Construction Project will disburden public spending, which will open up room for additional investments in the infrastructure aimed at improving economic growth; - The implementation of the public administration reform and other related	- Changing the dynamism in the performance of works under investment projects can jeopardise the medium-term macroeconomic, and thus fiscal, projections; - The failure to implement the fiscal consolidation measures in the planned scope may exacerbate the projected amounts of the budget deficit and public debt; - In the case of increased cost of the highway construction, the overall public expenses will increase, which will negatively reflect on the developments of the budget balance; - An increase in the costs of health system financing in relation to what is planned and the accumulation of arrears may negatively reflect on the projected public spending;

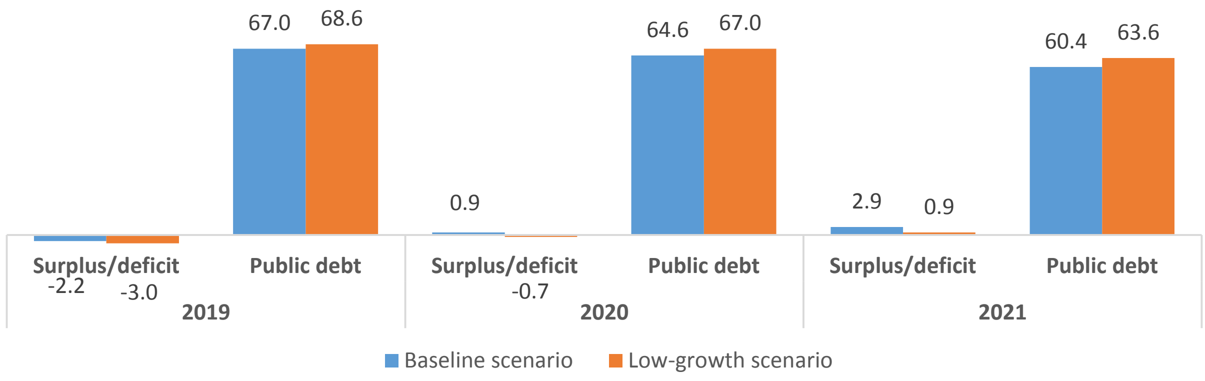
	reforms will optimise current public expenditure; - Improved control of public spending and reforms in the budgeting process will increase fiscal discipline which will positively reflect on the key fiscal indicators; - The multiplication effects of the highway construction project and other expected investments, as well as the Economic Citizenship Project will positively reflect on revenue developments; - Intensifying activities to reduce the grey economy and reform tax administration will expand the tax base, hence facilitating increased budget revenues.	- Implementation of the ESA2010 methodology may expand the existing institutional coverage of budget accounting to public companies which, according to ESA2010's qualitative or quantitative criteria, should be presented in the General Government sector. Consequently, there is a potential for an increase in the deficit and debt of the mentioned sector in the medium term. On the other side, the implementation of the mentioned methodology, according to the same principle, may also result in positive effects on fiscal indicators.

The alternative scenario is based on the macroeconomic low-growth scenario, which starts from the assumption that investment activities will fall in the coming medium-term period and oil prices will significantly rise on the world market, as explained in Chapter 2. In the case of these risks materialising, budget revenues would not be realised in the scope planned by the baseline scenario, expenditures would remain at the same level, resulting in a higher public finance deficit in the medium term and, therefore, a greater need for financing public spending.

Fiscal elasticity ratios show that, in the fiscal scenario, the revenue side is subject to macroeconomic impacts, while macroeconomic trends have little impact on the expenditure side of the budget, especially in Montenegrin conditions where budget spending is of a predominantly mandatory character. In view of the above, in case of the realisation of the macroeconomic low-growth scenario, revenues would increase annually by about 0.6 percent on average, while in the baseline scenario public revenues in the period 2019–2021 will annually go up by about 2.1 percent on average. At the same time, there would be an adjustment of the deficit so that in the low economic growth scenario the public finance deficit would amount to around 3.0 percent of GDP in 2019 and 0.7 percent of GDP in 2020, while in 2021 a surplus of 0.9 percent of GDP would be achieved. Furthermore, public debt would be at a higher level than in the baseline scenario, as shown in Chapter 3.5.

Given that the medium-term fiscal framework does not include the effects of implementation of the Economic Citizenship Programme or the full expected effects of the Public Administration Optimisation Plan, an "optimistic fiscal scenario" can be expected too. In the case of the mentioned scenario materialising, the revenues would significantly increase, taking into account the adopted criteria and prescribed level of fees for acquiring Montenegrin economic citizenship based on investment programmes (taking into account that the programme in the medium term comprises 2,000 potential investors that are obliged not only to implement the investment but also make a one-off payment to the budget). On the other side, full implementation of the Public Administration Optimisation Plan would result in a significant reduction in the gross wage bill in the medium term. Consequently, the projected fiscal balance would be improved, and thus the reduction of public debt would be ensured to the level set by the fiscal rules, before the projected by the baseline scenario.

Figure 3.6.1: Comparison of baseline and low-growth scenarios



3.6.2 Comparison with the previous programme

The differences in the projected levels of the key fiscal indicators in comparison to the Economic Reform Programme 2018–2020 were caused for the following reasons:

- Methodological changes in the treatment of the category *Expenses for purchase of securities*;
- Reformulating of the excise policy with regard to excise on tobacco and tobacco goods and excise on carbonated drinks with added sugar;
- The treatment of the category of costs of court proceedings within the overall expenditures and consequently the deficit;
- Changes in the dynamism of the performance of works on the priority section of the highway;
- Current public expenditure growth.

Table 3.6.2: Comparison to the previous programme, in € millions

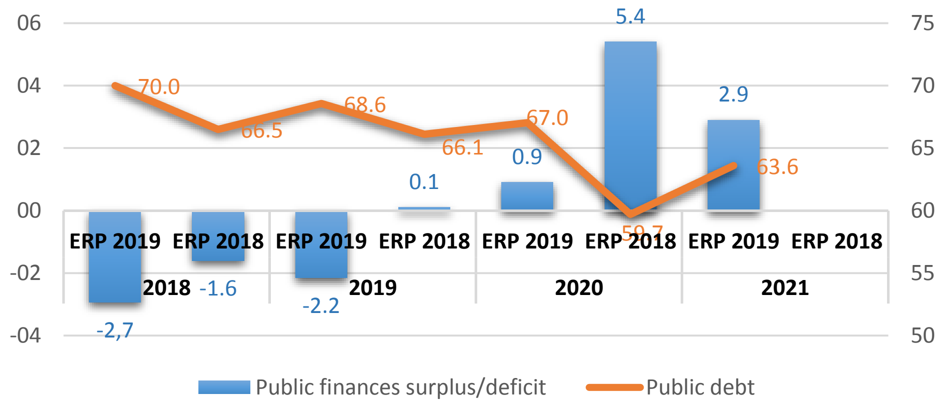
	2018–2020 ERP			
	2018	2019	2020	2021
Public revenues	1,944.82	2,019.96	2,077.86	
Public expenditure	2,013.52	2,017.05	1,823.72	
Public finance surplus/deficit	−68.71	2.91	254.14	
	2019–2021 ERP			
	2018	2019	2020	2021
Public revenues	1,963.01	2,059.85	2,111.61	2,144.06
Public expenditure	2,085.12	2,162.86	2,066.05	1,995.26
Public finance surplus/deficit	−122.11	−103.01	45.55	148.80
	DIFFERENCE			
	2018	2019	2020	2021
Public revenues	18.19	39.89	33.75	
Public expenditure	71.6	145.81	242.33	
Public finance surplus/deficit	−53.40	−100.10	−208.58	

As shown in Table 3.6.2, in all the projected years public revenues are executed or projected in amounts higher than presented in the previous programme, which is a result of the collection of dividends from Elektroprivreda Crne Gore AD (Montenegro Electrical Power Company), in line with the increase of the government's equity in the amount of €35.0 million in 2018, and its collection is also expected in the following medium-term period. The category of revenues that will record a fall in relation to the previous programme is excise due to the revision of the excise policy, caused by the fall in the collection of excise on tobacco in 2018.

On the other side, the projected expenditures are also higher in relation to the previous programme in all projected years as a consequence of the:

- changed dynamism in the withdrawal of funds for financing of the priority section of the highway in relation to the assumptions from the previous programme, as well as the planned additional funds in this respect in 2020;
- methodological changes related to the planning of expenses in respect of the costs of court proceedings within the overall expenses, in relation to the previous programme where this category of expenses made up an integrated part of debt repayment;
- current public spending growth conditioned by the growth of the aggregate gross wage bill and the need for additional financing of healthcare costs in 2018.

Figure 3.6.2: Comparison with the previous programme, % of GDP



As a result of the previously mentioned developments of public revenues and expenditures, in comparison to the previous programme, there will be an increase in the public finance deficit in 2018, whereas the planned surplus will be achieved in 2020 instead of 2019 (as planned in the previous programme) at a level lower than planned in the previous programme. The key reason for adjusting the projected surplus in 2020 is planning of the construction costs of the priority section of the highway also in 2020, in line with the projection of withdrawal of funds in this respect.

The projected increased deficit or lower achieved surplus will cause an increased shortfall, and thus the increased need for financing, which will also condition a higher level of public debt in all projected years. Another reason for increased public debt is the debt incurred by the Eurobond issue in 2018, which will be used for servicing the liabilities also in 2019.

3.7 Fiscal governance and budgetary framework

Sustainable and stable public finances represent a strategic commitment of Montenegro. In order to improve the fiscal policy credibility or to create the conditions for fiscal management improvement, activities are being undertaken as specified in the 2016–2020 Public Finance Management Reform Programme, as well as the adjustment of the legislative framework in the area of public finances to the EU integration requirements.

For the purpose of improving the fiscal framework, public spending planning and budgeting, activities are being undertaken to improve the system of strategic planning, coordination and monitoring of implementation of the policies of the Government and the strategic goals in the medium term.

In accordance with the set objective, in the previous period the Medium-term Government Work Programme was adopted for the period 2018–2020, which summarises he priorities and the objectives of the policy of the Government in the medium term. In order to create the conditions for further operationalisation of the objectives and activities through the medium-term work programmes of line ministries that implement policies in the areas of their competence, the Methodology for Development of Medium-Term Work Programmes for Ministries has been adopted. In addition, strengthening of the mechanisms for establishing and developing the systems for coordinating and monitoring of compliance of strategic documents that set the public policies has continued. To that end, the *Decree* on the method and procedure for developing, adjusting, monitoring and implementing strategic documents has been adopted, which sets the principles of planning, developing and implementing strategic documents, including the supporting methodology. All these activities are implemented in order for the medium-term fiscal framework to be credible and adequately reflect strategic goals and policies of the Government.

During 2018, the Law Amending the Law on Budget and Fiscal Responsibility was adopted, for the purpose of gradual harmonisation with European Union Directive No. 2011/85/EU on requirements for budgetary frameworks of the member states. According to this amendment, the securities purchase transaction that has a character of financing has been excluded from the calculation of the fiscal balance of the state.

As of 2020, three-year budgeting will be formally introduced in the budget system, where the first year will be mandatory, and the following two will be indicative. The implementation of the budget planning on a three-year level was planned for 2019, but it had to be postponed due to the delay in the implementation of the project "Enhancement of the budgetary system, medium-term budgetary framework and internal financial control", which is funded from EU funds.

In addition to the mentioned project, in 2019 the following will be implemented with EU financial support:

- the project "Budget Planning IT System Enhancement", which, through the enhancement of the system for budget planning, will create the conditions for budget planning in the medium term, as well as the conditions for qualitative budget planning and reporting;
- the project "Implementation of the System of Centralised Payroll Calculation", aimed at developing and implementing a programme arrangement that will facilitate centralisation and efficient processing of payroll calculations, with a higher degree of control and reporting, as well as efficient management of spending on wages in the public sector.

In 2018, the *Decision on capital budget development and setting and evaluating of the criteria for selecting capital projects* was adopted. The adoption of this decision created the prerequisites for improving the planning and managing investment projects through prescribing the criteria for proposing and evaluating the proposed projects, establishing the form for proposing capital projects, establishing the list of priority projects and reporting on their implementation.

In the coming period, programme budgeting will be implemented, which will contribute to the better performance of the available funds, efficient public spending planning and management, as well as better transparency of public finances. In accordance with the set schedule, the key elements of the programme budget will be gradually introduced, so that in the final phase the programme performance indicators may be developed. Also, the analysis of the budgetary legislation will continue, as well as its adjusting to the EU Acquis.

In 2019, the implementation of the following projects is planned in cooperation with the World Bank: the 'Support for PEFA Implementation in Montenegro' and the 'Fiscal Rules and Institution Enhancement' projects.

In accordance with the Strategy for implementation of accrual accounting in the public sector, an Action Plan was adopted in February 2018 to outline in detail the activities for implementation of the strategy.

Taking into account the identified needs for further development in the area of fiscal reporting, activities intensified in 2018 on establishing the Law on Accounting in the Public Sector. Adoption of this law is the first step on the path towards the introduction of accrual accounting and the approximation to international public-sector accounting standards, as well as financial reporting standards. This particularly results from the fact that currently there is no unique normative framework that outlines the basic principles for accounting given that the accounting principles are defined through a range of laws and enabling regulations.

As regards the statistics of public finances, the administrative capacities of the Ministry of Finance have been strengthened through engagement of three employees who are assigned tasks related to the implementation of ESA2010 methodology. At the same time, the second mission of the expert commissioned through IMF technical support took place in the period 17–21 September and was directed towards the education of new employees of the Ministry of Finance. In addition, representatives of the Central Bank of Montenegro and the Statistical Office attended the training.

In the area of strengthening public-sector internal financial controls (PIFC), internal auditors' capacities have been improved through the organisation of training and a certification process, which will also continue in the following period, with financial support from the EU programme IPA 2014.

As regards the strengthening of oversight over the fiscal policy implementation, options are being considered for identification of the most adequate model for establishing the Fiscal Council, and expert EU assistance has been sought to that end through the European Integration instrument.

3.8 Sustainability of public finances

In the coming period, public finance sustainability will be strengthened through the continuation of the implementation of the fiscal consolidation measures (detailed in Chapter 3.3) as well as the reforms planned in the public finance system.

Taking into account that Montenegro's public finances are mostly of a mandatory nature, their sustainability is under the greatest impact from: the pension, health and social care system, as well as policies related to the level of wages of public administration employees.

Based on the above, in order to reduce the share of the wage bill for employees in overall public spending, in the previous year activities were undertaken as outlined in the 2016–2020 Public Administration Reform Strategy and the 2018–2020 Public Administration Optimisation Plan, adopted in July 2018. The objective of the optimisation is to provide support for establishing an administration that can respond to the needs of citizens and the private sector in the best way, and at the same time disburden the central and municipal budgets. It implies the adoption and implementation of the established optimisation plan and redistribution or reduction of the number of employees in line with the needs of the public administration, while observing the needs of HR strengthening required for EU integration purposes. According to the Optimisation Plan, the targeted values of the reduction in the number of employees are as follows: 5 percent at the central level and 10 percent at the local level by 2020. In order to meet the projected values, in addition to the Optimisation Plan, the Government of Montenegro adopted a decision on discontinuing employment in state administration authorities and public institutions until 1 July 2019, except in sectors of special public interest where previous consent by the Government is required.

The activities directed towards the reform of public administration in view of ensuring quality of public services provided will be finances from the instrument for pre-accession support (IPA II) through direct budget support, amounting to €15.0 million.

In order to enhance the fiscal sustainability of the social care system, the financing of which makes up a significant portion of public spending, and an increase in the social security of citizens, significant reform changes have been completed through amendments to the 2017 Law on Social and Child Protection, which redefined the basic package of social care and abolished the benefits for mothers with three or more children, except in the cases specified in the Law Implementing the Constitutional Court Decision. In this way the funds for these purposes have been rationalised and the funds intended for payment of benefits to socially threatened categories of the population are subject to equitable distribution.

The existing pension system has a significant impact on the sustainability of public finances, taking into consideration the permanent deficit of the Pension and Disability Insurance Fund which requires subsidies from the budget in order to ensure the regular servicing of benefits in the area of pension and disability insurance. Considering the aforementioned, and in line with the recommendation of the European Commission, in 2018 the amending of the Law on Pension and Disability Insurance commenced was proposed for the purpose of strengthening the stability and sustainability of the pension system, better fairness and adequacy of pension benefits, and preventing people leaving the labour market early and early retirement. In view of improving the efficiency of the public procurement system, the prerequisites have been created for implementation of centralised public procurement through the adoption of the Decree on the consolidation of the procurement of goods and services. Pursuant to the decree, a central body will be established to implement consolidated public contracting for standardised goods and services for the needs of the state administration authorities. The expected effects of this reform should be lower prices due to economies of scale, which will reduce budget allocations for public contracts and also speed up the tendering procedures.

An important segment of the overall fiscal system is the state of local public finances. The adoption of the Law on Local Self-Government Financing will significantly improve the legal arrangements relating to local self-government financing and create normative assumptions for the stable functioning of the local public finance system. Namely, the prepared draft law envisages an increase in the percentage of personal income tax assigned to the municipalities of the northern region from 12 percent to 50 percent, and for municipalities with less than 3,000 inhabitants this percentage is increased to 70 percent, which will accommodate increased revenues, especially for the municipalities belonging to the northern region of Montenegro, all for the purpose of providing support for balanced regional development.

In order to ensure the generation of new revenues through expansion of the tax base, in the coming period the following projects will be implemented: electronic issuing of fiscal invoices Tax Administration Reform and the Economic Citizenship Project.

The improvement of tax administration, in cooperation with the World Bank, is aimed at improving the effectiveness of operational functions of the Tax Administration so as to enable the efficient collection of taxes and contributions from sources of economic activities. The planned activities will be financed from the signed credit facility of €14.0 million, where the most important segment is related to electronic issuing of fiscal invoices

Activities on the reduction of the tax debt have been continued through enforced collection measures and implementation of the Law on Rescheduling Tax Receivables. The Tax Administration is undertaking intensive activities to monitor all the taxpayers that have entered the rescheduling, not only from the aspect of settling the rescheduled liabilities, but also from the aspect of regular servicing of current liabilities. The Tax Debt Management Plan adopted at the beginning of 2017 specifies the activities that in the medium term will result in a reduction of tax debt, through the collection of part of the debt and the writing off of uncollectible liabilities and liabilities subject to the statute of limitations. Also, the *Decree on the conditions for deferring the collection of tax and non-tax receivables* has been adopted, which outlines the method of deferring the collection of due tax and non-tax receivables (through payment in instalments and postponement for a specific time period) through the specification of conditions and deadlines for deferring, establishing authorisations for decision-making and defining funds to secure the collection of such receivables. Deferment of the collection of tax and non-tax receivables may be approved for a taxpayer for tax debt incurred before 15 February 2017, i.e. after the publishing of the public invitation for rescheduling tax and non-tax receivables.

For the purpose of efficient public debt management, in the first quarter of 2018, the 2018–2020 Public Debt Management Strategy was adopted. The main objectives of the strategy are as follows:

- equalisation of debt repayment by years and extension of commercial debt maturity;
- reduction of risks through currency risk and interest rate risk management;
- gradual development of the domestic securities market;
- minimisation of borrowing costs.

4. STRUCTURAL REFORMS IN THE PERIOD 2019–2021

4.1 Identification of key obstacles to competitiveness and inclusive growth

In the previous years, the Economic Reform Programme (ERP) outlined detailed diagnostics of the obstacles to competitiveness and further economic growth and the development of Montenegro, and included reform measures for their elimination. Having in mind the structural nature of these obstacles, their elimination is of a long-term nature.

Although the reports produced by the majority of reference international institutions state that Montenegro's competitiveness has improved, obstacles have been identified and need to be eliminated in order to ensure its further improvement. Therefore, the report on Montenegro of April 2018, produced by the International Monetary Fund (IMF), specified challenges to competitiveness and the need to strengthen Montenegro's external position. To that end, it recognised the necessity of addressing structural issues in the labour market and the need to increase labour productivity. The lack of a legislative framework for public–private partnerships was recognised by the IMF as one of the shortcomings in the further strengthening of the competitiveness of the economy.

The 2019 Doing Business Report produced by the World Bank identified the following obstacles to the improvement of doing business and enhancement of the overall competitiveness of the Montenegrin economy: "business start-ups", "protection of minority investors", "cross-border trade", "contract enforcement", "addressing insolvency issue" and "getting electricity".

The EC report on Montenegro of spring 2018 sets out that the Montenegrin economy is assessed as moderately prepared "to face competitive pressures within the EU". The EC recognises that development of key infrastructure, in a fiscally responsible manner and in full compliance with the rules of competition and public procurement, is important for the further strengthening of competitiveness. It also recognises the development of human capital, emphasising that further education reform is necessary so that the knowledge and capabilities of each individual in the education system match the needs of the labour market. The EC still sees a simpler approach to financing small and medium-sized enterprises as important for the elimination of the obstacles to competitiveness and an increase in exports. Moreover, the EC's report on Montenegro underlines the need to further develop research and innovation so as to simplify synergy between academic institutions and enterprises.

The new methodology for measuring transitional progress towards a sustainable economy, which was designed by the EBRD[22], classifies the Montenegrin economy as being among countries with a moderate transitional gap and gives it a rating of 5.4 on a scale of 1 to 10. According to the EBRD's assessment, Montenegro should particularly make further improvements to competitiveness, the green economy and good governance.

A large number of the obstacles to improving competitiveness mentioned above, which were identified by reference to international organisations and institutions, have also been recognised by Montenegro in its strategic development documents, including obstacles related to the low level of added value in production and the low level of export diversification; insufficient predictability of the tax policy; the relatively high share of the informal economy; non-flexibility and high costs of the labour market; an insufficiently efficient state administration, etc.

[22] According to the EBRD, a sustainable market economy must be: 1) competitive, 2) well-governed, 3) "green", 4) inclusive, 5) resilient to external shocks and 6) integrated. According to this methodology, countries in transition are evaluated on the basis of the six qualities mentioned above on a scale of 1 to 10.

In order to ensure faster elimination of the obstacles to the improvement of competitiveness and in the framework of assessing the 2018 Economic Reform Programme, at the Ministerial Meeting held in May 2018 the EU gave six recommendations for development of the 2019 ERP.

Out of the six recommendations mentioned above, the first two refer to strengthening the country's micro-fiscal position, which is elaborated in detail in Chapter 3, while Recommendation No. 3 refers to Chapters 2 and 4 of the 2019–2021 Economic Reform Programme. The remaining three recommendations (Recommendations Nos. 4, 5 and 6) address certain parts of the structural reforms and are elaborated in Chapter 4.

More specifically, the following recommendations refer to further implementation of economic reforms in 2019:

- Continue efforts aimed at NPL resolution and corporate debt restructuring, focusing also on loans held outside the banking sector and the underlying obstacles that are outside the remit of the Central Bank. Establish a framework for the recovery and resolution of credit institutions. Consider conducting asset quality reviews in the banking sector and options for enhancing the emergency liquidity assistance framework. Enhance the accountability and transparency of macro-prudential policy by publishing a document outlining the Central Bank's competences, objectives and instruments in this area.

- Based on a mapping of the infrastructure and an analysis of market interests, develop a comprehensive action plan on broadband roll-out and coverage and implement the broadband cost reduction measure in line with Directive EU 2014/61. Ensure the collection and delivery of statistical data on research and development and innovation. Develop a model for the introduction of fiscal incentives for the research and innovation sector in line with EU state aid rules.

- Adopt legislation on concessions and public–private partnerships in line with EU rules and best practices accompanied by the action plan for institutional capacity building in this area. Ensure effective, efficient and independent rail regulatory and safety authorities to implement the full opening up of the railway market.

- Review active labour market policies in order to improve their coverage and effectiveness, in particular for young people, women and the long-term unemployed. Ensure better coordination between employment activation measures and social benefit schemes. Increase enrolment in vocational and higher education corresponding to labour market needs.

4.2 Summary of reform measures

This subchapter summarises the priority reform measures that are defined on the basis of the conducted diagnostics and in response to the obstacles to competitiveness and growth, through all eight areas, in line with the EC's Guidance Note. The table shows, in an integral manner, the significance of the proposed measures according to their estimated impact on economic competitiveness/growth, employment and fiscal sustainability. It shows the link between individual measures and the recommendations given to Montenegro at the Ministerial Meeting in May 2018, while also specifying the institutions responsible for implementation of the measures and the risk posed by implementation of the measure.

Table 4.1: Overview of Montenegro' s priority reform measures in the 2019–2021 Economic Reform Programme and their reference to the recommendations for Montenegro of the May 2018 Ministerial Meeting

#	Priority reform measure	Impact score (weighting)*	Impact on competitiveness	Impact on employment	Impact on fiscal ustainability	Reference to the recommendations of the May 2018 Ministerial Meeting (No.)	Implementing ministry
The energy market and transport market reform							
1.	*Improving the ownership, managerial and organisational structure in electrical power companies with state-dominant ownership*	12	Medium	Direct	Neutral	/	Ministry of the Economy
2.	*Improving legislative – regulatory and institutional framework for integration into the regional electricity market*	9	Large	Indirect	Neutral	/	Ministry of the Economy
3.	*Creating efficient and independent rail regulatory and safety authorities*	4	Small	Indirect	Neutral	5	Ministry of Transport and Maritime Affairs
Sector development							
4.	*Supporting investments in the development and modernisation of the industrial sector*	10	Large	Direct	Negative	/	Ministry of the Economy
5.	*Supporting investments in the food production sector in order to reach EU standards*	11	Large	Direct	Neutral	/	Ministry of Agriculture and Rural Development
6.	*Diversifying tourist products*	11	Medium	Direct	Positive	/	Ministry of Sustainable Development and Tourism
7.	*Strengthening prudential oversight and the bank resolution framework*	9	Large	Direct	Neutral	3	Ministry of Finance Central Bank
The business environment and reduction of the grey economy							
8.	*Implementation of new regulatory framework for the*	13	Medium	Indirect	Positive	5	Ministry of Finance

	Public Procurement policy and amendment to the Law on Concessions						Ministry of Economy
9.	*Adopting and implementing the Law on Administrative Charges*	10	Medium	Indirect	Neutral	/	Ministry of Finance
10.	*Adopting the Law on Issuing Electronic Fiscal Invoices in the Trade in Products and Services and implementing the electronic fiscal invoices system*	5	Small	Direct	Positive	/	Ministry of Finance
11.	*Improving support for the micro, small and medium-sized enterprise sector*	12	Large	Direct	Positive	/	Ministry of the Economy
Research, development and innovation (RDI) and the digital economy							
12.	*Improving the legislative and regulatory framework with the aim of reducing the costs of deploying high-speed electronic communications networks*	8	Medium	Indirect	Neutral	4	Ministry of the Economy
13.	*Strengthening the national innovative ecosystem*	12	Medium	Direct	Positive	/	Ministry of Science
Trade-related reforms							
14.	*Implementing the trade facilitation measures set out in the WTO Trade Facilitation Agreement and in CEFTA Additional Protocol No. 5*	9	Medium	Direct	Positive	/	Ministry of the Economy/Ministry of Finance
Education and skills							
15.	Development of qualifications and education curricula in accordance with the labour market needs	6	Middle	Indirect	Neutral	6	Ministry of Education
16.	*Implementation of apprenticeships with employers*	6	Middle	Indirect	Neutral	6	Ministry of Education
Employment and labour market							
17.	*Support for self-employment and strengthening of local employment initiatives*	6	Middle	Indirect Neutral		6	Ministry of Labour and Social Welfare

Social inclusion, poverty reduction and equal opportunities						
18.	*Development of day-care services for the elderly*	3	Small	Indirect	Neutral	Ministry of Labour and Social Welfare
19.	*Incentive for including children in sports activities*	6	Medium	Direct	Neutral	Ministry of Sports and Youth

*****Note: The weightings indicating the importance of individual structural measures are calculated on the basis of the OECD structural measure evaluation tool that looks at the impact of a structural measure on economic competitiveness/growth (substantial, large, medium or small impacts); employment (direct, indirect or small impacts on employment) and fiscal sustainability (positive, neutral and negative impacts on fiscal sustainability). On the basis of the tool, a weighting is automatically assigned when selecting the type and level of impact of a measure. Larger weightings reflect the greater importance of the measure, always in terms of its impact on economic competitiveness/growth, employment and fiscal sustainability.

4.3 Analysis by area and structural reform measures

4.3.1 Energy and transport market reform

Description/analysis of the main issues and obstacles to the development of the area: The natural gas market has not yet been established in Montenegro, since Montenegro does not have access to natural gas, nor does it have a developed gas infrastructure. The main obstacles to the reform and development of the electricity market are: unsuitable ownership; the managerial and organisational structure of electrical power entities, which has an unfavourable impact on the efficiency of their functioning, investments in the electrical power infrastructure, as well as on their overall performance and competitiveness. Moreover, the obstacles to the development of the electricity market also include an insufficient level of integration into the regional electricity market due to both insufficient infrastructural connection, through interconnectors with the neighbouring electrical power systems, and an incomplete legislative and regulatory framework in this area. The transport market needs to be liberalised in order to encourage development of a self-sustaining transportation system and achieve the relevant standards sooner, as regulated in the Trans-European Transportation Network. Since this is an iterative process which requires time, the reform measures in this document place the focus on improvement of the opening up of the market in rail transport. In order to have a fully transparent rail market, it is necessary to ensure independent regulatory bodies.

Report on implementation of the EC's recommendations of May 2018: Recommendation No. 5 was given for this area in the Ministerial Meeting held in Brussels in May 2018, which reads as follows: "Ensure effective, efficient and independent rail regulatory and safety authorities to implement the full opening of the rail market". Drafting of the Proposal for the Law Amending the Law on the Railways is in progress and it will set out the reorganisation of the work carried out by the Railway Directorate, in such a way that regulatory and safety functions are dealt with within the Railway Directorate as an autonomous administrative authority, with a clear indication of the functions and competences of both bodies. The law is expected to be adopted in 2019, which will create the legal basis for the beginning of implementation of this reform measure.

Priority Reform Measure No. 1: Improving the ownership, managerial and organisational structure of electrical power companies with state-dominant ownership

Description of the measure: In the conclusions of the Ministerial Meeting of May 2018, no recommendations were given for the field of energy. Energy is one of the most important sectors of the Montenegrin economy. This reform measure aims to improve the management of the electrical power companies with state-dominant ownership, as follows: Montenegro Electrical Power Company (EPCG), Montenegrin Electricity Transmission System JSC (CGES), Montenegrin Electricity Distribution System (CEDIS), Montenegrin Electricity Market Operator Ltd. (COTEE) and Montenegrin Power Exchange (BELEN). The measure aims to enable faster reform and more intensive development of the electrical power sector, as well as to boost the competitiveness of companies and ensure faster integration of the Montenegrin market into the regional electricity market. This measure is in line with the Energy Policy of Montenegro to 2030, the Energy Development Strategy of Montenegro to 2030 and the Action Plan for its implementation in the period 2016–2020, and with energy policy of the Energy Community and European Union. Implementation of the measure is a priority with EPCG, since state ownership of EPCG increased from 57% to 71% following termination of the contract on strategic partnership with the company A2A, with this share rising to 98% in 2019 in line with the contractual commitment.

Timetable for implementation of the measure:

a. **Activities planned in 2019:** Analysis of the ownership, managerial and organisational structure of electrical power companies with state-dominant ownership and the selection of optimal ownership and managerial-organisational models (responsibility of: Ministry of the Economy, companies concerned); beginning of implementation of the selected models in priority companies (responsibility of: Ministry of the Economy, the companies concerned);
b. **Activities planned in 2020:** Continuation of implementation of optimal ownership and the managerial-organisational model for the companies concerned (responsibility of: Ministry of the Economy, the companies concerned);
c. **Activities planned in 2021:** Continuation of implementation of optimal ownership and the managerial-organisational model for the companies concerned (responsibility of: Ministry of the Economy, the companies concerned);

Expected impact of the measure on competitiveness: This measure creates conditions for increasing the interest of narrowly specialised companies in strategic partnership with Montenegrin electrical power companies. This measure is expected to contribute to an increase in investments in the Montenegrin electrical power sector and to an improvement in knowledge, which will further have a significant impact on portfolio diversification and an improvement in the competitiveness of the electrical power companies.

Key performance indicators (KPI):

- Optimal models of ownership, managerial and organisational structure of electrical power companies with state-dominant ownership are established, along with the plan of activities for their implementation, by the end of Q3 2019;
- Optimal model implemented in a minimum of one priority company concerned, by the end of 2020.

Estimated costs of measure/activity and budgetary impact: The total amount of additional costs of implementation of the measure is estimated at €130,000, of which €30,000 needs to be allocated in the central budget for its financing, while the remaining sum needs to be allocated by the electrical power companies.

Expected impact on employment and gender equality: A positive impact on employment in the electrical power sector and other sectors is expected in the medium term and the long term, as a result of the portfolio diversification of the companies and more intensive investment activities. From a gender-equality perspective, the measure is neutral.

Potential risks: Since the measure includes the complex process of restructuring several electrical power companies, there is a potential risk of extending the deadlines for the implementation of certain activities within this measure. To mitigate the risk, engagement of additional members of the teams implementing the measure is planned.

Priority Reform Measure No. 2: Improving the legislative-regulatory and institutional framework for integration into the regional electricity market

Description of the measure: In the conclusions of the Ministerial Meeting of May 2018, no recommendations were given for the area of energy. This reform measure includes activities involving improvement to the legislative-regulatory and institutional frameworks, and aims to develop a competitive and transparent electricity market in Montenegro and to integrate it into the regional electricity market. The measure is in line with Energy Policy of Montenegro to 2030, the Energy Development Strategy of Montenegro to 2030 and the Action Plan for its implementation in the period 2016–2020. This measure is also set out in the Annex to the Conclusions of the Western Balkans Summit in Vienna of 27 August 2015, in which national and regional activities for removing barriers to development of the regional electricity market were indicated as so-called “soft measures”. These “soft measures” are implemented with the support of the Energy Community Secretariat. Key activities include the creation of conditions for the efficient functioning of a transparent short-term electricity market at the national and regional levels, active participation in the regional balancing market and improvement to cross-border electricity exchange.

Timetable for implementation of the measure:

a. **Activities planned in 2019:** Transposition into Montenegrin legislation and implementation of Regulation (EU) 347/2013 on the guidelines for the Trans-European Energy Infrastructure; transposition into Montenegrin legislation and implementation of Regulation (EU) 1227/2011 on wholesale energy market integrity and transparency; creation of a model of national connectivity with the neighbouring electricity markets; establishment of an efficient electricity balancing market at the regional level;

b. **Activities planned in 2020:** Transposition into Montenegrin legislation of Regulation (EU) 2015/1222 establishing a guideline on capacity allocation and congestion management, and of Regulation (EU) 2016/1719 establishing a guideline on forward capacity allocation, and their implementation; continuation of activities towards connecting the national market with the neighbouring electricity markets;

c. **Activities planned in 2021:** Continuation of activities towards improving the operation of the regional electricity market.

Expected impact of the measure on competitiveness: This measure has a significant impact on increasing the efficiency of operation of electrical power companies. Furthermore, the measure will ensure the creation of reliable price signals in the functional energy market, thus reflecting impartial and competitive interaction between supply and demand, which will contribute to the overall economic development.

Key performance indicators (KPI):

- Adoption of the legislation into which Regulation (EU) 347/2013 and Regulation (EU) 1227/2011 are transposed, by the end of 2019;
- Adoption of the legislation into which Regulation (EU) 2015/1222 and Regulation (EU) 2016/1719 are transposed, by the end of 2020;
- A piece of secondary legislation adopted on the basis of the law, into which Regulation (EU) 347/2013 will be transposed, and this will define the methodology and criteria for assessing investments in infrastructure projects in the area of electrical power and the increase in the risks associated with such projects, by the end of 2019.

Estimated costs of the measure/activity and budgetary impact: It is estimated that this measure will not require any additional budgetary funds.

Expected impact on employment and gender equality: The measure is not expected to have a significant direct impact on employment and gender equality.

Potential risks: This reform measure was also set out in the 2018–2020 Economic Reform Programme for Montenegro; however, activities planned for 2018 have not been fully implemented, partially due to the untimely adoption of the adjusted subject legislation for the contractual parties to the Energy Community. These pieces of legislation are adopted in line with the Treaty Establishing the Energy Community, and their adoption is expected during 2019. Due to the high level of complexity and the regional dimension of the measure, and the large number of participants in its implementation, there is a potential risk of failure to reach agreement between the institutions and entities responsible for implementation of the activities planned within this measure. More intensive cooperation with the Energy Community Secretariat is planned in order to mitigate the risk.

Priority Reform Measure No. 3: Creating efficient and independent rail transport regulatory and safety authorities

Description of the measure: Upon adoption of the amendments to the Law on the Railways, the activities performed by the Railway Directorate will be reorganised in such a way that regulatory and safety affairs will be placed within the purview of the Railway Directorate as an autonomous administrative authority of the Government of Montenegro, with clear specification of the functions of both bodies, in line with Directive 2012/34 which specifies requirements for the functioning of the Single European Rail Area. Moreover, implementation and models for addressing this reform measure are also specified in the 2017–2027 Railway Development Strategy, adopted by the Government in Q1 2017. Recommendation No. 4 of the Report on Implementation of the EC's Recommendations of May 2017 states the following: "Montenegro is invited to ensure effective, efficient and independent rail regulatory and safety authorities to implement the full opening up of the rail market", which is also the recommendation given in the Ministerial Meeting between EU and Montenegro held on 25 May 2018.

Timetable for implementation of the measure:

a. **Activities planned in 2019:** Adoption of the new Law on the Railways (which did not happen as originally planned in 2018 due to lengthy administrative procedures) and the formal beginning of implementation of the functioning of the independent regulatory body (Q3 2019) within the Railway Directorate.
b. **Activities planned in 2020:** Full implementation of the functioning of the independent regulatory body within the Railway Directorate, in line with EU rules and recommendations, administrative capacity building and training.
c. **Activities planned in 2021:** Administrative capacity building (training courses, professional education).

Expected impact of the measure on competitiveness: In the conditions of a liberalised rail market, clearly defined legislation in this area and the strong role of an independent regulator may serve as an incentive to include new operators in the market, which would improve competitiveness and the quality of services. New operators are expected to appear in this period of implementation of the reform measure, which will have a direct impact on traffic volume, thus additionally stimulating GDP growth.

Key performance indicators (KPI):

- 2019: Adoption of the Law on the Railways
- 2020: Fully institutionalised regulatory body, competences defined, operationalisation
- 2021: Number of employees that were trained

Estimated costs of the measure/activity and budgetary impact: Funds for operation of the Railway Directorate, as the administrative authority functioning under the auspices of the Government, are planned under the annual government budget, while €315,000 per year is planned under the Railway Directorate as an expenditure for performance of the functioning of an independent regulatory authority.
Expected impact on employment and gender equality: The emergence of new operators is expected to increase the number of employees, although the efficiency of operation of firms is expected to increase considerably compared to the way they have operated so far, i.e. it is expected that a lower number of highly productive employees will be engaged in operations.

Potential risks: There is the risk of a shortage of staff capacities for full completion of all the necessary tasks and activities of the regulator. The whole Western Balkan region has a limited number of trained professionals who can perform these tasks in a completely satisfactory manner.

4.3.2 Sector development

Analysis of the main obstacles: The key development sectors in Montenegro are industry, agriculture and services, primarily those in tourism. In that regard, reform measures within the sectors are specified in the 2019 ERP for the areas of industry, agriculture, tourism and financial services, while a diagnosis of the condition in these areas is outlined below.

Industry: The key obstacles to more rapid industrial development and the still-present structural weaknesses of Montenegrin industry are: insufficient diversification with a dominant share of the products with lower processing phase ; the dominant role of traditional sectors in exports; low labour productivity; insufficient investment in modernisation; underutilised scientific and research potential; and a weak link between the economy and science. In 2017 industry accounted for 11.6 percent of GDP, whereas the share of the processing industry in GDP remained at the level of the previous year, accounting for 4.7 percent. The share of processing industry in the overall industry structure in 2017 remained at the level of the year before, amounting to 57.6 percent. Slow growth in the processing industry is preventing an increase in labour productivity and a rise in employment. There is still a low level of investment in industrial modernisation (the share of investments in fixed assets in the processing industry increased slightly compared to 2016, but still accounts for 3.7 percent of total investments in 2017). The share of industry in total exports in 2017 amounted to 91.5 percent, of which the processing industry accounted for 70.2 percent. The main export subsectors of the processing industry still remain the metal, food and timber industries, accounting for 65.5% of the export structure in the processing industry, with a predominance of products with low value added and a low level of product finalisation in both manufacturing and export segments. Insufficient investment in knowledge and innovation and the weak connection of the economy with science and research still exist (investments in R&D in 2016 amounted to 0.32 percent of GDP, of which the business-entrepreneurial sector accounted for merely 0.05 percent of GDP). In addition to the already initiated activities involving the awarding of grants for innovative projects (on the basis of co-financing the development of innovative market-oriented products, services and technologies), these obstacles will also be eliminated by setting up the Scientific and Technological Park (STP) in Podgorica which, as a driver of innovative activity, will foster cooperation between academic scientific and research institutions and the economy.

In parallel, activities involving a comprehensive assessment of the implementation of industrial policy so far have been launched recently and, based on such an assessment of progress in implementation, established recommendations, the industrial policy will be redefined, and alignment with the updated EU Industrial Policy Strategy will be ensured.

Agriculture: Agriculture is one of strategic development sectors in Montenegro. Its share in GDP in 2017 amounted to 6.8 percent. The gross value of production in the agriculture, forestry and fisheries sector in 2017 amounted to €482.9 million, which is a 1.4 percent rise compared to 2016, whereas gross value was 0.4 percent lower compared to 2017. The main goal of Montenegro's agricultural policy is to boost the competitiveness of agricultural production and improve living conditions in rural areas. The main obstacles to strengthening the competitiveness of the food production sector in Montenegro are low productivity per unit of area, an unfavourable age structure in rural areas, an underdeveloped rural infrastructure and the lack of a proper form of association of agricultural producers in the majority of sectors of agricultural production.

In the recent period, significant funds have been made available to Montenegrin producers from the World Bank-funded project MIDAS and pre-accession funds for rural development, as well as from the national budget, with the aim of strengthening the food production sector. In 2017, around €17 million was invested in the agriculture sector, of which assistance from IPA funds amounted to €3,200,000 (total investments amounted to €6,300,000), while €11 million was allocated through the measures of the agriculture budget and these included direct support measures (subsidies) and measures which aim to support investments in rural areas, such as support for cultivating new plantations, purchase of livestock and diversification of economic activities.

As a result of investing in food processing facilities and reaching EU food safety standards, Montenegro fulfilled the recommendations given by the EC for this area. At the moment, Montenegro has 15 export facilities approved by the EU. The assignment of export codes will contribute to the growth in exports of agricultural and food products.

Tourism: Despite satisfactory results measured by means of tourist traffic indicators, the main obstacles to achieving the strategic goal in the development of tourism include: an insufficient number of accommodation capacities (primarily hotels) of higher and high categories; an unbalanced development of tourism by region; and a still high level of seasonality in the tourist industry. In fact, analyses reveal that 90–95 percent of the accommodation capacities and tourist traffic (number of tourists, overnight stays and revenues) are located and operated in the coastal region and that 65–70 percent of tourist traffic takes place during the three summer months of the year (June, July and August).
The consequences of this condition and these developments in the tourist sector are the following:

- The northern region of Montenegro is insufficiently developed from a tourist perspective, with the population constantly migrating to other parts of the country;
- In the periods before and after the (peak) tourist season, the tourist industry does not operate at a satisfactory level, ultimately leading to seasonal employment, which does not contribute to an increase in the total number of employed.

Banking services: At the Ministerial Meeting held in May 2018, a special recommendation was given to Montenegro regarding the financial sector. In order to foster NPL resolution and restructure corporate debt outside the banking sector, in recent years Montenegro has undertaken a number of legal and institutional reforms seeking to improve the framework for the enforced collection of claims, including claims arising from loans. A multidimensional approach was taken, since individual measures could not yield results in this regard, whereby the share of NPLs in total loans saw a multiannual decline from around 26 percent in 2011 to 7 percent at the end of November 2018. Therefore, NPLs cannot be deemed an issue of systemic importance any longer, but as an individual issue, i.e. one that concerns individual banks. Activities by the Central Bank were focused on implementation of the Law on Consensual Financial Restructuring of Debt to Financial Institutions, the application of which has been extended until May 2019. The effects of the adopted solutions are evident, given that implementation of this law by 30 September 2018 led to the restructuring of loans worth €36.7 million, of which the corporate sector accounted for €35.1 million, or 95.7 percent, and households accounted for €1.6 million, or 4.3 percent. The Central Bank will continue to implement activities aimed at reducing NPLs through an active supervisory process and continuous communication with each individual bank in the system, as well as through more intensive oversight of banks in their fulfilment of the obligations arising from amendments to the *Decision on the minimum standards for credit risk management in banks*, and these include monitoring implementation of the established strategies and achievement of the goals related to NPL resolution, which should additionally contribute to a further reduction of the level of NPLs at the banks.

The legislative framework for implementation of the Law on Financial Leasing, Factoring, Purchase of Receivables, Micro-Lending and Credit-Guarantee Operations was adopted in Q2 2018 and prescribes, among other things, the obligation to issue licences to companies dealing with the purchase of receivables (also known as factoring companies) to which corporate loans were transferred from the banking sector. The working version of the Draft Law on the Resolution of Credit Institutions was updated and is fully harmonised with the BRRD Directive. The law creates the legal preconditions for the establishment of the resolution function and the implementation of possible resolution measures in line with the directive. The working version of the Draft Law on Credit Institutions and part of accompanying secondary legislation are being finalised under the Twinning Project, financed by the EU and covering support to the financial services regulation, which started in April this year. The need to implement an Asset Quality Review (AQR) will be considered in the short term. In fact, having in mind the activities undertaken in 2018 towards a radical change in the regulatory framework for the purpose of ensuring harmonisation with the relevant EU directives, implementing Basel III standards and embarking on the application of IFRS 9, and also given the downward trend of NPLs in 2018, we believe that conducting AQR, despite its importance, should not be given priority over the activities mentioned above. In 2019, consideration will be given to the possibility of conducting AQR for vulnerable banks. The framework for emergency liquidity assistance has improved due to adoption of the *Decision on more detailed requirements for extending loans to banks in case of liquidity needs*[23]. Aimed at improving the accountability and transparency of the macro-prudential policy, the Central Bank adopted the *Decision on implementation of the macro-prudential policy* in June 2018 and posted it on its website[24].

Report on implementation of the EC's recommendations of May 2008: At the Ministerial Meeting held in May 2018, concrete recommendations were given for the area of banking services. At that point, Montenegro was given a recommendation to continue efforts aimed at NPL resolution and corporate debt restructuring, focusing also on loans held outside the banking sector and the underlying obstacles that are outside the remit of the Central Bank; to establish a framework for the recovery and resolution of credit institutions and to consider conducting Asset Quality Reviews in the banking sector and options for enhancing the emergency liquidity assistance framework; as well as to enhance the accountability and transparency of macro-prudential policy by publishing a document outlining the Central Bank's competences, objectives and instruments in this area.

Priority Reform Measure No. 4: Supporting investments in the development and modernisation of the industrial sector

Description of the measure: In line with the following strategic documents: Industrial Policy of Montenegro to 2020, Montenegro Development Directions 2018–2021 and the Regional Development Strategy to 2020, this is a multiannual reform measure which aims to ensure continuous improvement of industrial development and represents a combination of two measures from the area of industrial sector development, specified in the 2018–2020 ERP. As a response to the key "bottlenecks" in the industrial sector, the measure focuses on financial incentives for investing which contributes, in both the manufacturing and services sectors, to an increase in employment, thus ensuring the development

[23] Official Gazette of Montenegro No. 82/17.

[24] http://www.cbcg.me/slike_i_fajlovi/fajlovi/fajlovi_naslovna/okvir_makroprudenciona_politika.pdf.

of new or the diversification of existing capacities (implementation of the Programme Line for Direct Investment Incentives), while also focusing on technological modernisation through introduction of equipment/machines (implementation of the Programme line for Modernisation of the Processing Industry).
In the segment related to financial incentives for new investments focused on creating new jobs within Component 1, after significant effects were achieved on the basis of the first two public calls and after implementation of six investment projects, the total value of which was €8.7 million, and recruitment of 285 new employees, there has been an interruption in implementation caused by certain difficulties and delays in the procedure for formal evaluation of the validity of applications for the third public call from 2017, which was formally finalised in 2018. Negative experiences with the third public call, in terms of a large number of inaccurate applications and the lack of conclusion of new contracts in 2017 and 2018, resulted in certain changes which will simplify the procedures for filing applications and will facilitate the criteria for the awarding of funds (loosening the criteria for investments and number of newly employed), while it will also enable a faster and simpler approach to funding in a shorter procedure for the awarding of grants, without restricting the period for filing applications for the public call.

Within Component 2, which focuses on modernisation through a credit arrangement provided by the Investment and Development Fund of Montenegro, with co-financing by the Ministry of the Economy in the form of grants for up to 20 percent of the eligible costs of procurement, in the past two years of Programme implementation, based on five applications, technological modernisation was enabled through the purchase of new machines and accompanying equipment worth €531,366 (grants from the Ministry of the Economy amounted to €71,136). The trend of increased interest in and value of the granted financial support in 2018, shows the increasingly important effects of implementation of the initiated activities, which have resulted in seven applications being accepted, based on which machinery and supporting equipment was procured in value of €808,250 (grant support of the Ministry of the Economy of €126,500), which is 52.1 percent higher relative to the previous two years.

Timetable for implementation of the measure:

a. **Activities planned in 2019:** Component 1: Fostering new investments in manufacturing and in the services sector, expansion or diversification of the existing manufacturing capacities, focusing on creating new jobs – Competent institution: Ministry of the Economy/Secretariat for Development Projects. Component 2: Fostering investments in technological modernisation through the procurement of new or used manufacturing equipment, and new parts/specialised tools necessary for putting unused machines into operation – Competent institution: Ministry of the Economy/Investment and Development Fund of Montenegro.
b. **Activities planned in 2020:** Further implementation of programme activities.
c. **Activities planned in 2021:** Further implementation of programme activities.

Expected impact of the measure on competitiveness: Investing in the construction of new or expansion of the existing industrial capacities and investing in new technology and modernisation of industry will contribute to an increase in the quality and quantity of production, an improvement in operational performances, diversification of the product range and creation of new jobs. Implementation of the measure in its full capacity should, in the medium term, contribute to an increase in the share of industry in GDP, an increase in the Gross Value Added of the processing industry, its export potential, as well as to an improvement in the ranking in the Global Competitiveness Index.

Key performance indicators (KPI): The performance indicators for this measure, in terms of results, are the number of concluded contracts/accepted applications for the public call, the amount of granted subsidies and the number of job positions envisaged in the contracts for implementation of investment projects, in the part of the component's measure which has a direct impact on employment. At the level of the impact indicators, performance is measured by increasing the scope of investments in the industrial sector.

KPI	2018	2019	2020	2021
Number of concluded contracts/accepted applications	7	14	20	25
Amount of granted subsidies	€456,500	€1,200,000	€1,900,000	€2,250,000
Number of positions envisaged in the contracts for implementation of investment projects	90	200	250	300

Estimated costs of the measure/activity and budgetary impact: In 2018, no contracts were concluded for activities that involve fostering investments which contribute to employment, while subsidies granted for payment of the third tranche on the basis of implementation of the already initiated projects amounted to €330,000.[25] In 2018, seven applications for implementation of activities aimed at technological modernisation were accepted, while the subsidies amounted to €126,500. The additional costs for implementation of Component 1 of the measure in 2019 will amount to €720,000 and, for implementation of Component 2, will amount to €23,500. The total budget allocation for implementation of the measure in 2019 is €1.2 million. The budgetary allocation envisaged for implementation of the measure in 2020 will amount to €1.9 million, while in 2021 it will be €2.25 million.

Expected impact on employment and gender equality: Component 1 has a direct impact on employment[26], where the financing of investments projects is set which create new jobs for an indefinite period in those positions in which the investment project is implemented, while placing the focus on underdeveloped areas and equitable development of the country. The effects of the initiated implementation of six projects in 2016 include 285 newly employed for an indefinite period, with the obligation that the beneficiaries of funds maintain the number of newly employed continuously for at least 3-5 years (depending on the size of company) after implementation of the investment project is finalised. From a gender-equality perspective, this measure is assessed as neutral.
Potential risks: For Component 1, the risk to the efficient implementation of the measure includes the quality of the applications that are filed and the quality of documentation necessary to participate in the public call, while there is also the risk of defaulting on contractual commitments; for Component 2, the original risk of insufficient interest among business entities has been successfully eliminated and the measure is being implemented at a satisfactory pace, without any risks at the moment.

Priority Reform Measure No. 5: Supporting investments in the food production sector in order to reach EU standards

Description of the measure: This measure supports the **establish**ing of new plantations of agricultural crops, expansion of the livestock population, procurement of specialised machinery, construction and reconstruction of primary production facilities, procurement of processing equipment, construction and reconstruction of facilities for processing agricultural and fish products, with the aim of improving food safety standards and the health and welfare of animals and plants, through gradual harmonisation with the EU's food quality and food safety standards. This measure is being implemented in line with the 2015–2020 Strategy for Development of Agriculture and Rural Areas and the 2016–2020 Programme for Development of Agriculture and Rural Areas (IPARD).

Timetable for implementation of the measure: This reform measure is split into two activities: "Investment in physical capital of agricultural holdings" and "Investment in physical capital in relation

[25] Two instalments of €120,000 are still to be paid out.

[26] The amount of funds for incentivising investments ranges from €3,000 to €10,000 per newly employed person and is determined on the basis of the criteria laid down by the programme line which include references from a business entity, the value of investment project, effects on research and development, human resources, the environment, economic effects and effects on regional development, the volume of international trade, etc.

to processing of agricultural and fish products". Investments will be realised in 2019, 2020 and 2021. Even though the IPARD programme covers the period 2015–2020, the spending of funds will continue until 2023.

Expected impact on competitiveness: The measure will contribute to an increase in production in the primary and processing sectors. A better supply of the processing sector with domestic raw materials will contribute to an increase in the value added of production, as well as to a reduction in import dependency and to greater competitiveness of domestic products. In the past couple of years, an increase in exports of dried and smoked meat, meat products, fruit, wine, beer, alcoholic beverages and aromatic oils has been recorded.

Key performance indicators (KPI): The effects of the success in implementing this measure may be analysed on the basis of the number of filed applications, the number of **realized investments**, the value of realised investments, the surface area of new plantations, the number of newly constructed facilities in primary production and the number of facilities operating with food that have reached EU standards.

Estimated costs of the measure/activity and budgetary impact: The support planned for 2019 totals €20 million, of which IPA funds account for €9 million, private sources €8 million and the national contribution €3 million. The support planned for 2020 totals €22 million, of which IPA account funds account for €10 million, private sources €8.8 million and the national contribution €3.2 million. The support planned for 2021 totals €25 million, of which IPA funds account for €11.3 million, private sources €10 million and the national contribution €3.7 million.

Expected impact on employment and gender equality: The social outcome of the measure is reflected in fostering women and young people by assigning higher scores during project evaluation to the projects they implement, which encourages them to start businesses in the food production sector and stimulates the creation of new jobs.

Potential risks: Implementation of the proposed measure depends on the availability of loan support to the producers, since investments are 100 percent pre-financed by producers who are refunded 50–60 percent of the investment value upon finalisation of the investment. These rules are statutory and harmonised with the relevant EU rules. Access to funding will be facilitated through legislative amendments which refer to the recognition of land in rural areas as collateral and the establishment of an electronic property register. Moreover, the Investment and Development Fund has developed a special credit line to address the issue of farmers who have no access to loan funds, while the plan is to set up a guarantee fund which will be available to all farmers for the purpose of pledging collateral. Farmers/producers may use various sources of funding (banks, microcredit organisations, etc.) to finance investments.

Amount in € millions	2019	2020	2021
Total for IPARD II programme	20.0	22.0	25.0
National contribution	3	3.2	3.7
IPA	9	10	11.3
Contribution of agricultural producers	8	8.8	10

Priority Reform Measure No. 6: Diversifying the tourist product

Description of the measure: Diversifying the tourist product means the development of different forms of tourist offers depending on the potentials of the regions, so that they are synergistically unified into a single product that will serve the purpose of achieving the strategic goal of tourist development, i.e. positioning Montenegro on the world tourist map as a high-end, year-round tourist destination.

The measure is implemented through activities involving the development of nature-oriented tourism, including cultural, rural, health, nautical, sports and other forms of tourism, and the development of a tourist product for selected target groups of tourists.

Activities within this measure focus on more intensive development of the northern and central regions of Montenegro, as well as on their merging with the offer of the coast into a single product, with the aim of boosting competitiveness of Montenegro as a tourist destination at the regional and global levels. Activities within this measure are implemented in compliance with the principle of sustainability (correlation with the National Sustainable Development Strategy). One of the results of the improvement and diversification of the offer in the northern and central regions is an increase in the number of new jobs, an increase in tourist traffic (number of tourists, overnight stays and revenues from tourism), reduction of migration from the northern to the southern regions and an improved standard of living of the population (correlation with the Millennium Development Goals).

The implementers of the activities within the measure are predominantly small and medium-sized enterprises, in which the conditions are created to employ a large number of women and young people (correlation with the EC's Recommendation No. 6).

Timetable for implementation of the measure:

a. **Activities planned in 2019** – Hiking and biking, panoramic routes of Montenegro, Tourism Incentive Programme, All the Wonders of Montenegro (MSDT)
b. **Activities planned in 2020** – Hiking and biking, panoramic routes of Montenegro, Tourism Incentive Programme, All the Wonders of Montenegro (MSDT)
c. **Activities planned in 2021** – Hiking and biking, panoramic routes of Montenegro, Tourism Incentive Programme, All the Wonders of Montenegro (MSDT)

Expected impact of the measure on competitiveness: Tourism is one of priority sectors of Montenegro's economy, particularly due to its export component, i.e. the fact that 90 percent of tourist turnover is generated by foreign tourists. Implementation of the measure will result in extension of the duration of the tourist season which will further have an impact on increasing the utilisation of accommodation capacities and the creation of new jobs.
The measure will also contribute to raising awareness about sustainable development of the environment (because it constitutes the foundation for the sustainable development of tourism), primarily through making good use of natural potentials and cultural and historical heritage in the tourist sector.

Continuous improvement of the tourist product is expected to further expand the export component of tourist services, with multiplier effects on other economic sectors: transport, agriculture, trade, etc. The trend of an increase in the number of tourists, overnight stays and revenues generated from tourist spending is expected to continue, while the growth (both direct and indirect) of the total share of tourism in GDP is expected to increase in the coming 10-year period at the average annual rate of around 3.9 percent (according to the World Travel and Tourism Council's report).

Implementation of this measure is boosting Montenegro's competitiveness as a tourist destination, not only in the region, but also beyond it, because it is creating a unique product (the offer of all the regions of Montenegro is integrated), i.e. tourists are offered quite a diverse experience in a relatively short period, due to the geographical characteristics of the country.

Key performance indicators (KPI): The key performance indicators for implementation of the measure are an increase in the number of tourists and number of overnight stays in the hinterland away from the coast (i.e. in the central and northern regions of Montenegro):

Montenegrin hinterland (northern and central regions)	Index 2019/2018	Index 2020/2019	Index 2021/2020
Number of tourists	101	102	103
Number of overnight stays	102	103	104

As for performance indicators, one must be aware that the tourist product is quite a complex product – when it comes to performance in tourism, one has to be aware of its specificity, i.e. its multiplier effect on other economic sectors (it contributes to the greater scope of operations in other economic sectors: agriculture, transport, trade, telecommunication, etc.).

Estimated costs of the measure/activity and budgetary impact: As for implementation of the activities mentioned for 2019, the additional cost of implementation of the measure amounts to €189,000. This amount is envisaged in the budget.

Expected impact on employment and gender equality: Since tourism is a labour-intensive activity, it is expected to make an increased contribution to the total number of employed (among whom women account for a large share), which also contributes to the economic empowerment of women (correlation with the Strategy of Development of Women's Entrepreneurship and activities aimed at achieving gender equality). According to the forecasts for the coming 10-year period, the share of the total number of employed in the tourist sector (both, directly and indirectly) in the total number of employed people is expected to increase at a average annual rate of 1.3 percent, while a significant number of new jobs are expected to be created in underdeveloped areas.

Potential risks: The risks to the implementation of the measure are primarily related to the execution of plans within the set time limits, having in mind the obligation to conduct tender procedures, which may ultimately lead to the funds not being spent for the purposes they were allocated for. Measures for mitigation of the negative effects will be implemented by establishing public–private partnerships and ensuring more efficient use of EU funds.

Priority Reform Measure No. 7: Enhancing the framework for prudential supervision and solvency of banks

Description of the measure: In order to enhance the framework for prudential oversight and resolution of banks which fosters financial stability, a radical reform of the regulatory framework governing banking operations will be conducted in the process of harmonisation of legislation with the new EU law in the area of financial services, in accordance with the timeframe set out in the 2019–2020 Programme of Accession of Montenegro to the EU. For that purpose, a set including three laws will be adopted: the Law on Credit Institutions, the Law on the Resolution of Credit Institutions and the Law Amending the Law on Bankruptcy and Liquidation of Banks, and after that the Law on Supplementary Supervision of Financial Conglomerates will be adopted as well. This is in line with Recommendation No. 3 of the Joint Conclusions from the meeting of EU ministers and Western Balkan countries held in May 2018.

Timetable for implementation of the measure:

a. **Activities planned in 2019:** Adoption of the Law on the Resolution of Credit Institutions which will implement Directive 2014/59/EU establishing a framework for the recovery and resolution of credit institutions and investment firms (BRRD Directive); adoption of the Law on Credit Institutions which will implement Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms and Regulation No. 575/2013/EU on prudential requirements for credit institutions and investment firms, including preparation of a part of secondary legislation for the implementation of that law; adoption of the Law Amending the Law on Bankruptcy and Liquidation of Banks.

b. **Activities planned in 2020:** Adoption of a set of secondary pieces of legislation for implementation of the Law on the Resolution of Credit Institutions and the Law on Credit Institutions; adoption of the Law on the Supplementary Supervision of Financial Conglomerates which will implement Directive 2002/87/EC on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate.
c. **Activities planned in 2021:** Adoption of a piece of secondary legislation for implementation of the Law on the Supplementary Supervision of Financial Conglomerates.

The institution competent for implementation of the activities mentioned above is the Central Bank of Montenegro, while supplementary supervision of financial conglomerates is also the responsibility of the Central Bank, but also of the Capital Market Commission and Insurance Supervision Agency.

Expected impact on competitiveness/rationale of the measure: Through the harmonisation of the regulatory framework with the EU law governing banking operations, this measure will contribute to the strengthening of financial stability and the creation of a more favourable business environment in Montenegro.

Key performance indicators (KPI): The following performance indicator will be used for monitoring and evaluating the effects of reform measures: adopted legislation.

Estimated costs of the measure/activity and budgetary impact: Implementation of the measure does not require funds from the budget of Montenegro. Activities are carried out with the EU financial support through the IPA 2014 Twinning project – Support for Financial Services Regulation.

Expected impact on employment and gender equality: There is no direct impact on employment, but there is the possibility of a positive indirect impact on employment in the banking and real sectors, as a consequence of the creation of a stable and more favourable business environment. There is no impact on gender equality.

Potential risks: In order to minimise the risks of not adopting the legislation mentioned above, a one-year period has been envisaged for implementation of procedural activities, such as establishing a proposal for a legal text by the competent ministry and its submission to the Parliament of Montenegro for adoption.

4.3.3 The business environment and reduction of the informal economy

Analysis of main obstacles: Obstacles in this area include business barriers to economic operations and the existence of a certain share of the informal economy which disrupts local competition and has an unfavourable impact on the government budget. In addition to administrative barriers which have been continuously eliminated for the purpose of improving the business environment, one of the obstacles which exist to a certain extent is the access of business operators to financing, which particularly refers to the small and medium-sized enterprise sector.

Even though the financing of micro, small and medium-sized enterprises (MSMEs), in the form of credit support, is largely used by different categories of business start-ups and the existing MSMEs, obstacles also include the insufficient availability of other financial instruments which correspond to the needs of MSMEs, such as: grants, which strengthen productivity and the efficiency of operations; innovation;

internationalisation of enterprises; and mutual cooperation and networking. Start-ups face restrictions with regard to preparation for their establishment, the possibilities of initial financing and monitoring and support for the work of enterprises in the first years of operation, which calls into question the survival of start-ups and the growth, innovation and the competitiveness of MSMEs on international markets.

In addition, the Government has focused on elimination of the obstacles to strengthening the business environment, such as: improving the efficiency of state administration; reduction of the costs of administrative procedures; and reduction of their duration. Montenegro, as a safe, economically sustainable and politically stable state with the potential for further economic growth, will make targeted efforts to stimulate further improvement of the business environment.

The results described in the Global Competitiveness Report, the Report on the Index of Economic Freedoms prepared by the Heritage Foundation and Fraser Institute and announcements made by the credit rating agencies S&P and Moody's concerning Montenegro's credit rating are confirmation of the reform efforts made by the Government of Montenegro in maintaining the stability of public finances and implementing the measures set out by the fiscal strategy.

Analysis of the current business environment has revealed that, under the valid legislative framework, citizens and the economy are exposed to high expenditure for numerous administrative charges and that there are numerous payments. This causes negative implications for the operations of business entities as it creates additional costs and the need to allocate additional time to complete numerous prescribed procedures. Besides the economy, citizens are also burdened with high expenditure and they also need to allocate additional time to pay for the necessary charges. An additional problem is also caused by frequent amendments to laws which mainly introduced new charges or increased the existing ones, thus causing a negative impact on the predictability of the existence of a charge and of its amount.

Further improvement to the business environment requires a further increase in efficiency in conducting public procurement procedures for both public and private parties, while additional harmonisation with EU rules is also required. An efficient public procurement system is necessary to achieve the goals of a free market and to create conditions for market competition.

Moreover, in line with the obligations of the negotiation process with the EU, "Montenegro must harmonise its legislative public procurement system with EU law in all areas, focusing strongly on the areas of concessions, public–private partnerships (PPP) and procurement in the defence sector". This also requires preparation of the Strategy for the Development of Public–Private Partnerships in Montenegro, as a complementary document to the 2016–2020 Strategy for Development of the Public Procurement System in Montenegro.

Under the current regulatory framework in Montenegro, public–private partnerships are recognised in some of the legislation in this sector, but there is no established overarching legislation that would address all the issues relevant for investments of this type. As for investment in Montenegro, particularly in areas that are important for performing affairs of public interest, it is believed that the adoption of legislation which would regulate this area would also send a message to the private sector about the readiness of public services to embark on the joint performance of certain tasks. This primarily refers to healthcare, education and utilities, and well as to the realisation of capital investments in the transport sector.

Report on implementation of the Policy Guidelines of May 2018: With Recommendation No. 5 given at the Ministerial Meeting held in May 2018, Montenegro was recommended to adopt laws on concessions and public–private partnerships in line with EU rules and best practices, accompanied by an action plan for institutional capacity building in this area. For that reason, the aim of adoption of the

Law on Public–Private Partnerships, the draft version of which was prepared and agreed upon with the European Commission, is to ensure integrated regulation of this area with regard to the conclusion of public contracts as concessions for public works, or as concessions for public services, and the conclusion of other contracts on public–private partnerships for public works and public services. The Law on Public–Private Partnerships needs to harmonise this area with the requirements set out by European directives and to bring into our regulatory system best practice in the conclusion of contracts on public works and public services through all forms of public–private partnerships. In parallel with this law, draft amendments to the Law on Concessions were also prepared regulating concessions and licences for natural resources in line with the best European practices. Moreover, the drafting of the new Law on Public Procurement is in its final phase, which will achieve full alignment with the relevant EU Directive.

Priority Reform Measure No. 8: Implementing the new regulatory framework of the policy on public–private partnerships Law and amending the Law on Concessions

Description of the measure: The new investment model to be introduced into Montenegro's regulatory system through adoption of the Law on Public–Private Partnerships includes the concept of joint investment by the state and the private sector through public–private partnerships, and certain new concepts, such as works concessions and services concessions. Implementation of the legislative framework requires the creation of institutional preconditions and preparation of a strategic document which will systematically establish further steps for improving public procurement policy, while focusing on public–private partnerships. It has to be especially recognised that the institutions envisaged to drive the development of public–private partnerships as a new policy should be properly prepared through activities that ensue after adoption of the law. This particularly refers to the line institutions that will be leading public–private partnership projects, as well as to the local governments and business organisations and legal entities performing affairs of public interest. As for the new policy on public–private partnerships and obligations that will fall within the competence of the Montenegrian Investment Agency and Ministry of Finance, the strategic goals must determine the activities regarding administrative capacity building and preparation of methodologies and manuals for implementation of public–private partnership projects. In addition to the adoption of the Law on Public Private Partnership and its alignment with the EU *acquis*, that will govern concessions for works and concessions for services, a new Law on Public Procurement will also be adopted in 2019. In addition to that, amendments will also be made to the Law on Concessions, which will govern concessions on natural resources.

Timetable for implementation of the measure:

a. **Activities planned in 2019:** Adoption and commencement of implementation of the Law on Public–Private Partnerships, the new Law on Public Procurement and amendments to the Law on Concessions. Providing expert assistance in adopting secondary legislation on the basis of the Law on Public–Private Partnerships, preparation of a strategic document based on the experiences of the EU member states that constitute best practice, which is an important precondition for preparation of the document. In that regard, an overview of the current condition focusing on the new regulatory framework is particularly important for those that will be preparing the strategic document. The aim of the aforementioned is to strengthen the promotional message of the state, while expressing readiness for new investments on the basis of this model. Training and informing the line institutions, local governments and the private sector about the new regulatory framework needs to be envisaged as preparation for the identification of further steps in formulating this policy. Preparation of the strategic document for public–private partnerships with the activities set out in it for the next medium-term period should be finalised with its adoption by the end of 2019 and would complement the Strategy for Development of the Public Procurement System by the end of 2020. Application of the new

Law on Public Procurement will function within the new institutional framework, in line with the process of the public administration reform aligned with the best EU practices.

b. **Activities planned in 2020:** Implementation of the measures should first start with training public institutions so as to prepare capacities for implementation of the new legislative framework for public–private partnerships. In that segment, expert assistance will be provided in designing methodologies and manuals for preparation and implementation of public–private partnership projects. Evaluation and preparation of the reports on achievement of the strategic goals set for 2020, along with implementation of the measures envisaged for this period in the strategic document.

Expected impact of the measure on competitiveness: Implementation of the measure will contribute to creating a clear framework of the Government's policy, the aim of which is to promote this type of investment, follow the principles and meet the requirements in this area, in line with the best practice and provisions of EU directives.

Key performance indicators (KPI): The indicators for 2019 are: the Law on Public–Private Partnerships adopted; secondary legislation passed and the strategy for this area adopted. Likewise, the adopted new Law on Public Procurement and amended Law on Concessions.

Estimated costs of the measure/activity and budgetary impact: Implementation of the measure requires funds of €70,000 for the activities indicated below:

Activities	*Implementer of the activity*	*Starting date*	*Planned ending date*	*Cost estimate*	*Reference to the source of funding*
Review of the existing legislative framework for PPP and public procurement and of relevant secondary legislation in order to harmonise them with EU law	*Ministry of Finance*	*2019*	*Q2*	*€10,000*	*Donor support*
Preparing draft secondary legislation (including forms, standardised tender documentation, contract models and manual)	*Ministry of Finance / Investment Agency of Montenegro*	*2019*	*Q2/Q3*	*€20,000*	*Donor support*
Organising training courses for civil servants involved in the PPP process	*Ministry of Finance*	*2019*	*2020*	*€20,000*	*Donor support*
Training material for special target groups involved in public procurement	*Ministry of Finance*	*2019*	*2019/20*	*€10,000*	*Donor support*
Conducting an awareness-raising campaign to inform the public	*Ministry of Finance / Investment Agency of Montenegro*	*2019*	*2019/20*	*€10,000*	*Donor support*

At the same time, it is expected that implementation of the measure will be supported by the European Commission and European Bank for Reconstruction and Development (EBRD), as a continuation of the support for introduction of the regulatory framework for public–private partnerships.

Expected impact on employment and gender equality: The measure has a direct impact on employment, as it contributes to the development of new forms of investment, as well as to the innovation, establishment and expansion of the sector for the performance of public works and public services, thus creating new jobs. This measure also contributes to the creation of a new framework for development of sectors in which implementation has been mainly the responsibility of the public sector, whereas the private sector will be involved in the implementation of public–private partnerships.

Priority Reform Measure No. 9: Adoption and implementation of the Law on Administrative Fees

Description of the measure: Since the business environment is burdened with numerous administrative barriers, an initiative was launched to draft a new Law on Administrative Fees so as to improve the business environment. Recognising the fact that the Ministry of Finance decided to carry out a comprehensive analysis of the valid provisions and new provisions proposed by the line institutions, activities were launched to draft the new law with the aim of improving and enhancing economic activities.

A particular problem in the implementation of the existing law includes high administrative fees and the large number of these (659 fees from the Law in force), which is constantly being voiced by representatives of business associations in Montenegro.
As a result of this problem, in the application of the existing law there are high costs for businesses, particularly for small and medium-sized enterprises, and for citizens as well; there are also a large number of payments. This creates negative implications for the operation of business entities as it creates additional costs and requires time to complete the numerous statutory procedures. Besides businesses, this also has a negative impact on citizens who also pay additional costs and need to allocate additional time to paying the required charges. Another problem includes the frequent amendments to the laws, which mainly introduced new fees or increased the amount of the existing ones, which has had a negative impact on the predictability of the fees and of their amount. The most recent amendments to the law proposed the reduction for 72 fees (11% of total amount of fees), which is an important step for improvement of the business environment.

Timetable for implementation of the measure:
Activities planned in 2019: Establishing a proposal for the Law on Administrative Fees and its adoption in parliamentary procedure;
Activities planned in 2020: Full implementation of this law.

Key performance indicators (KPI): The key performance indicator in 2020 is the ranking on the Doing Business list as a result of implementation of the law.

Expected impact of the measure on competitiveness: Implementation of this law should lead to a reduction in the costs paid by businesses and should also save time. Therefore, a positive impact on competitiveness may be expected.

Estimated costs of the measure/activity and budgetary impact: Implementation of the measure does not require additional budgetary funds. It is expected that the abolition of certain charges will impact the reduction of budget revenues by approximately €2 million, which will be offset by the revenues from charges on document replacement (passport and identity cards) as early as in 2019.

Expected impact on employment and gender equality: It is expected that the costs of business operations will be reduced, which will create room for the registration of new businesses and the creation of new jobs and, by doing so, an increase in budgetary revenues.

Potential risks: No potential risks were identified in the implementation of the measure.

Priority Reform Measure No. 10: The Law on Issuing Electronic Fiscal Invoices in the Trade in Products and Services and implementing the electronic fiscal invoices system

Description of the measure: This priority reform measure is transferred over from last year. The Implementing Study into the Feasibility of the Electronic Fiscal Invoices System was produced in cooperation with the World Bank. One of the conclusions in the study states that a tax gap exists in Montenegro and that there is significant room for the collection of additional public revenues. In the period from 10 September to 10 October 2018, the Ministry of Finance conducted a public consultation on the text of the draft law. Several roundtable discussions were held during the public consultation, in which resistance was recognised on the side of taxpayers, who stated that the following items were the main shortcomings of the new electronic fiscal invoices system: the high amount of implementation costs, insufficiently clear rules for issuing fiscal invoices in wire transfers (non-cash payments), coverage with internet access, etc. The recognised shortcomings that need to be eliminated led to extension of the planned implementation deadlines. Adoption of the new law in 2019 is also connected with fulfilling the requirements for the World Bank PBG2 guarantee.

Timetable for implementation of the measure:

a. **Activities planned in 2019:** Establishing the proposal for the Law on Issuing Electronic Fiscal Invoices in the Trade in Products and Services and its adoption in parliamentary procedure.
b. **Activities planned in 2020:** Testing the system and partial introduction of the data submission process by sectors.
c. **Activities planned in 2021:** Full implementation of the electronic fiscal invoices system and use of this system by all sectors.

Key Performance Indicators (KPI): In 2019, the key performance indicators are the adoption of the Law on Issuing Electronic Fiscal Invoices in the Trade in Products and Services in the parliamentary procedure, adoption of including secondary legislation, as well as successfully completed testing of the system. Also, the partial introduction of the system.

Expected impact of the measure on competitiveness: Competition from the informal sector is a huge obstacle to taxpayers who are operating legally. This measure would address this issue by expanding the scope of taxable transactions through a more efficient control mechanism available to tax inspectors and better risk analysis, which would reduce the scope of illegal operations of competition from the informal sector.

Estimated costs of the measure/activity and budgetary impact: The total estimated costs for implementation of the electronic fiscal invoices system are: €2.5 million in 2019 and 2020 for the procurement of the necessary hardware and development of the necessary software and for consulting services. The project is planned to be financed from budgetary funds. According to the Feasibility Study produced in cooperation with the World Bank, the expected increase in revenue in the most important tax forms would range from €13 million to €17 million, while revenue is expected to rise further once the system becomes fully operational.

Expected impact on employment and gender equality: The scope of informal sector in the area of employment is expected to shrink in the case of adoption of the solution which will link data on fiscal device operators to the data on taxes and contributions paid.

Potential risks: The current model of fiscal devices would be replaced once an electronic fiscal invoice system is introduced, which is why distributors of the existing fiscal devices might show some resistance to the implementation of this system, because this may impact their businesses. Transition to the new system will incur certain costs for taxpayers who own fiscal devices and who will not be able to adjust to the new system, as a result of which this group of taxpayers might also show some resistance during implementation.

Priority Reform Measure No. 11: Improving support for the sector of micro, small and medium-sized enterprises

Description of the measure: Support for the MSME sector, which includes improving access of MSMEs to sources of financing, is the measure set out in the 2018–2022 Strategy of Development of Micro, Small and Medium-Sized Enterprises, 2018–2021 Development Directions and the recommendations of the EU's Small Business Act (SBA). Reform Measure No. 11: *Improving support to the micro, small and medium-sized enterprises sector* is formulated in the 2019–2021 ERP as a combination of Reform Measures No. 12: *Improving financial support to the small and medium-sized enterprises* and No. 13: *Improving non-financial support to small and medium-sized enterprises* from the 2018–2020 ERP, while financial support from Montenegro's Investment and Development Fund of Montenegro, outlined in the previous documents, is provided continuously and more detailed implementation is elaborated in the report (412 loan facilities and €209.4 million were invested in the period from 1 January to 31 December 2018).

Support for the MSME sector will focus on further improvement of the possibility to provide financial assistance, particularly for the purposes of strengthening innovation, grouping in clusters, introducing international standards, strengthening support for setting up enterprises and ensuring smooth development and a reduction in the number of failed businesses.

The reform measure includes implementation of several grant programme lines for MSMEs, as follows: a) the Programme Line for Improving Innovation, which will provide grants for MSMEs up to €3,500 for implementation of innovation activities with assistance from consultants and in cooperation with science and research institutions, science and technological park, centre of excellence, innovation and entrepreneurship centre, business incubators and consulting firms; b) the Programme Line for Introduction of International Business Standards, which will provide grant support up to €5,000 for MSMEs, for the purpose of achieving compliance with international standards for products and services, management systems, staff, testing, control and certification, as well as for obtaining accreditation for conformity assessment; c) the Programme Line for Cluster Development, which will provide grant support up to €15,000 to innovative clusters for the purposes of fostering innovative activity, exchanging knowledge and competence, networking, promotion, dissemination of information and cooperation between enterprises and other organisations within the cluster. These activities represent a part of the Programme for Improving the Competitiveness of the Economy for 2019. Furthermore, preparatory activities for implementation of the pilot grant scheme for innovative MSMEs and clusters will be implemented from IPA 2014, while the continuation of implementation will be carried out under IPA 2016. In addition, the Investment and Development Fund of Montenegro will start with implementation of credit guarantees within the LGF COSME programme and promotion and strengthening of investment readiness of innovative start-ups in order to improve the use of ENIF fund within WB EDIF.

Implementation of the following non-financial-support activities has been envisaged as support for establishing new enterprises and for the solving issues in operations, as well as improving cooperation with partners: a) the Programme Line for Support to Entrepreneurship which is a combination of non-financial and financial support, through organising a cycle of educational and training courses; and b) the Programme Line for the provision of Mentoring Services, as a form of direct work with enterprises for the purposes of analysing the current situation, providing support for the preparation of development plans and for their implementation and establishing business cooperation. These activities represent a part of the Programme for Improving the Competitiveness of the Economy for 2019. Special support for the internationalisation of MSMEs will be provided through the services of the EEN Montenegro (COSME programme), in the segment of provision of advisory services regarding international markets, technology transfer, organisation of training courses for strengthening export opportunities and involvement in value chains, connection between businesses, etc. Moreover, technical assistance will be provided to clusters in order for them to develop projects, with which they will apply for the Programme Line for Cluster Development. With the objective of improving access to financing sources for MSMEs and strengthening private sector development through advanced advisory services, a technical support is planned as part of IPA 2016.

Timetable for implementation of the measure:

a. **Activities planned in 2019:** Implementation of programme lines[27] for financial support in the form of grants: a) the Programme Line for Improving Innovation, for 2019; b) Programme Line for introduction of International Business Standards; c) The Programme Line for Cluster Development d) the preparation of Pilot grant scheme for innovative MSMEs and clusters (IPA 2014) - institution competent for implementation of the activities is the Ministry of the Economy e) Implementation of LGF COSME credit guarantees and promotional activities and training courses on how to use instruments for investing in equity capital of ENIF fund – the institution competent for the implementation of activities is the Investment and Development Fund of Montenegro. Implementation of the non-financial support programme lines: a) the Programme Line for Support to Entrepreneurship – the institution competent for implementation of activities is the Ministry of the Economy, in cooperation with the Investment and Development Fund of Montenegro; b) the Programme Line for the provision of Mentoring Services; c) the provision of advisory services of EEN Montenegro – the institution competent for the implementation of activities is the Ministry of the Economy.
b. **Activities planned in 2020:** Continuation of the implementation of programme lines for financial support in the form of grants and programme lines of non-financial support to MSMEs from 2019, implementation of pilot grant schemes for innovative MSMEs and clusters (IPA 2014), technical support for improvement of sources of financing for MSMEs and strengthening private sector development though advanced advisory services (IPA 2016) – the institution competent for the implementation of activities is the Ministry of the Economy in cooperation with the Investment and Development Fund of Montenegro.
c. **Activities planned in 2021**: Development and implementation of the programmes for financial and non-financial support to MSMEs from national and international sources.

Expected impact of the measure on competitiveness: Implementation of the measure will contribute to a higher share of MSMEs in exports and in GVA, which will have an impact on improving the competitiveness of the economy. A better rating in terms of the WEF indicator *Financing of SMEs and Innovation Capability* is also expected.

Key performance indicators (KPI): The performance indicators for the measure mentioned above in terms of results are: the number of approved projects, the value of granted subsidies and the number of training courses. In terms of impact indicators, performance will be measured by the increase in the number of MSMEs and investments by MSMEs in innovation.

KPI	2018	2019	2020	2021
Number of projects approved to MSMEs	52	65	85	100
Value of granted subsidies	€231,379.82	€340,000.00	€700,000.00	€900,000.00
Number of training courses	5	8	15	25

Estimated costs of the measure/activity and budgetary impact: In 2018, a total of €421,643.37 was spent (on 52 grant award projects – financial support of €231,379.82 and 5 training courses and other forms of non-financial support of €190,263.55). The additional costs for implementation of the measure in 2019 amount to a total of €335,919.58, whereby part for the financial support amounts to €108,620.18, while non-financial support amounted to €227,299.40.
The total amount planned for implementation of the reform measure in 2019 is €757,562.95 (financial support for grants is €340,000.00, non-financial support is €417,562.95). In addition to the at least same

[27] Programme for Improving the Competitiveness of the Economy for 2019.

amount of Budget funds planned for 2020 and 2021, implementation of financial and non-financial activities is also planned: IPA 2014, amounting to €75,000 and as part of IPA 2016[28] with the indicative amount of €2,200,000, while for 2021 an indicative amount of €700,000 is planned under IPA 2016 funds.

Expected impact on employment and gender equality: The measure has an indirect impact on employment, since it contributes to the development of the business operations of MSMEs, and to the innovation, creation and expansion of export opportunities and, consequently, to the creation of opportunities for new jobs. It also contributes to improving the innovative and development capacities of the employees. This measure also contributes to the establishment of new enterprises, to their survival and development through making connections and participating in business networks and value chains. The focus is on the implementation of projects by women and young people, and on projects implemented in the northern region and in less developed municipalities.

Potential risks: An insufficient level of information about procedures and insufficient demand by MSMEs, a demanding application procedure, insufficient interest in the training and establishment of enterprises.

4.3.4 Research, development and innovation (RDI) and the digital economy

Analysis of the main obstacles: Montenegro has made great effort in this area to create a more favourable, stimulating sustainable, innovative and developing environment. In that regard, the main direction to be followed is smart specialisation, i.e. development and the use of innovation to foster economic growth and competitiveness by using the existing knowledge base and competences.

According to the 2018 ERP's Global Innovation Index, Montenegro ranked among the 20 countries that achieved better results in innovation in comparison to their level of development. It has the lowest ranking in respect of Knowledge and Technology Outputs.

One of the identified challenges is a lower level of investment in research and development (R&D), which has a significant impact on the competitiveness of the research and innovation community in the international arena. According to the latest official data, the total national spending on R&D in 2016 accounted for 0.32 percent of GDP. The business/entrepreneurial sector in Montenegro accounts for a relatively small share in total spending on R&D – merely 0.05 percent of GDP in 2016, while the EU28 average for that same year amounted to 1.32 percent. Available data reveals that this sector still makes little investment in R&D, which has an impact on the innovative potentials of enterprises, i.e. on the possibility to create new products and services, as well as on their capacity to absorb technologies from abroad, which significantly impedes the commercialisation of innovation. This indicates a need to strengthen financial instruments for research and innovation.

The level of only 1,509 researchers, and only 624 researchers, if expressed in terms of full-time equivalent, makes up a small share in the total population of Montenegro, which is why the main focus is placed on strengthening human resources and research capacities. Universities, in which the majority of researchers are employed, are primarily oriented towards teaching, while research activities are performed during regular working hours. The business/entrepreneurial sector employs around 7.75 percent of all people engaged in R&D, while the share of employing researchers is even lower. All this results in a weaker intensity of scientific results and of the production of high technologies.

[28] The funds for IPA 2016 stated here are indicative in nature until final adoption of the Action Document for the Competitiveness and Innovation sector and will be precisely defined after tender procedure is successfully completed.

As the Global Competitiveness Index ranked Montenegro 48th out of 137 countries in terms of technological readiness. The technology used in industry is obsolete and underdeveloped, characterised by low-end processing and a lack of development of high technology.

The brain drain of the best talents is another challenge to be addressed in the coming period.

Report on implementation of EC's recommendations of May 2018: Recommendation No. 4, given in the Ministerial Meeting held on 25 May 2018, refers to this reform area. As far as statistics are concerned, Montenegro is working actively to improve the quality of its R&D statistics, while in 2019 it will include a wide range of indicators in the segment of surveys for innovation statistics, which will enable Montenegro's inclusion into the EU Innovation Scoreboard. As a response to the recommendation concerning fiscal incentives for research and development and the issues identified in the reform area, priority was given to the comprehensive reform measure "Strengthening the national innovation ecosystem".

Thanks to the new EC instrument 'Policy Support Facility (PSF)', we have made some progress in this direction. Recently the Government of Montenegro adopted the Program of supporting innovative start-ups, which is indeed much broader and applies to all innovative activities. During 2018 many steps have been taken to solve the problems identified in this reform area. We are now acting to reach the goal of Strengthening the National Innovation Ecosystem. We are aware of all challenges, but we think that we are on a good way given that most probably Montenegro will be the first country outside the EU28 to adopt the S3 Strategy.

Priority Reform Measure No. 12: Improving the legislative-regulatory framework with the aim of reducing the costs of deploying high-speed electronic communication networks

Description of the measure: The conclusions of the Ministerial Meeting held in May 2018 contain a recommendation to develop a comprehensive action plan on broadband roll-out and coverage, based on a mapping of the infrastructure and an analysis of market interests. Moreover, it is recommended to implement Directive 2014/61 on measures to reduce the costs of deploying a high-speed electronic communications network, through adoption of the Law on Access to and Deployment of a High-Speed Electronic Communications Network.

The measure, i.e. adoption of the Law on Access to and Deployment of a High-Speed Electronic Communications Network, was included in last year's ERP. Since the Law on Spatial Planning and Construction of Structures adopted in Q3 2017 sets out a completely new concept of regulating this area, it needs to be harmonised with the Law on Measures to Reduce the Costs of Deploying a High-Speed Electronic Communications Network, the adoption of which is planned for Q4 2019. Moreover, on the basis of the Law on Spatial Planning and Construction of Structures, on 23 November 2017 the Government of Montenegro adopted the Decree on the content and manner of keeping documentary basis and information system and indicators for monitoring the implementation of planning documents. This decree sets out that a spatial documentary basis will be established within three years from the day of its entry into force. In fact, until the spatial documentary basis is established in the digital form, the Law on Access to and Deployment of a High-Speed Electronic Communications Network cannot be applied, since that system is the basis for its implementation.

Harmonisation of the Law on Access to and Deployment of a High-Speed Electronic Communications Network with the Law on Spatial Planning and Construction of Structures began in 2018. Adoption of this law will facilitate the deployment of high-speed networks across the entire territory of Montenegro, ensure good coordination and more efficient execution of construction works, thus reducing construction costs through an integrated and coordinated approach of all infrastructure operators.

The precondition for creating the national plan for broadband roll-out and coverage of the population with new-generation access networks is the finalisation of the already initiated process of mapping the telecommunication infrastructure in the system of the geo-referenced database of electronic communication infrastructure developed by the regulator. The mapping process is in progress and the plan is to finish it in 2019. On the basis of mapping, a precise and detailed picture of the current development of networks will be created, areas without broadband access will be identified, and conditions will be created for market potential testing in order to eliminate the existing gap in infrastructure, i.e. the zones of potentially failed market operations will be identified. In line with the results of this analysis, it is necessary to develop a national plan for broadband roll-out and coverage of the population with new-generation access networks, as well as the modalities of financing the further development of networks in public–private partnerships, also by using funds from the Western Balkan Investment Framework for financing infrastructure projects in the area of digitalisation.

Timetable for implementation of the measure:

a. **Activities planned in 2019**: Proposal for the Law on Access to and Deploying High-Speed Electronic Communication Networks established by the Government of Montenegro, completion of the mapping process, testing the market potential, drafting the national plan for broadband roll-out and coverage of the population with new-generation access networks.
b. **Activities planned in 2020:** Beginning of implementation of the law, completion of drafting of the national plan for broadband roll-out and coverage of the population with new-generation access networks, filing applications for financing projects from the funds.
c. **Activities planned in 2021:** Full implementation of the law, implementation of the national plan for broadband roll-out and coverage of the population with new-generation access networks.

Expected impact of the measure on competitiveness: The electronic communications market in Montenegro is based on competitiveness and transparency. Development of competitiveness in this area is an important factor for achieving goals, such as the broad scope of coverage and the quality of broadband internet access. Infrastructure mapping, implementation of Directive 2014/61 and development of the national plan for development of new-generation networks are measures which directly and strongly contribute to greater transparency of the data on the existing infrastructure and to the higher level of its utilisation, as well as to a reduction of costs and simplification of the procedures for the construction of the new infrastructure. All these measures will have a direct positive impact on development of competitiveness and development of the market in general.

Key performance indicators (KPI): % of coverage with new-generation networks

2019:
– Proposal for the Law on Access to and Deployment of a High-Speed Electronic Communications Network is established by the Government of Montenegro (Q4)
– Finalisation of the mapping process
2020:
– Adoption of the law in the Parliament of Montenegro, beginning of implementation of the law,

– Finalisation of the national plan for broadband roll-out and coverage of the population with new-generation access networks.

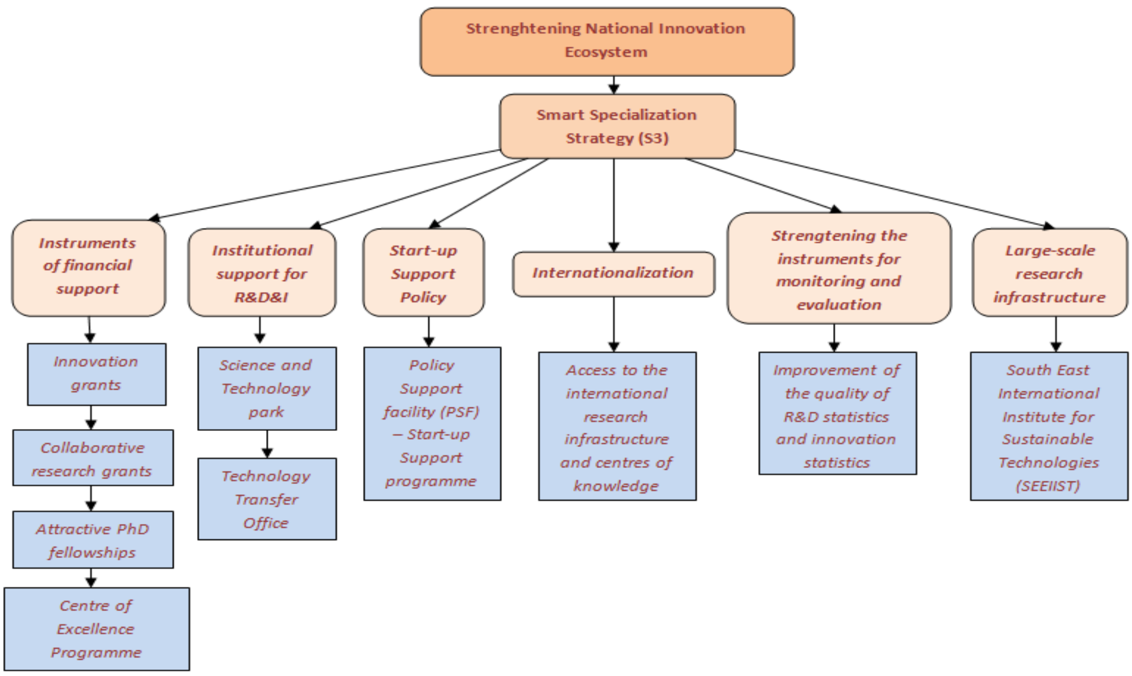
2021:
– Full implementation of the law
– Implementation of the national plan for broadband access roll-out and coverage of the population with new-generation access networks.

Estimated costs of the measure/activity and budgetary impact: Adoption of the law and preparation of the plan do not have an impact on the budget of Montenegro, whereas the later financing of the construction of infrastructure depends of the modality of public–private partnerships, i.e. the manner of financing, which will be specified in the national plan, depending on the availability of funding from the pre-accession funds.

Expected impact on employment and gender equality: Improvement of broadband access creates opportunities for establishing an environment for innovation and investment, and thus for creating new jobs and more equitable regional development. Numerous recent analyses carried out by renowned institutions have clearly identified a positive correlation between the use of broadband access and employment in several different industries. Expansion of broadband access directly increases the number of the employed.

Potential risks: Full implementation of this measure significantly depends on implementation of the Law on Spatial Planning and Building Construction and establishment of the documentary basis, since a spatial information system will be established only in 2021. Moreover, implementation of this measure will be impacted by the securing of funding from pre-accession funds for financing projects of construction of broadband access in areas in which there is no commercial interest in the construction.

Priority Reform Measure No. 13: Strengthening the national innovative ecosystem



Description of the measure: The measure relies completely on the Strategy of Innovation Activity 2016–2020 and the Strategy of Scientific and Research Activity2017–2021, and it will constitute a crucial link of the Strategy for Smart Specialisation (S3)[29], currently under preparation.

The implementation of the measure started in 2018 as Montenegro recognised that the key to progress in this area was to focus on sustainability of the innovative ecosystem and converting targeted investments in innovation into concrete results which contribute to the competitiveness of the country. Recommendation No. 4 given at the Ministerial Meeting held in May 2018 refers to this measure.

Strengthening the national innovation ecosystem includes the following:

- **Implies** Strengthening financial support instruments for research and innovation through grant schemes for innovative and scientific-research projects and the programme for Centres of Excellence; all these instruments aim at stimulating cooperation between scientific and research institutions and business sectors, stimulating investments made by grant beneficiaries and foster excellence. In the field of strengthening human resources and research capacities, the focus is on new attractive fellowships for PhD research with EU standards, this will create a critical mass of about 50 young researchers, and at the same time stimulate a new employment scheme for the PhDs.
- **Implies** Further development of institutional support of the business sector in all phases and segments of their growth and business, by creating conditions for technological transfer, the adoption of new technologies, support for attracting funds for research and innovation, and the establishment of strong cooperation with the academic sector. This segment of the measure relates to the upgrade of the already successfully implemented measure relating to "Tehnopolis" from the 2016 ERP. The implementation of the measure of Science and Technology Park in Podgorica from the 2018 ERP is being prolonged due to the pace of the negotiations on the modality of its establishment and the choice for drafting the technical documentation.
- **Implies** Development of support for the innovative start-ups with guidance from the European Commission within the Policy Support Facility (PSF), by creating measures within the Programme of Supporting the Innovative Start-ups with the goal to motivate enterprises to focus on knowledge-based activities permanently and to provide support to start-ups in the innovation business.
- **Implies** Development of a regional centre of excellence, a large-scale research infrastructure based on state-of-the-art technologies, which will attract best talents. No matter where the infrastructure will be located, the national social and economic benefits will be large. The project will, among other things, develop the competitiveness of local industries through technology transfer and numerous business opportunities related to the construction of technology and building the facility to accommodate it, including its maintenance and improvement.

Timetable for implementation of the measure:

a. **Activities planned in 2019:** The activities relate to the following: implementation of the Innovative Grants Programme (Ministry of Science – MoS), a Centres of Excellence Programme

[29] The Government of Montenegro has adopted the Smart Specialisation Guidelines (2019-2024) on the session held on 20 December 2018, while the adoption of the Strategy is expected in Q1 of 2019.

(MoS), a Call for Grants for scientific research projects (MoS), Fellowships for PhD researchers (MoS), and the Measure 2.4. "Support of employment of PhDs in academic institutions and/or the economic sector" (IPA II, "Education, Employment and Social Policy" sector) (MoS, MF-Directorate for Financing and Contracting EU Support Funds - CFCU). In the context of strengthening the institutional support, the expert assistance will be carried out in order to prepare the specifications for procurement of equipment for two laboratories and the Data centre within the Innovation and Entrepreneurship Centre "Tehnopolis" (AP IPA 2014, "Competitiveness and Innovation" sector – MoS, MF-CFCU); establishment of and development of the design for the STP in Podgorica (MoS); implementation of the "Preparation for efficient functioning of STP in Podgorica" supported by the EUIF (MoS);.as well as activities on the establishment of the Technology Transfer Office at the University of Montenegro (University of Montenegro). Activities will include start of the Preparatory Group for the South East European International Institute for Sustainable Technologies (SEEIIST) (MoS and line ministries), as well implementation of the Programme of Supporting Innovative Start-ups (MoS and line ministries).

b. **Activities planned in 2020:** The activities planned for 2020 include continuation of activities started in 2019, additional implementation of AP IPA 2016 – procurement of equipment for two laboratories of the IPC "Tehnopolis"and the Data centre t (MoS, MF-CFCU), as well as activities on the construction of the Scientific-technological Park in Podgorica.
c. **Activities planned in 2021:** The activities planned for 2021 include continuation of the previously started activities.

Expected impact of the measure on competitiveness:
Grant schemes foresee a mandatory additional investment by the grant beneficiaries, as well as new employment, particularly in the real sector, which will further strengthen their competitiveness. Institutional support of the business entities, linking it to the scientific and research institutions, and use of available funds will also have positive effects on the competitiveness. Implementation of the Preparatory phase of the SEEIIST project will affect positively complementary activities in various capacity building projects. This will further strengthen the competitiveness of all potential users. In the long run, SEEIIST will enable the strengthening of the competitiveness of domestic enterprises through technology transfer.

In the context of competitiveness, the impact will be measured by:
- Global Innovation Index that aims to capture multidimensional aspects of innovation, providing a rich and detailed database for 126 countries.
- Global Competitiveness Index, especially in terms of monitoring the "Innovation capacities" indicator.

Key Performance Indicators (KPI): Key Performance Indicators of the measure for three years are the following:

- Number of grants awarded;
- Number of new employees in the research and innovation sector;
- Number of enterprises that introduce new products / services;
- Private sector R&D investment;
- Getting the STP into operation and equipping the laboratories in "Tehnopolis".

The first four indicators refer to all three years, while the fifth indicator refers to 2021.

Estimated costs of the measure/activity and budgetary impact: While noting that the table contains only additional costs, the funds for 2019 were allocated in the central budget in order to finance the measure amounting to €2.4 million, while the funds envisaged for 2020 amount to €7 million and for 2021 they amount to €6.6 million. Moreover, non-budgetary funds were also allocated as follows: in 2019, €628,823.00 from IPA II, €250,000.00 from the World Bank loan, €70,000.00 from other grants and €1 million from the DG RTD's funds for the preparatory phase of the SEEIIST project, while in 2020

€400,000.00 is planned from local budgets and €1,558,823.00 from IPA II and €150,000.00 from other grants. Non-budgetary funds are planned for 2021 and are as follows: €600,000.00 from local budgets and €470,000.00 from other grants. The total additional cost of the measure in 2019 amounts to €2,840,323.00 (of which €1,891,500.00 is from the budget).

NOTE: An estimate of the funds needed to set up the Technology Transfer Office (TTO) at the University of Montenegro still needs to be made in 2019, and in that same year measures to foster start-ups will be identified as well, which is why these funds could not have been included in the budget. A sizeable part of the financial support will be provided from EU funds through the 2020 IPA Programme for Sector Competitiveness and Innovation, and its preparation is in progress.

All activities within this measure aim to create new jobs: grants for innovation - 20 new jobs, programme of centres of excellence - 5 new jobs, grants for scientific research projects - 20 new jobs; Fellowships for doctoral research - about 50 hired and trained young researchers. Measure 2.4 IPA II Operational Program 2015-2017 - 23 PhD jobs; while the STP in Podgorica plans to employ about 10 people. The Programme for supporting start-ups in Montenegro will also aim to stimulate self-employment.
The measure is gender neutral.

Potential risks:

- *Potential risks by individual segments of this measure are:*Financial instruments- Risk: insufficient response of target groups – Probability: 30 percent. Mitigation measures: Strengthening promotional activities for the instruments (info-days, public consultations, direct meetings, media, etc.).
- Institutional support - Risk: sustainability of these infrastructures – Probability: 50 percent; Mitigation measures: Provide expert support for defining the basic principles for the selection of adequate management and staff in these infrastructures; and staff training.
- In terms of support for innovative start-ups, there is a risk of the partial application of the Programme due to the insufficient higher-level capacity (ministries, universities, support organisation), which fail to enable a systemic effect and are not preventing the departure of exceptional entrepreneurs abroad. Probability: 30 percent, Mitigation measure: establish a coordination body, employing exceptional human resources at the STP.
- SEEIIST - Risk: lack of political and financial support to the project; Probability: 50 percent. Mitigation measures: Involving all participating Parties in the preparatory phase of the project, during which a Business Plan with a clear financial framework for the project will be developed, as well as the action plan for inclusion to the ESFRI Roadmap.

4.3.5 Trade-related reforms

Description/analysis of the main issues and obstacles to the development of the area: Despite the significant potentials for strengthening exports and reducing external economic imbalance, Montenegro is characterised by a narrow export base, a low level of export diversification, as well as by a low level of added value in production. Even though trade in the region is fully liberalised, non-tariff barriers still exist and have a negative impact on the market. Also, the structure of Montenegrin exports has changed considerably in favour of exports of services. According to the preliminary data, Montenegro’s total foreign trade in goods in the period January–August 2018 amounted to €1,945.2 million, which is 12.4 percent growth compared to the same period of the year before. The export of goods was worth €260.9 million, while imports were worth €1,684.3 million. Compared to the same period of the previous year, exports increased by 7.3 percent, while imports increased by 13.2 percent. The coverage of imports by exports amounted to 15.5 percent, which was lower than during the same period of the previous year (16.3 percent). The biggest foreign trade partners in exports and imports were: Serbia, Hungary and Bosnia and Herzegovina. The biggest foreign trade partners in imports were: Serbia, China and Germany. The most extensive foreign trade in goods was achieved with CEFTA signatories and the European Union.

Montenegro has participated in negotiations on concluding CEFTA Additional Protocol No. 6 which envisages the opening up of the services market between CEFTA parties, which will expand the liberalisation achieved in the trade in goods and services. The service sector is playing an increasingly important role in the economies and trade of all CEFTA parties, with a great potential to increase the intra-regional trade in services. In line with the aforementioned, Additional Protocol No. 6 on Trade and Services is accompanied by the following annexes: Temporary Entry and Stay of Natural Persons Providing Services (Annex 1), Regulatory Principles of Telecommunications (Annex 2) and the List of Specific Obligations in Services (Annex 3). The aim of the protocol is to develop and improve trade and economic cooperation between CEFTA parties, establish a proper legislative framework for the trade in services and eliminate the existing restrictions in access to the market. The technical part of the negotiations was finalised in December 2016 and its adoption is expected in 2019. Moreover, CEFTA structures agreed that the mechanism for the resolution of trade disputes needed to be changed, particularly in respect of identifying disputes and bilateral consultations which rarely produce results. Planned amendments will introduce clear procedures and deadlines, thus improving the efficiency of this mechanism, which should lead to the additional elimination of non-tariff barriers to regional trade. In September 2018, the Government of Montenegro established the Basis for conducting negotiations and concluding Additional Protocol No. 7, and appointed a negotiating team.

According to the Doing Business report produced by the World Bank, trade facilitations and the time and costs of the trade in goods across the borders of Montenegro are considerable higher than the EU average and that of the countries of CEFTA region. To be specific, according to the Doing Business report produced by the World Bank in 2019, out of the total of 190 economies, Montenegro ranked 47th in terms of doing business in cross-border trade, which is the least favourable ranking among the CEFTA parties.[30]

The 2018–2022 Trade Facilitation Strategy, with the detailed Action Plan for its implementation, was adopted for the purposes of simplification, harmonisation and reduction of the duration and costs of procedures in cross-border trade. In this way, all the obligations laid down in the WTO Trade Facilitation Agreement and CEFTA Additional Protocol No. 5 were consolidated, including the obligations related to trade facilitation arising from the process of Montenegro's accession to the EU. Implementation of the trade facilitation measures set out in the strategy will lead to the elimination of administrative inefficiencies and bottlenecks in cross-border trade, which is expected to have an indirect positive impact on the growth of exports and a direct impact on boosting economic competitiveness.

Besides the Trade Facilitation Strategy, trade facilitation measures are closely connected and will have an impact on implementation of the measures set out by the Integrated Border Management Strategy and the Business Strategy of the Customs Administration. Moreover, from the perspective of Montenegro's accession to the EU, implementation of trade facilitation measures is particularly important for meeting the requirement of Negotiating Chapter 30 – External Relations, Chapter 29 – Customs Union, Chapter 12 – Food Safety, Veterinary and Phytosanitary Policy and Chapter 24 – Justice, Freedom and Security, which addresses border controls. For that reason, all measures will be implemented in full compliance with the EU model.

Report on implementation of EC's recommendations of May 2018: No recommendations were given for this measure in the Ministerial Meeting held on 25 May 2018.

[30] Kosovo is the only one with lower ranking, i.e. it ranks 51st.

Priority Reform Measure No. 14: Implementing trade facilitation measures in line with the WTO Trade Facilitation Agreement and CEFTA Additional Protocol No. 5

Description of the measure: the Multi-Annual Action Plan for a Regional Economic Area in the Western Balkan Six (MAP) recognises the importance of trade facilitations. In order to reduce the duration of customs clearance of the goods set out by the Trade Facilitation Strategy, five areas (operational goals) were identified in which intensive activities need to be undertaken, as follows: improving transparency and access to information; harmonisation and rationalisation of formalities, documentation and charges; conducting a simplified and expedited customs clearance procedure; enhancing cooperation and increasing the effectiveness of border controls; expanding automatic processing and electronic data exchange. Within each operational goal, individual measures and the activities associated with them are formulated and need to be implemented in order to achieve the goals. The National Committee on Trade Facilitations is responsible for the coordination, monitoring and reporting on the implementation of measures and activities.

It is expected that implementation of the measures related to investment activities will pose the greatest challenge to implementation of the trade facilitation concept, and these are: implementation of the electronic filing of documents; setting up the National Computerised Transit System (NCTS); developing the information system of the Directorate for Food Safety, Veterinary and Phytosanitary Administration and connecting with the Systemic Electronic Exchange of Data – SEED+[31]; and initiation of the "one-stop shop" project for implementation of the procedures in cross-border trade.

Timetable for implementation of the measure:

a. **Activities planned in 2019:** Appointing focal points; Implementation of the programme of authorised business operators; Procurement of the IT equipment necessary for establishing the NCTS and inclusion in SEED+;
b. **Activities planned in 2020:** Development and implementation of the IT applications for the NCTS; Establishing a functional system at the Directorate for Food Safety, Veterinary and Phytosanitary Affairs as the basis for involvement in SEED+;
c. **Activities planned in 2021:** Development and implementation of IT applications for the NCTS; Mutual connecting and establishing of electronic data exchange between national border authorities within SEED+.

Expected impact of the measure on competitiveness: Implementation of the measures will have an impact on a reduction of the duration and costs of customs clearance of goods and will thus increase the competitiveness of the Montenegrin enterprises (particularly small and medium-sized ones) on international markets. Moreover, it is also expected to improve Montenegro's position on the Doing Business list, an indicator of cross-border trade, as well as its ranking within the Logistics Performance Index and the OECD's Trade Facilitation Indicators.

Key performance indicators (KPI): Reduction of the time needed for customs clearance by 10 percent per year compared to the year before.[32]

Estimated costs of the measure/activity and budgetary impact: Funds for implementation will be allocated in the budget of Montenegro – mainly as part of the regular tasks of the state administration – as well as through different projects and programmes of international donors, EU support through pre-accession support instruments and from other international sources. In that regard, funds amounting to €1,179,000 are envisaged for implementation of the measure in 2019, of which €139,800

[31] SEED+ – Systematic Electronic Exchange of Data.

[32] The time specified in the study into measuring average time needed for customs clearance will be taken as a starting point.

will be allocated in the central budget, while the remaining part amounting to €1,039,200 will be financed from other sources of financing. As for the measures within investment activities for which no sources of financing have been planned for the time being, such as the measure for establishing a one-stop shop, consultations are being initiated with the international community to identify the optimal implementation and financing models.

Expected impact on employment and gender equality: Activities will have a positive impact on additional employment and respect for gender equality.

Potential risk 1: Delay in the beginning of implementation of the SEED+ project in the CEFTA region;
Likelihood of occurrence of risk 1: 15 percent;
Planned mitigation measures for risk 1: Active involvement in the CEFTA structure in order to foster the activities for the start of implementation of the SEED+ project;

Potential risk 2: Lack of availability of technical-expert assistance for additional training and development of administrative capacities for implementation of the measures;
Likelihood of occurrence of risk 2: 10 percent;
Planned mitigation measures for risk 2: Explore different models of provision of technical assistance, including participation in and/or organisation of donor conferences, etc.; Organise training for employees who currently do not have the required knowledge and skills; Identify and reassign employees.

Potential risk 3: Flexibility of the private sector to adjust to the measures;
Likelihood of occurrence of risk 3: 15 percent;
Planned mitigation measures for risk 3: Ensure that the measures that are implemented provide unambiguous and concrete facilitations for the private sector and introduce planned measures to the private sector in a timely manner.
Institution competent for measure implementation: Ministry of the Economy/Ministry of Finance

4.3.6. Education and Skills

Description/analysis of the main issues and obstacles to the development of the area: The data of the Employment Office reveals a structural mismatch between supply and demand. In fact, the supply of labour force does not correspond to the demand, i.e. there is a need for qualifications, which do not exist in the labour market. On the other hand, there is a labour supply of people with qualifications which are not requested on the market. The interest among students for enrolment in the programmes needed in the labour market is not sufficient. Employers believe there is a mismatch between the skills and knowledge pupils acquire in the education system and those required in the labour market. For this reason, it is necessary to continuously improve the quality of vocational education and its relevance to the labour market. The education supply should be prepared in cooperation with employers, in line with the information from the labour market regarding missing skills and qualifications. Education curricula which contain learning outcomes, prepared on the basis of occupational standards and standards of qualifications, will enable faster employability of individuals, life-long learning and mobility.

Report on implementation of the EC's recommendations of May 2018: This measure represents a response to the EC's Recommendation No. 6 given at the Ministerial Meeting held in May 2018, in the part concerning harmonisation of the enrolment policy in vocational education with the labour market needs. For this reason, it is necessary to ensure that education supply matches the labour market needs and then to promote enrolment in educational programmes for the qualifications recognised as being in shortage in the labour market.

Fifteen new modular curricula, based on learning outcomes, were prepared for the 2018/2019 school year. In the period from June to September 2018, around 250 teachers received training on how to apply the new modular curricula. The promotional campaign “Professional is Crucial – Get a Job, Earn Money and Develop Yourself” was conducted in May and June. In the campaign, representatives of secondary vocational schools visited elementary schools and three regional promotions of secondary vocational education were organised.

Priority Reform Measure No. 15: Development of qualifications and education curricula in accordance with the labour market needs

Description of the measure: One of the goals set out by the Vocational Education Development Strategy to 2020 is to ensure that vocational education is relevant to the labour market. In order to achieve this goal and eliminate the structural mismatch between the supply of and demand for the labour force, it is necessary to develop qualifications, based on learning outcomes, that match the labour market needs and, in line with them, design modular curricula.

The measure is a continuation of the same measure under which activities were implemented in previous years. As far as this measure is concerned, 10 modular curricula were prepared for the 2017/2018 school year. Fifteen education curricula were prepared for the 2018/2019 school year. The measure is a response to Recommendation No. 6 of the European Commission given at the Ministerial Dialogue in May 2018, with regard to aligning the policy on enrolment in vocational education with the labour market needs.

Timetable for implementation of the measure:

a. **Activities planned in 2019**: Development of occupational standards, qualifications and education curricula and training teachers on how to implement the curricula. The Ministry of Education is responsible for implementation of the activities.
b. **Activities planned in 2020:** Development of occupational standards, qualifications and education curricula and training teachers on how to implement the curricula. The Ministry of Education is responsible for implementation of the activities.
c. **Activities planned in 2021:** Development of occupational standards, qualifications and education curricula and training teachers on how to implement the curricula. The Ministry of Education is responsible for implementation of the activities.

Expected impact of the measure on competitiveness: Linking education to the labour market by developing qualifications and preparing education supply in cooperation with employers, on the basis of the actual needs of the labour market and the projection of the development of activities, while implementing the curricula in the actual working environment, will contribute to an increase in competitiveness and to greater employability of the labour force.

Key performance indicators (KPI): The performance indicators are the following: a) In 2019, 15 education curricula are developed and a minimum of 250 teachers are trained; b) In 2020, 10 education curricula are developed and a minimum of 300 teachers are trained; c) In 2021, 15 education curricula are developed and a minimum of 300 teachers are trained.

Estimated costs of the measure/activity and budgetary impact:

In 2018, budgetary funds of €246,080.00 were allocated for and spent on the implementation of the measure mentioned above.

- 2019 – from the budget €270,000.00

- 2020 – from the budget €357,352.50 (€300,000.00 plus IPA co-financing of €57,352.50) and IPA funds €325,000.00 (2015–2017 Sectoral Operational Programme on Employment, Education and Social Policies)
- 2021 – from the budget €357,352.50 (€300,000.00 plus IPA co-financing of €57,352.50) and IPA funds €325,000 (2015–2017 Sectoral Operational Programme on Employment, Education and Social Policies)

Expected impact on employment and gender equality: A labour force with the qualifications required by the labour market will be more competitive and will thus find jobs more easily. The intention behind the education curricula is for different target groups (youth, adults) to acquire qualifications, regardless of their gender.

Potential risks: There is no risk to the implementation of the measure.

Priority Reform Measure No. 16: Implementation of apprenticeship with employers

Description of the measure: One of the measures in the Vocational Education Development Strategy to 2020, within the priority Qualitative and Efficient Vocational Education is on-the-job, hands-on learning. Apprenticeship education in vocational schools can be implemented in the school or dual education. The Law on Vocational Education envisages that the funds for fees for students in the dual form of education for the first and second grades will be provided from the Budget, while the fees in the third grade will be an obligation of the employer. The fee for the first grade will amount to no less than 10 percent of the average net wage, for the second grade no less than 15 percent and for the third grade the fee will amount to a minimum of 20 percent of the average net wage. Individual Apprenticeship Agreements will outline the rights and obligations of students and employers in dual education.

The measure titled *Implementation of Apprenticeship with Employers* is linked to the measure implemented in the previous year. In the 2017/2018 school year there were 276 students in the dual form of education. The measure is a response to the European Commission's Recommendation No. 6 from the May 2018 Ministerial Dialogue regarding the harmonisation of the vocational education enrolment policy with the needs of the labour market.

Timetable for implementation of the measure:

a. **Activities planned in 2019:** A minimum of 500 students will be educated in the dual education form with employers in the 2018/2019 school year. The Ministry of Education is responsible for the implementation of the activities.
b. **Activities planned in 2020:** A minimum of 750 students will be educated in the dual education form with employers in the 2019/2020 school year. The Ministry of Education is responsible for the implementation of the activities.
c. **Activities planned in 2021:** A minimum of 1,000 students will be educated in the dual education form with employers in the 2020/2021 school year. The Ministry of Education is responsible for the implementation of the activities.

Expected impact of the measure on competitiveness increase: a) A minimum of 500 students in the dual form of education in the 2018/2019 school year; b) A minimum of 750 students in the dual form of education in the 2019/2020 school year; c) A minimum of 1,000 students in the dual form of education in the 2020/2021 school year.

Key performance indicators (KPI): The basis for successful vocational education is quality apprenticeship carried out in an actual work environment in cooperation with employers. Performance indicators are the number of employers engaged in dual education and the number of students who are apprentices to employers.

Estimated cost of the measure/activity and the budgetary impact: Government budget funds of €250,000 spent in 2018 are also envisaged for the implementation of the reform measure.
- 2019 – €262,112 from the budget
- 2020 – €300,000 from the budget
- 2021 – €300,000 from the budget

Expected impact on employment and gender equality: The implementation of apprenticeship with employers will facilitate easier transition for young people educated in vocational schools into the labour market and will reduce the risk of unemployment for students graduating from vocational schools. There are no restrictions related to gender equality – the programmes are available to all students, irrespective of gender.

Potential risks: Insufficient interest by employers and students in getting involved in dual education.

4.3.7. Employment and the labour market

Analysis of main obstacles: The labour market records positive trends that show growth in the activity rate[33] up to 57.8 percent, in the employment rate up to 49.5 percent and a fall in the unemployment rate down to 14.1 percent. At the same time, it records a decrease in the registered unemployment rate down to18.03 percent[34]. In spite of the recorded positive trends, challenges remain with regard to insufficient engagement of the population in the labour market that is able to work, particularly women, among whom the activity rate amounts to 49.1 percent, and the employment rate 42.5 percent, as well as among young people (15–24) where the activity rate amounts to 35.5 percent, and the employment rate 26.0 percent. Although the rate of long-term unemployment has recorded a reduction in relation to the previous years and amounts to 10.5 percent, the share of long-term unemployment in the overall unemployment is still high at around 72.75 percent and continues to be one of the key challenges in the labour market, which has been causing a mismatch between supply and demand in the labour market for a long time. On the other hand, the opening up of new jobs that is still insufficient and is characterised by the conspicuous employment of a foreign labour force, then the presence of informal labour and insufficient activity and motivation of sensitive target groups and users of social protection benefits represent an additional factor of the low activity of the population that is able to work and the growth of formal employment. Amendment of legal provisions in the area of the labour market, aimed at creating the prerequisites for increased flexibility in the labour market and increased adjustability of active employment policy measures to the requirements of the labour market and strengthening of the role of intermediation in employment, is still on-going.

Report on implementation of the EC Recommendations of May 2018: In line with Recommendation No. 6 from the Brussels 2018 Ministerial Meeting relating to the greater coverage and efficiency of active labour market policies particularly for young people, women and the long-term unemployed, in addition to the standard programmes, a pilot programme of active employment policy has been introduced, which is intended for women who are the former claimants of benefits in respect of giving birth to three or more children or beneficiaries of family cash benefit.
In the aggregate number of unemployed people (3,649) included in the active employment policy measures, the share of women is 64.1 percent, of young people 28.7 percent, of long-term unemployed people 27.5 percent, while the share of people from the least developed region amounts to around 47 percent. Furthermore, with a view to encouraging self-employment and developing entrepreneurship, the Employment Office has been implementing measures of granting loans to unemployed people and this form of support has ensured the opening of 96 new jobs.

[33] MONSTAT LFS Q2/2018 data for population 15+.
[34] Montenegro Employment Office, as of 24 December 2018.

Additionally, the Vocational Development Programme for Tertiary-Educated People covers 3,055 unemployed tertiary-educated people, of whom 58 percent are females.
For special target groups, in this case disabled people, active policy measures have been undertaken through subsidised employment and grants for professional rehabilitation and employment grant schemes, in which 698 disabled people have been included.
With a view to the greater coverage and efficiency of active employment policy measures, in cooperation with the International Labour Organization, new active employment policy programmes are under preparation, to be implemented in 2019.
Through a new form of activation of the beneficiaries of social benefits, the Employment Office, in cooperation with social work centres, produced 3,594 individual activation plans in the first nine months of 2018. Of that number, 1,509 people are planned to be included in the active employment policy measures, while 482 people who are beneficiaries of social benefits have been included so far. In the same period, 192 people have been employed.
For the purpose of greater coverage of active labour market measures in the following three-year period, the measure of support for self-employment and strengthening of local employment initiatives will be implemented.

Priority Reform Measure No. 17: Support for self-employment and strengthening of local employment initiatives

Description of the measure: The measure is directed towards the fulfilment of Recommendation No. 6 in terms of greater inclusion in the active employment policy measures and their adjustment to the labour market requirements. **It will be implemented through two activities, as follows**: implementation of a self-employment programme, through 400 grants to unemployed people registered with the Employment Office through three annual invitations and execution of a project of fostering local employment initiatives aimed at improving the capacities of actors at the local level through support for the identification of which vocations are in short supply, development of local strategies and employment plans, then the development of active labour market measures adjusted to the local level. The measure will be implemented within the 2015–2017 Sector Operating Programmes for Employment, Education and Social Policies, financed with EU funds (allocation from IPA 2015–2017).

Timetable for implementation of the measure:

a. **Activities planned in 2019:** In 2019, the publishing of the first invitation for awarding grants for self-employment to unemployed people is planned. The activities envisaged by the project of fostering local employment initiatives will commence. The activities will be undertaken by the Ministry of Labour and Social Welfare, the Ministry of Finance and Employment Office of Montenegro.
b. **Activities planned in 2020:** In 2020, the publishing of the second invitation for awarding grants for self-employment to unemployed people is planned. The activities envisaged by the project of fostering local employment initiatives will continue. The activities will be undertaken by the Ministry of Labour and Social Welfare, the Ministry of Finance and the Employment Office of Montenegro.
c. **Activities planned in 2021:** In 2021, the publishing of the third invitation for awarding grants for self-employment to unemployed people is planned. The activities envisaged by the project of fostering local employment initiatives will continue. The activities will be undertaken by the Ministry of Labour and Social Welfare, the Ministry of Finance and the Employment Office of Montenegro.

Expected impact of the measure on an increase in competitiveness: The measure has a direct impact on employment through the inclusion of unemployed people in the market labour through support for self-employment and will contribute to greater economic activity through further development of entrepreneurship and self-employment in all sectors.

Key performance indicators (KPI): The key performance indicators for the mentioned measure are as follows:
- for support for self-employment – a minimum of 120 unemployed people awarded grants for business start-ups at the annual level;
- for the project of fostering local employment initiatives – in 2019 the indicator is a completed analysis of the needs of the local labour markets; in 2020 a minimum of 11 local partnerships for employment established and a minimum of 15 strategies for employment and development of human resources completed at the local level.

Estimated cost of the measure/activity and the budgetary impact:

- **2019** – for the support for self-employment the amount of €157,500.00 will be provided from the Budget, while the amount of €892,500.00 will be provided from EU funds, which in total amounts to €1,050,000.00. At the same time, for the development of local partnerships the amount of €14,100.00 will be provided from the Budget, and € 79.900.00 from EU funds, which in total amounts to €94,000.00;

- **2020** – for the support for self-employment the amount of €157,500.00 will be provided from the Budget, while the amount of €892,500.00 will be provided from EU funds, which in total amounts to €1,050,000.00. At the same time, for the development of local partnerships the amount of €49,350.00 will be provided from the Budget and €279,650.00 from EU funds, which in total amounts to €329,000.00;

- **2021** – for the support for self-employment the amount of €157,500.00 will be provided from the Budget, while the amount of €892,500.00 will be provided from the EU funds, which in total amounts to €1,050,000.00. At the same time, for the development of local partnerships the amount of €7,050.00 will be provided from the Budget and €39,950.00 from the EU funds, which in total amounts to €47,000.00.

Expected impact on employment and gender equality: Implementation of the measure will have a positive impact on employment, given that in a three-year period up to 400 unemployed people will be included in the labour market. There are no restrictions that relate to gender equality, given that the measure will be available to all unemployed people irrespective of gender.

Potential risks: Potential risks for the implementation of the measure may be: delays in the public tender procedure, or the contracting or project implementation, which could threaten the efficient use of funds; an insufficient quality of the business plans submitted by unemployed people; an insufficient level of understanding of the role and responsibility of local institutions/organisations regarding the approach to employment and activation.
In view of reducing the potential risks, measures of active promoting of the programme will be undertaken, not only with the unemployed people but also with the actors at the local level too. The Employment Office of Montenegro will offer expert assistance for creating qualitative business plans.

4.3.8 Social inclusion, reduction of poverty and equal opportunities

Analysis of main obstacles: Social and child protection is improved within the "Social Protection System Reform Continuation" and "Capacity Development for Providing Social Protection Service in Montenegro" projects, pursuant to the Law on Social and Child Protection and its amendments, as well as strategic documents.

In 2017, the Law Amending the Law on Social and Child Protection was adopted and thus some child protection benefits have increased (child allowance, new-born child benefit, benefit in respect of giving birth to children) and it is also specified that the beneficiaries of personal disability benefits may not at the same time be the beneficiaries of attendance allowance and that the amount of their allowance will remain the same as it was in the period when they used such benefits in parallel.

The data indicates that the number of families that are users of family cash benefits amounted to 9,413 in August 2018, and for this purpose an amount of €918,905.29 has been allocated, which is less than the number of 14,737 families and the allocation of €1,338,798.01 in July 2013 when the Law on Social and Child Protection came into force.

After abolishing the benefits in respect of giving birth to three or more children in 2017, the new benefit pursuant to the Law on Enforcement of the Decision of the Constitutional Court of Montenegro is being received by 2,174 women and, in August 2018, the amount of €558,871.00 was allocated for this purpose, and €97,067.40 for pension and disability contributions, which is significantly lower than the number of beneficiaries of the benefit in respect of giving birth to three or more children, which amounted to about 22,000 and for the needs of which, in 2016, an amount of around €59,000,000.00 was allocated, which is significantly higher than the expenses for all other benefits under social and child protection.

For the purpose of further improvement of the linkage between the labour market and the social protection system, the centres for social work and the Employment Office have adopted a Cooperation Platform, pursuant to which IT support has been provided whereby Centres for Social Work and the Employment Office electronically exchange data on the beneficiaries of social protection.

One of the obstacles in the area of social and child protection is hindered access to services in the system of social and child protection, particularly when it comes to children, disabled persons and the elderly, who constitute the most sensitive groups at risk of poverty. Endeavours are being made for the improvement of the area of services. In the coming period, special focus will be on care for the elderly in the form of developing services, taking into account the increasingly conspicuous issue of ageing in Montenegro, especially with regard to day-care services for the elderly, which will lead to an increased number of service providers and therefore to higher employment. By the end of 2018, a total number of 10 day-care facilities will be organised for the elderly, with capacity for about 200 beneficiaries.

As regards the pension system, the share of general revenues in the financing of the pension system in 2017 amounted to about 25 percent of the total expenses of the Pension and Disability Insurance Fund of Montenegro. The total number of users of benefits paid by the Pension Fund is 130,138 (data for November 2018), of which 124,333 are pensions (114,673 pensions in Montenegro and 9,328 abroad) and 5,863 are beneficiaries of other pension- and disability-insurance-related benefits. The dependency ratio (number of the insured persons in relation to the number of pensioners) is 1.62:1.

The Government is implementing a series of measures aimed inclusion of children in processes of the society through system of education, sports, improving social protection and like, in order for this to contribute over the long run improvement of human resources in the country. Thus, it is easier for parents to include children in sports with adoption of the new Law on Sports, which is explained in more details under the Priority Reform Measure No. 19.

Report on the implementation of the policy guidelines 2018, if relevant to the given area: In mid-2017, the Law Amending the Law on Social and Child Protection was adopted, which increased specific childcare benefits (before EC Recommendation No. 6 was given in 2018) based on the re-allocation of funds after the abolishment of benefits for mothers of three or more children, for the purpose of ensuring fairer distribution of social funds. Cooperation has been enhanced between the Centres for Social Work and the Employment Office in view of work activation among social protection beneficiaries.

In line with Recommendation No. 2 from the Ministerial Meeting in Brussels 2018, relating to the preparation of pension reform, amendments to the Law on Pension and Disability Insurance have been prepared in order to change the valorisation and indexation of pensions and to tighten eligibility for early retirement, draft amendments to the Law on Pension and Disability Insurance have been prepared.

The adoption of the Law Amending the Law on Pension and Disability Insurance is planned by the end of 2019.

Priority reform plans: In the coming period, as a response to address the problem in the area of services, priority will be given to the development of day-care services for the elderly, and the focus will be on pension reform relating to the review of the legal requirements for retirement and higher fairness, as well as activities of including children in socio-economic flows.

Priority Reform Measure No. 18: Development of day-care services for the elderly

Short description of the measure: The reform measure envisages enhancement of the protection of the elderly in the form of an increased number of day-care facilities for this category of people. Support for the service of Day-Care for the Elderly is implemented within the project *Continuation of Social Protection System Reform* implemented by the Ministry of Labour and Social Welfare and with participation of local self-governments with technical support by UNDP. The reform measure is in accordance with the 2018–2022 Strategy of Social Protection System Development for the Elderly. The measure is a response to one of the six EC recommendations from the May 2018 Ministerial Dialogue as regards "Social inclusion, reduction of poverty and equal opportunities" where, among other things, it is stated that "weak results in the labour market are linked to the weaknesses in the social protection system, characterised by weak services and targeting".

Measure implementation activities by years: The mentioned measure has been implemented continuously. In 2019, the scope of service provision is planned to be expanded with the opening of three more day-care facilities. In 2020 and 2021, a minimum of one day-care facility for the elderly is planned to be opened each year, depending on the interest of local self-governments and funds available in the Montenegrin budget.

Fiscal impact: Until and including 2018, a total of €254,189.02 was allocated from the budget for the opening (refurnishing and equipping) and operation of 10 day-care facilities. Local self-governments are taking part by assigning the land or buildings to be refurnished for the needs of day-care. For the three day-care facilities planned in 2019, funds have been indicatively provided in the budget of Montenegro, but the total amount will be subsequently determined and will depend on the participation of local self-governments. Given that the mentioned activities have been undertaken in continuity and that they depend on the degree of interest of local self-governments, it is planned that in both 2020 and 2021 at least one day-care facility for the elderly will be opened.

Expected impact on competitiveness: The implementation of the measure will have a positive impact on the labour market in terms of an increased number of employees to provide day-care services, and the employees will be mostly females. It is a measure that will be implemented in the long run and will affect further employment.

Expected social outcome of the measure: The implementation of the measure will have a positive impact on the following: the protection of the elderly, a reduction in poverty and socialisation, increased employment and, in specific cases, opportunities will be given to family members to take care of their elderly members and, during their time there, they will have an employment engagement.

Potential risks in the measure implementation: Less likely risks in the implementation of the measure may arise in the form of a low level of interest from local self-government in this kind of service or an insufficient amount of funds allocated from the budget of Montenegro. The measures for mitigation of the potential risks would be in the form of adequate estimates of the needs for opening day-care facilities.

Priority Reform Measure No. 19: Incentive for including children in sports activities

Description of the measure: The Law on Sports (OGM 44/18) envisages the method for encouraging inclusion of as many children as possible in sports activities. The law specifies possibilities in the form of co-financing for children doing sports. The measure is in the form of a subsidy for doing sports for children between 7 and 15 years of age (children between 7 and 15 make up 10 percent of the total number of children in Montenegro). The incentive measures stipulated by the law will have a positive impact primarily on the children who will do the sports, then on their parents and family, for whom it will be financially easier to guide their children towards proper development through doing sports, and finally the sports club where the children do their sports, which will be co-financed in this way. The implementation of the provisions of the law relating to children's sports facilitates parents to include their children in sports and directly affects the improvement of their socio-economic status. On the other hand, the sports clubs that get engaged in the implementation of these specific legal provisions will have a sustainable source of funding, given that in the mentioned way they will be co-financed from the budget though a public invitation for including children in sports activities.

Timetable for implementation of the measure: 2019 and continuously.

a. Activities planned in 2019: Establish the system at the outset; the Ministry of Sports will at least once every two years adopt an act to specify the kinds of sports to be co-financed from the funds of the budget of Montenegro, the data on the age of children whose sports activities will be co-financed from the budget, the method for the payment of funds and the period for which the funds will be paid; announce a public invitation within 30 days of the date of the adoption of the above-mentioned act; the ministry will take the decision on the sports clubs selected to include the co-financed children in sports activities in every municipality in Montenegro; pursuant to the decision, agreements will be concluded to determine the mutual rights and obligations of the sports clubs and the ministry.
b. Activities planned in 2020: After the system has been established, activities are to be directed towards increasing the number of included children.
c. Activities planned in 2021: Activities are to be directed towards having as many children included as possible, and focus on under-represented regions of Montenegro (the north).

Expected impact of the measure on competitiveness increase: The implementation of this measure will contribute to the enhancement of the work of sports clubs and potential new employment of the people performing expert sports activities, so that in this way they can be more competitive and provide better conditions in order to be selected to carry out the activities pursuant to the public invitation. In the long run, the measure may be identified as a kind of investment in research and development, in the development of human potential and investment in a healthy nation, which will have a long-term positive impact on economic growth and competitiveness.

Key performance indicators (KPI): An increased number of children included in doing sports activities through the child sports system; the amount of funds paid to sports clubs on account of co-financing the fees for children doing sports through the described system (this data will show the extent of the impact that the measure has had on the disburdening of the budget of children's parents/guardians, on one hand, and how much funds the sports clubs has received in that respect, on the other).

Estimated cost of the measure/activity and the budgetary impact: Up to €500,000.00 from the Budget of Montenegro – funds planned in the budget for 2019.

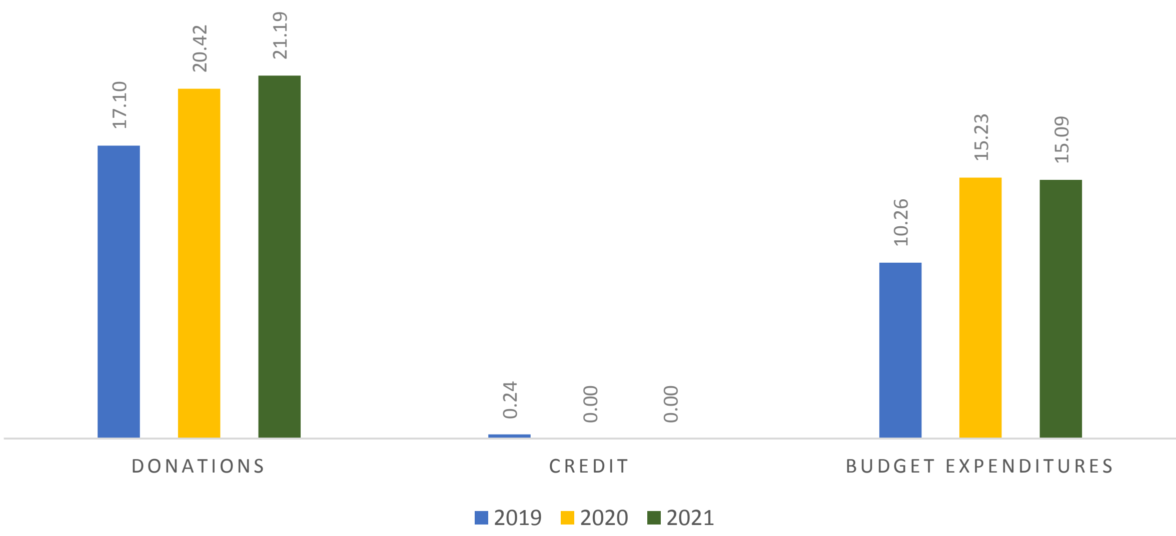
Expected impact on employment and gender equality: It is expected that the implementation of this measure will have an indirect impact on employment, taking into account the fact that sports clubs will have to provide a sufficient number of coaches in relation to the number of children doing sports at the time.

Potential risks: Abandonment by a large number of children.

5. BUDGETARY IMPLICATIONS OF STRUCTURAL REFORMS

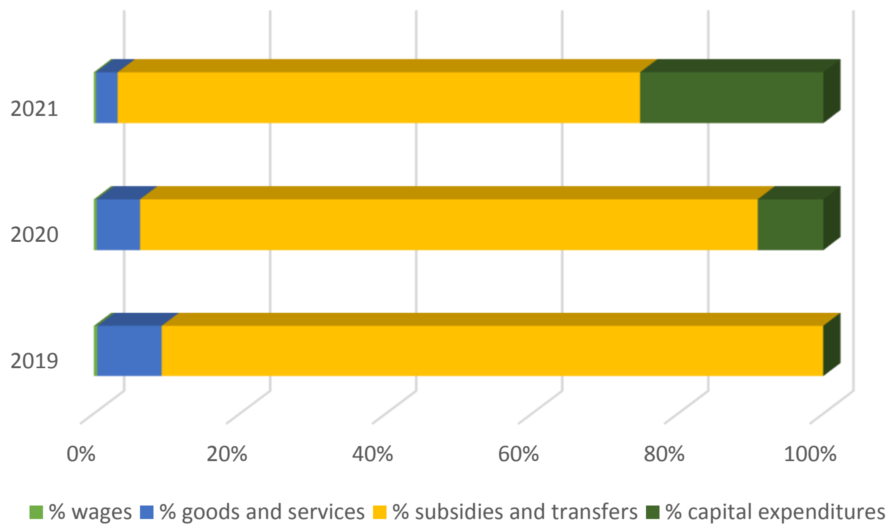
In line with EC guidelines, Chapter 5 of the 2019–2021 Economic Reform Programme provides an overview of the total additional costs related to the structural reform measures. Based on Tables 10a and 10b in the Annex which include additional costs for each of the 19 priority structural reforms, the text below provides a cumulative overview of their structure and funding sources.

Figure 5.1: Estimated total additional implementation costs of the priority reform measures for the 2019–2021 ERP (in € millions)



From the aspect of the mentioned additional cost calculation methodology in relation to the base year of 2018, the highest amount from the budget is related to Measure No. 5 in the area of agriculture – around €10 million for a three-year period – all for the purpose of adjusting to EU food quality and safety standards. In addition, the additional cost of the mentioned measure will be supported by the ensured donor assistance. From the aspect of budget allocations, Reform Measure No. 13 relating to the strengthening of the national innovative ecosystem is also significant (around €14.0 million over the medium term) and it represents investments in research and development, which will finally contribute to increased productivity, and therefore to an increased TFP coefficient.

Figure 5.2: Breakdown of estimated additional implementation costs of the priority reform measures for the 2019–2021 ERP (in € millions)

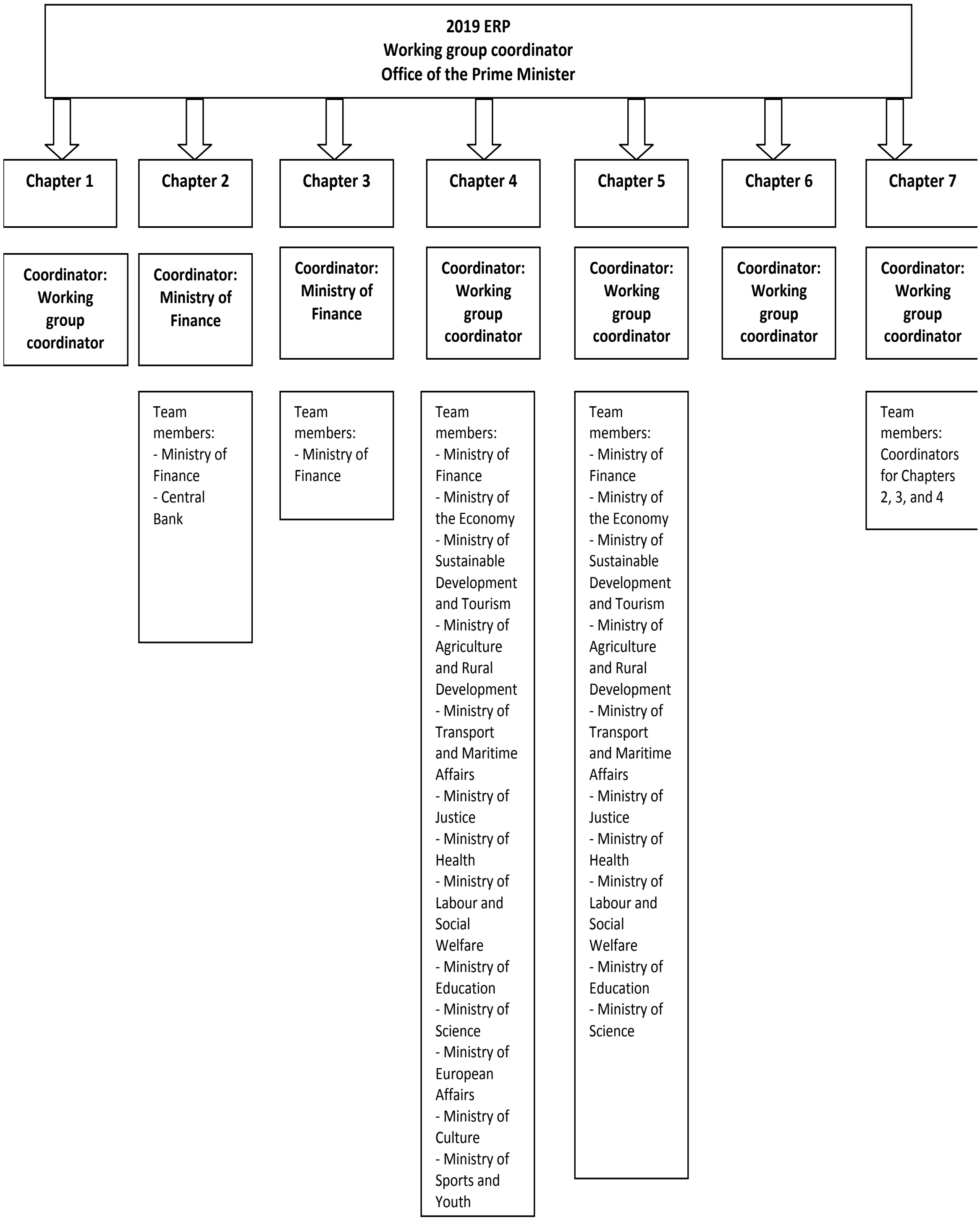


Based on the presented Figure 5.2, it can be concluded that the reform measures included in the 2019–2021 Economic Reform Programme are of an administrative and legislative nature, unlike previous programmes, where infrastructure investments through the capital budget were the focus. The subject measures will positively affect the budget in the long run, while their impacts on employment, competitiveness, and consequently economic growth will be visible in the medium term.

The revenue side of the budget will be mostly affected by Reform Measure No. 10 relating to the adoption of the Law on E-Fiscalisation and Implementation of the E-Fiscalisation System that will commence to apply as of 2020, while its full implementation is expected in 2021, so in the first year of application it will contribute to the collection of revenues from income tax, profit tax and value added tax amounting to €13 million, and in the year of full implementation of an amount exceeding €17 million.

6. INSTITUTIONAL ISSUES AND STAKEHOLDER INVOLVEMENT

The process of preparing the Montenegro Economic Reform Programme commenced with the Government's adoption of the *Decision on establishing the team for preparation of the Economic Reform Programme (ERP)* for the current year. In doing so, the Government established the working team for preparation of the 2019 ERP. The diagram below shows the National Coordination for the ERP, coordination of the chapters and the institutions that were represented in the preparation of the 2019 ERP:



The 2019–2021 Montenegro Economic Reform Programme has been developed in joint consultation with the relevant ministries responsible for implementation of specific reform measures, the international community, whose activities complement the subject programme, and also with important stakeholders in the society which were informed about the fact that the Economic Reform Programme drafting process had started and which were invited to submit their proposals for reforms which could, in their opinion, be part of the 2019–2021 ERP or which, by taking part in the working groups for drafting specific laws, have indirectly contributed to drafting of the 2019 ERP.

In order to improve the text of the Draft Montenegro Economic Reform Programme for 2019–2021, and in line with the European Commission's Guidance Notes, the Draft Programme was subjected to a consultation process with stakeholders in the period from 12 December 2018 to 31 December 2018. During the observed period, the draft programme was available to media representatives and the wider public at the following link on the government website: http://www.gov.me/vijesti/194646/Objavljen-Nacrt-programa-ekonomskih-reformi-CG-2019-2021.html.

A roundtable discussion was also organised as part of the consultation process about the draft programme on 24 December 2018, in order to improve the text of the programme. On this occasion the representatives of employers, non-governmental organisations, representatives of professional associations, representatives of trade unions, representatives of the University of Montenegro, as well as the broader public, were invited to take part in the roundtable discussion and provide their proposals for improving the text of the 2019 ERP. The proposals for the improvement of the draft ERP text in written form are attached to this document.

Furthermore, the document was the subject of deliberation by the Parliamentary Committee on the Economy, Finance and the Budget where, in addition to Members of Parliament, the representatives of trade unions also took part.

After all the proposals and suggestions were received during the consultation process, resulting in improvements to the text of the 2019 ERP, the document was finalised and submitted for procedural consideration and adoption at a session of the Government of Montenegro.

Annex 1: Projections of fiscal indicators for the period 2019–2021

GDP (in € millions)	4,604.5		4,788.6		4,956.8		5,138.3	
Local self-government	**2018**		**2019**		**2020**		**2021**	
	€ millions	**% of GDP**	**€ millions**	**% of GDP**	**€ millions**	**% of GDP**	**€ millions**	**% of GDP**
Direct revenues	**217.09**	**4.71**	**231.84**	**4.84**	**238.68**	**4.82**	**242.48**	**4.89**
Taxes	**138.25**	**3.00**	**147.7**	**3.09**	**149.9**	**3.02**	**151.7**	**3.06**
Personal income tax	33.93	**0.74**	41.76	**0.87**	42.73	**0.86**	43.34	**0.87**
Tax on immovable property transactions	16.70	**0.36**	17.03	**0.36**	17.33	**0.35**	17.65	**0.36**
Local taxes	87.63	**1.90**	88.94	**1.86**	89.83	**1.81**	90.73	**1.83**
Duties	**6.69**	**0.15**	**6.76**	**0.14**	**6.96**	**0.14**	**7.10**	**0.14**
Fees	**52.00**	**1.13**	**57.00**	**1.19**	**59.00**	**1.19**	**60.00**	**1.21**
Other revenues	**16.15**	**0.35**	**16.31**	**0.34**	**16.83**	**0.34**	**17.17**	**0.35**
Receipts from repayment of loans	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**
Donations	**4.00**	**0.09**	**4.04**	**0.08**	**6.00**	**0.12**	**6.50**	**0.13**
Expenditures	**179.52**	**3.90**	**192.66**	**4.02**	**201.03**	**4.06**	**207.69**	**4.19**
Current spending of local self-governments	**132.94**	**2.89**	**141.1**	**2.95**	**146.4**	**2.95**	**150.0**	**3.03**
Current expenditures	**82.23**	**1.79**	**89.36**	**1.87**	**93.67**	**1.89**	**96.18**	**1.94**
Gross wages and contributions charged to employer	**47.68**	**1.04**	**51.63**	**1.08**	**53.18**	**1.07**	**54.88**	**1.11**
Other personal earnings	**3.29**	**0.07**	**4.19**	**0.09**	**4.77**	**0.10**	**4.87**	**0.10**
Expenditures for goods and services	**15.05**	**0.33**	**16.05**	**0.34**	**17.37**	**0.35**	**17.72**	**0.36**
Current maintenance	**6.23**	**0.14**	**6.86**	**0.14**	**7.49**	**0.15**	**7.64**	**0.15**
Interest	**4.19**	**0.09**	**4.47**	**0.09**	**4.56**	**0.09**	**4.65**	**0.09**
Rent	**0.60**	**0.01**	**0.61**	**0.01**	**0.62**	**0.01**	**0.63**	**0.01**
Subsidies	**1.24**	**0.03**	**1.26**	**0.03**	**1.29**	**0.03**	**1.31**	**0.03**
Other expenditures	**3.95**	**0.09**	**4.28**	**0.09**	**4.37**	**0.09**	**4.46**	**0.09**
Social protection transfers	**0.83**	**0.02**	**0.85**	**0.02**	**0.86**	**0.02**	**0.88**	**0.02**
Social-protection-related rights	0.83	**0.02**	0.85	**0.02**	0.86	**0.02**	0.88	**0.02**
Transfers to institutions, individuals, non-governmental and the public sector	**46.34**	**1.01**	**47.26**	**0.99**	**48.21**	**0.97**	**49.17**	**0.99**
Capital budget	**46.59**	**1.01**	**51.59**	**1.08**	**54.62**	**1.10**	**57.71**	**1.16**
Borrowings and credits	**1.50**	**0.03**	**1.53**	**0.03**	**1.56**	**0.03**	**1.59**	**0.03**
Repayment of outstanding liabilities from the previous period	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**
Reserves	**2.04**	**0.04**	**2.08**	**0.04**	**2.1**	**0.04**	**2.2**	**0.04**
Repayment of guarantees	**0.00**	**0.00**	**0.0**	**0.00**	**0.0**	**0.00**	**0.0**	**0.00**
Net increase of liabilities	**0.00**	**0.00**	**0.0**	**0.00**	**0.0**	**0.00**	**0.0**	**0.00**
Surplus/deficit	**37.56**	**0.82**	**39.18**	**0.82**	**37.65**	**0.76**	**34.79**	**0.70**
Adjusted surplus/deficit	**37.56**	**0.82**	**39.18**	**0.82**	**37.65**	**0.76**	**34.79**	**0.70**
Primary deficit	**41.75**	**0.91**	**43.65**	**0.91**	**42.21**	**0.85**	**39.45**	**0.80**
Debt repayment	**57.00**	**1.24**	**57.00**	**1.19**	**55.00**	**1.11**	**51.00**	**1.03**
Repayment of principle to residents	11.00	**0.24**	13.0	**0.27**	14.0	**0.28**	14.0	**0.28**
Repayment of principle to non-residents	4.00	**0.09**	4.0	**0.08**	4.0	**0.08**	4.0	**0.08**
Repayment of liabilities from the previous period	42.00	**0.91**	40.0	**0.84**	37.0	**0.75**	33.0	**0.67**
Expenditures for acquisition of securities	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**
Shortfall	**−19.44**	**−0.42**	**−17.82**	**−0.37**	**−17.35**	**−0.35**	**−16.21**	**−0.33**
Financing	**19.44**	**0.42**	**17.82**	**0.37**	**17.35**	**0.35**	**16.21**	**0.33**
Borrowings and credits from domestic sources	5.00	**0.11**	8.0	**0.17**	8.0	**0.16**	8.0	**0.16**
Borrowings and credits from foreign sources	4.00	**0.09**	6.0	**0.13**	6.0	**0.12**	6.0	**0.12**
Proceeds from privatisation and sale of property	5.00	**0.11**	5.00	**0.10**	5.00	**0.10**	5.00	**0.10**
Use of local self-government deposits	0.44	**0.01**	−6.18	**−0.13**	−6.65	**−0.13**	−7.79	**−0.16**
Transfers from the budget of Montenegro	**5.00**	**0.11**	**5.0**	**0.10**	**5.0**	**0.10**	**5.0**	**0.10**

GDP (in € millions)	4,299.0		4,604.5		4,788.6		4,956.8		5,138.3	
Budget of Montenegro	2017		Estimate 2018		Estimate 2019		Estimate 2020		Estimate 2021	
	€ millions	% of GDP	€ millions	% of GDP	€ millions	% of GDP	€ millions	% of GDP	€ millions	% of GDP
Direct revenues	**1,566.27**	**36.4**	**1,745.92**	**37.9**	**1,828.00**	**38.2**	**1,872.93**	**37.8**	**1,901.57**	**37.0**
Taxes	**971.2**	**22.6**	**1,068.9**	**23.2**	**1,115.7**	**23.3**	**1,161.0**	**23.4**	**1,191.8**	**23.2**
Personal income tax	112.0	**2.6**	124.9	**2.7**	112.6	**2.4**	116.0	**2.3**	118.2	**2.3**
Corporate profit tax	49.2	**1.1**	68.2	**1.5**	71.8	**1.5**	76.2	**1.5**	78.1	**1.5**
Tax on immovable property transactions	1.5	**0.0**	1.8	**0.0**	1.9	**0.0**	1.9	**0.0**	2.0	**0.0**
Value added tax	548.7	**12.8**	616.9	**13.4**	652.9	**13.6**	678.1	**13.7**	698.3	**13.6**
Excise taxes	225.1	**5.2**	221.2	**4.8**	239.6	**5.0**	251.2	**5.1**	257.1	**5.0**
Tax on international trade and transactions	25.4	**0.6**	26.6	**0.6**	27.3	**0.6**	27.8	**0.6**	28.3	**0.6**
Other state revenues	9.2	**0.2**	9.3	**0.2**	9.6	**0.2**	9.8	**0.2**	9.9	**0.2**
Contributions	**495.0**	**11.5**	**524.4**	**11.4**	**531.0**	**11.1**	**539.6**	**10.9**	**545.1**	**10.6**
Contributions for pension and disability insurance	303.0	**7.0**	317.0	**6.9**	321.7	**6.7**	327.0	**6.6**	330.2	**6.4**
Contributions for health insurance	167.4	**3.9**	182.0	**4.0**	183.6	**3.8**	186.6	**3.8**	188.4	**3.7**
Contributions for insurance against unemployment	12.6	**0.3**	13.6	**0.3**	13.1	**0.3**	13.3	**0.3**	13.4	**0.3**
Other contributions	11.9	**0.3**	11.8	**0.3**	12.7	**0.3**	12.8	**0.3**	13.0	**0.3**
Duties	**13.6**	**0.3**	**16.7**	**0.4**	**14.7**	**0.3**	**15.1**	**0.3**	**15.4**	**0.3**
Fees	**19.0**	**0.4**	**26.4**	**0.6**	**36.5**	**0.8**	**42.1**	**0.9**	**47.7**	**0.9**
Other revenues	**35.7**	**0.8**	**71.1**	**1.5**	**70.8**	**1.5**	**72.1**	**1.5**	**58.4**	**1.1**
Receipts from loan repayment	6.6	**0.2**	**11.1**	**0.2**	**7.9**	**0.2**	**8.0**	**0.2**	**8.2**	**0.2**
Donation	25.3	**0.6**	**27.2**	**0.6**	**51.4**	**1.1**	**35.0**	**0.7**	**35.0**	**0.7**
Expenditures	**1,803.14**	**41.9**	**1,905.59**	**41.4**	**1,970.20**	**41.1**	**1,865.02**	**37.6**	**1,787.57**	**34.8**
Current budgetary spending	**1,551.3**	**36.1**	**1,640.9**	**35.6**	**1,649.3**	**34.4**	**1,646.1**	**33.2**	**1,667.6**	**32.5**
Current expenditures	**781.8**	**18.2**	**836.3**	**18.2**	**845.1**	**17.6**	**836.0**	**16.9**	**843.6**	**16.4**
Gross wages and contributions charged to employer	**445.4**	**10.4**	**459.8**	**10.0**	**472.1**	**9.9**	**469.5**	**9.5**	**464.5**	**9.0**
Other personal earnings	**10.6**	**0.2**	**13.2**	**0.3**	**15,1**	**0.3**	**14.3**	**0.3**	**14.3**	**0.3**
Expenditures for goods and services	**95.9**	**2.2**	**112.0**	**2.4**	**99.7**	**2.1**	**101.0**	**2.0**	**105.0**	**2.0**
Current maintenance	**20.2**	**0.5**	**21.0**	**0.5**	**23.1**	**0.5**	**22.8**	**0.5**	**23.1**	**0.4**
Interest	**98.7**	**2.3**	**88.6**	**1.9**	**95.8**	**2.0**	**86.9**	**1.8**	**84.3**	**1.6**
Rent	**8.9**	**0.2**	**11.1**	**0.2**	**9.8**	**0.2**	**9.9**	**0.2**	**10.1**	**0.2**
Subsidies	**27.8**	**0.6**	**30.6**	**0.7**	**30.8**	**0.6**	**30.1**	**0.6**	**30.4**	**0.6**
Other expenditures	**38.2**	**0.9**	**43.6**	**0.9**	**42.1**	**0.9**	**42.4**	**0.9**	**42.9**	**0.8**
Capital expenditure in the current budget	**36.0**	**0.8**	**56.3**	**1.2**	**56.7**	**1.2**	**59.0**	**1.2**	**69.0**	**1.3**
Social protection transfers	**538.1**	**12.5**	**544.5**	**11.8**	**554.5**	**11.6**	**571.2**	**11.5**	**582.9**	**11.3**
Social-protection-related rights	98.7	**2.3**	82.3	**1.8**	81.0	**1.7**	81.3	**1.6**	81.5	**1.6**
Funds for technological redundancies	13.0	**0.3**	14.2	**0.3**	14.8	**0.3**	16.4	**0.3**	14.4	**0.3**
Pension- and disability-insurance-related rights	401.3	**9.3**	414.8	**9.0**	429.0	**9.0**	442.0	**8.9**	452.0	**8.8**
Other health-protection-related rights	16.5	**0.4**	20.0	**0.4**	19.0	**0.4**	19.5	**0.4**	20.0	**0.4**
Other health-insurance-related rights	8.6	**0.2**	13.2	**0.3**	10.6	**0.2**	12.0	**0.2**	15.0	**0.3**
Transfers to institutions, individuals, the non-governmental and public sectors	**166.9**	**3.9**	**208.7**	**4.5**	**208.9**	**4.4**	**199.0**	**4.0**	**203.0**	**4.0**
Capital budget	**251.9**	**5.9**	**264.7**	**5.7**	**320.9**	**6.7**	**218.9**	**4.4**	**120.0**	**2.3**
Borrowings and loans	**4.9**	**0.1**	**4.6**	**0.1**	**2.3**	**0.0**	**2.4**	**0.0**	**2.6**	**0.0**
Reserves	**19.7**	**0.5**	**23.9**	**0.5**	**20.0**	**0.4**	**17.0**	**0.3**	**15.0**	**0.3**
Repayment of guarantees	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Repayment of liabilities from the previous period	**40.0**	**0.9**	**22.9**	**0.5**	**18.5**	**0.4**	**20.5**	**0.4**	**20.5**	**0.4**
Net increase of liabilities	**14.0**	**0.3**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Surplus/deficit	**−236.9**	**−5.5**	**−159.7**	**−3.5**	**−142.2**	**−2.97**	**7.9**	**0.2**	**114.0**	**2.2**
Adjusted deficit/surplus	**−250.9**	**−5.8**	**−159.7**	**−3.5**	**−142.2**	**−2.97**	**7.9**	**0.2**	**114.0**	**2.2**
Primary deficit	**−152.2**	**−3.5**	**−71.0**	**−1.5**	**−46.4**	**−1.0**	**94.8**	**1.9**	**198.3**	**3.9**
Debt repayment	**358.6**	**8.3**	**696.3**	**15.1**	**373.6**	**7.8**	**518.3**	**10.5**	**412.7**	**8.0**
Debt repayment to residents	226.0	**5.3**	234.8	**5.1**	44.1	**0.9**	104.7	**2.1**	43.7	**0.9**
Debt repayment to non-residents	132.6	**3.1**	461.5	**10.0**	329.5	**6.9**	413.6	**8.3**	369.0	**7.2**
Repayment of liabilities from the previous period	0.0	**0.0**	0.0	**0.0**	0.0	**0.0**	0.0	**0.0**	0.0	**0.0**
Expenditures for acquisition of securities	**0.0**	**0.0**	**69.2**	**1.5**	**40.2**	**0.8**	**0.0**	**0.0**	**0.0**	**0.0**
Shortfall	**−609.5**	**−14.2**	**−925.2**	**−20.1**	**−556.0**	**−11.6**	**−510.4**	**−10.3**	**−298.7**	**−5.8**
Financing	**609.5**	**14.2**	**925.2**	**20.1**	**556.0**	**11.6**	**510.4**	**10.3**	**298.7**	**5.8**
Borrowings and credits from domestic sources	260,1	**6,0**	213,6	**4,6**	180,0	**3,8**	16,2	**0,3**	50,0	**1,0**
Borowings and credits from foreign sources	352,8	**8,2**	900,1	**19,5**	190,0	**4,0**	488,2	**9,8**	242,7	**4,7**
Privatisation proceeds	6.2	**0.1**	15.7	**0.3**	6.0	**0.1**	6.0	**0.1**	6.0	**0.1**
Increase/decrease of deposits	**−9.6**	**−0.2**	−204.3	**−4.4**	180.0	**3.8**	0.0	**0.0**	0.0	**0.0**

GDP (in € millions)	4,299.0		4,604.5		4,788.6		4,956.8		5,138.3	
Public spending	**2017**		**2018**		**2019**		**2020**		**2021**	
	€ millions	**% of GDP**	**€ millions**	**% of GDP**	**€ millions**	**% of GDP**	**€ millions**	**% of GDP**	**€ millions**	**% of GDP**
Direct revenues	**1,785.39**	**41.53**	**1,963.01**	**42.63**	**2,059.85**	**43.0**	**2,111.61**	**42.6**	**2,144.06**	**41.7**
Taxes	**1,104.35**	**25.69**	**1,207.20**	**26.22**	**1,263.40**	**26.4**	**1,310.90**	**26.4**	**1,343.53**	**26.1**
Personal income tax	145.62	3.39	158.82	3.45	154.39	3.2	158.78	3.2	161.55	3.1
Corporate profit tax	49.23	1.15	68.17	1.48	71.80	1.5	76.24	1.5	78.07	1.5
Tax on immovable property transactions	15.17	0.35	18.53	0.40	18.92	0.4	19.26	0.4	19.61	0.4
Value added tax	548.71	12.76	616.91	13.40	652.86	13.6	678.08	13.7	698.26	13.6
Excise taxes	225.08	5.24	221.18	4.80	239.56	5.0	251.15	5.1	257.10	5.0
Tax on international trade and transactions	25.42	0.59	26.63	0.58	27.33	0.6	27.81	0.6	28.32	0.6
Local taxes	85.91	2.00	87.63	1.90	88.94	1.9	89.83	1.8	90.73	1.8
Other state taxes	9.20	0.21	9.31	0.20	9.60	0.2	9.77	0.2	9.89	0.2
Contributions	**494.95**	**11.51**	**524.44**	**11.39**	**531.02**	**11.1**	**539.64**	**10.9**	**545.05**	**10.6**
Duties	**20.17**	**0.47**	**23.43**	**0.51**	**21.46**	**0.4**	**22.01**	**0.4**	**22.52**	**0.4**
Fees	**79.77**	**1.86**	**78.42**	**1.70**	**93.50**	**2.0**	**101.13**	**2.0**	**107.72**	**2.1**
Other revenues	**49.10**	**1.14**	**87.23**	**1.89**	**87.16**	**1.8**	**88.92**	**1.8**	**75.59**	**1.5**
Receipts from loan repayment	**6.58**	**0.15**	**11.06**	**0.24**	**7.87**	**0.2**	**8.00**	**0.2**	**8.15**	**0.2**
Donations	**30.46**	**0.71**	**31.23**	**0.58**	**55.44**	**1.2**	**41.00**	**0.8**	**41.50**	**0.8**
Public spending	**2,012.46**	**46.81**	**2,085.12**	**45.28**	**2,162,86**	**45.2**	**2,066.05**	**41.7**	**1,995.26**	**38.8**
Current public spending	**1,714.46**	**39.88**	**1,773.83**	**38.52**	**1,790.49**	**37.4**	**1,792.51**	**36.2**	**1,817.55**	**35.4**
Current expenditures	**862.06**	**20.05**	**918.54**	**19.95**	**934.65**	**19.5**	**929.64**	**18.8**	**939.79**	**18.3**
Gross wages and contributions charged to employer	**492.11**	**11.45**	**507.48**	**11.02**	**523,69**	**11.0**	**522.68**	**10.5**	**519.38**	**10.1**
Other personal earnings	**13.88**	**0.32**	**16.51**	**0.36**	**19,26**	**0.4**	**19.07**	**0.4**	**19.17**	**0.4**
Expenditures for goods and services	**110.66**	**2.57**	**127.10**	**2.76**	**115.75**	**2.4**	**118.37**	**2.4**	**122.72**	**2.4**
Current maintenance	**26.37**	**0.61**	**27.22**	**0.59**	**29.98**	**0.6**	**30.29**	**0.6**	**30.74**	**0.6**
Interest	**102.51**	**2.38**	**92.84**	**2.02**	**100.23**	**2.1**	**91.46**	**1.8**	**88.98**	**1.7**
Rent	**9.52**	**0.22**	**11.72**	**0.25**	**10.43**	**0.2**	**10.52**	**0.2**	**10.73**	**0.2**
Subsidies	**29.02**	**0.67**	**31.80**	**0.69**	**32.08**	**0.7**	**31.41**	**0.6**	**31.74**	**0.6**
Other expenditures	**41.97**	**0.98**	**47.57**	**1.03**	**46.38**	**1.0**	**46.82**	**0.9**	**47.33**	**0.9**
Capital expenditure in the current budget	**36.01**	**0.84**	**56.32**	**1.22**	**56.36**	**1.2**	**59.00**	**1.2**	**69.00**	**1.3**
Social protection transfers	**538.86**	**12.53**	**545.31**	**11.84**	**555.32**	**11.6**	**572.06**	**11.5**	**583.78**	**11.4**
Social-protection-related rights	99.52	2.31	83.12	1.81	81.84	1.7	82.16	1.7	82.38	1.6
Funds for technological redundancies	12.97	0.30	14.20	0.31	14.83	0.3	16.40	0.3	14.40	0.3
Pension- and disability-insurance-related rights	401.26	9.33	414.75	9.01	429.03	9.0	442.00	8.9	452.00	8.8
Other health-protection-related rights	16.49	0.38	20.00	0.43	19.00	0.4	19.50	0.4	20.00	0.4
Other health-insurance-related rights	8.62	0.20	13.24	0.29	10.63	0.2	12.00	0.2	15.00	0.3
Transfers to institutions, individuals, the non-governmental and public sectors	**212.76**	**4.95**	**255.07**	**5.54**	**256.10**	**5.3**	**247.21**	**5.0**	**252.17**	**4.9**
Capital budget	**298.00**	**6.93**	**311.28**	**6.76**	**372.51**	**7.8**	**273.54**	**5.5**	**177.71**	**3.5**
Capital budget of Montenegro	251.88	5.86	264.70	5.75	320.93	6.7	218.93	4.4	120.00	2.3
Capital budget of local self-governments	46.12	1.07	46.59	1.01	51.59	1.1	54.62	1.1	57.71	1.1
Borrowings and loans	**7.20**	**0.17**	**6.10**	**0.13**	**3.81**	**0.1**	**3.99**	**0.1**	**4.14**	**0.1**
Reserves	**21.68**	**0.50**	**25.92**	**0.56**	**22.08**	**0.5**	**19.12**	**0.4**	**17.16**	**0.3**
Repayment of guarantees	0.00	0.00	0.00	0.00	0.00	**0.0**	0.00	**0.0**	0.00	**0.0**
Net increase of liabilities	**13.99**	**0.33**	**0.00**	**0.00**	**0.00**	**0.0**	**0.00**	**0.0**	**0.00**	**0.0**
Repayment of liabilities from the previous period	**71.90**	**1.67**	**22.89**	**0.50**	**18.53**	**0.4**	**20.50**	**0.4**	**20.50**	**0.4**
Surplus/deficit	**−227.07**	**−5.28**	**−122.11**	**−2.65**	**−103.01**	**−2.2**	**45.55**	**0.9**	**148.80**	**2.9**
Adjusted surplus/deficit	**−241.06**	**−5.61**	**−122.11**	**−2.65**	**−103.01**	**−2.2**	**45.55**	**0.9**	**148.80**	**2.9**
Primary deficit	**−138.55**	**−3.22**	**−29.27**	**−0.64**	**−2.79**	**−0.1**	**137.02**	**2.8**	**237.77**	**4.6**
Debt repayment	**371.79**	**8.65**	**753.28**	**16.36**	**430.60**	**9.0**	**573.29**	**11.6**	**463.67**	**9.0**
Repayment of principle to residents	236.29	5.50	245.82	5.34	57.10	1.2	118.71	2.4	57.70	1.1
Repayment of principle to non-residents	135.50	3.15	465.46	10.11	333.50	7.0	417.58	8.4	372.97	7.3
Repayment of liabilities from the previous period	0.00	0.00	42.00	0.91	40.00	0.8	37.00	0.7	33.00	0.6
Expenditures for acquisition of securities			**69.25**	**1.50**	**40.22**	**0.84**	**0.00**	**0.00**	**0.00**	**0.00**
Shortfall	**−598.86**	**−13.93**	**−944.63**	**−20.52**	**−573.83**	**−12.0**	**−527.74**	**−10.6**	**−314.88**	**−6.1**
Financing	**598.86**	**13.93**	**944.63**	**20.52**	**573.83**	**12.0**	**527.74**	**10.6**	**314.88**	**6.1**
Borrowings and credits from domestic sources	264.39	6.15	218,60	4,75	188.00	3.9	24.17	0.5	58.00	1.1
Borrowings and credits from foreign sources	353.34	8.22	904,14	19,64	196.01	4.1	494.21	10.0	248.67	4.8
Proceeds from privatisation and the sale of property	9.27	0.22	20,75	0,45	11.00	0.2	11.00	0.2	11.00	0.2
Transfers from the budget of Montenegro	3.63	0.08	5,00	0,11	5.00	0.1	5.00	0.1	5.00	0.1
Use of state deposits	**−31.77**	**−0.74**	**-203,85**	**-4,43**	**173.82**	**3.6**	**−6.65**	**−0.1**	**−7.79**	**−0.2**

ANNEX 2

Table 1a: Macroeconomic prospects

In percentage unless otherwise stated	ESA Code	2017	2017	2018	2019	2020	2021
		(€ bn)	Rate of change				
1. Real GDP at market prices	B1*g	4.141	4.7	4.1	2.8	2.3	2.4
2. GDP at current market prices	B1*g	4.299	8.7	7.1	4.0	3.5	3.7
Components of real GDP							
3. Household consumption	P3	3.155	3.9	1.6	1.4	1.3	0.8
4. Government consumption	P3	0.765	−1.4	0.3	−0.5	−0.5	−0.5
5. Gross fixed capital formation	P51	1.162	18.7	20.7	3.5	1.5	−4.4
6. Changes in inventories and net acquisition of valuables	P52+P53	0.130	:	−2.0	0.0	0.0	0.0
7. Export of goods and services	P6	1.634	1.8	6.9	4.2	3.9	3.9
8. Import of goods and services	P7	2.704	8.4	8.5	1.5	1.0	−2.4
Contribution to real GDP growth							
9. Domestic demand		5.1	7.4	6.8	2.0	1.3	−0.9
10. Changes in inventories and net acquisition of valuables	P52+P53	0.1	1.9	−0.1	0.0	0.0	0.0
11. Net export	B11	−1.1	−4.6	−2.7	0.8	1.0	3.3

Table 1b: Price development

Percentage change, annual average	ESA Code	2017	2018	2019	2020	2021
1. GDP deflator		3.8	2.9	1.2	1.2	1.2
2. Household consumption deflator		1.9	3.0	1.4	1.4	1.5
3. HICP – change		2.0	:	:	:	:
4. National CPI – change		2.7	0.5	−1.1	0.0	0.1
5. Public consumption deflator		3.6	4.3	2.5	2.5	2.5
6. Investment deflator		−0.4	2.1	1.5	1.5	1.5
7. Export price deflator (goods and services)		8.0	3.3	1.3	1.3	1.3
8. Import price deflator (goods and services)		2.5	3.2	2.0	2.0	2.0

Table 1c: Labour market developments

	ESA Code	2017	2018	2019	2020	2021
		Level/Rate of change				
1. Population (thousands)		623.1	623.8	624.5	625.2	625.9
2. Population (growth rate in %)		0.1	0.1	0.1	0.1	0.1
3. Working age population (people) [1]		417.9	416.4	415.0	413.7	412.4
4. Participation rate		0.0	0.0	0.0	0.0	0.0
5. Employment, people [2]		229.3	234.3	236.7	238.8	240.1
6. Employment, working hours [3]		:	:	:	:	:
7. Employment (growth rate in %)		2.3	2.2	1.0	0.9	0.5
8. Public sector employment (people)		:	:	:	:	:
9. Public sector employment (growth rate)		:	:	:	:	:
10. Unemployment, rate [4]		:	:	:	:	:
11. Labour productivity, people [5]		2.4	1.8	1.8	1.4	1.8
12. Labour productivity, hours worked [6]		:	:	:	:	:
13. Compensation of employees	D1	:	:	:	:	:
[1] Age group 15-64 years						
[2] Occupied population, domestic concept national accounts definition						
[3] National accounts definition						
[4] Harmonised definition, EUROSTAT, levels						
[5] Real GDP per employee						
[6] Real GDP per hour worked						

Table 1d: Sector balances

% of GDP	ESA Code	2017	2018	2019	2020	2021
1. Balance vis-à-vis the rest of the world	B.9	−16.1	−18.1	−17.0	−15.9	−12.5
of which:						
- balance of goods and services		−23.4	−25.1	−24.2	−23.1	−19.8
- balance of primary and secondary incomes		7.4	7.1	7.1	7.2	7.3
- capital account						
2. Net balance of the private sector	B.9/ EDP B.9					
3.Net balance of general government (public sector)		6.7	6.5	6.6	6.6	6.6
4. Statistical discrepancy		9.3	9.2	9.2	9.2	9.2

Table 1e: GDP, investments and gross value added

	ESA code	2017	2018	2019	2020	2021
GDP and investments						
GDP level at current market prices (in domestic currency)	B1g	4.3	4.6	4.8	5.0	5.1
Investment ratio (% of GDP)		26.9	31.0	31.3	31.1	29.1
Growth of Gross Value Added, percentage changes at real [constant] prices						
1. Agriculture		−3.1	2.0	3.0	2.0	2.0
2. Industry (excluding construction)		−0.6	7.3	4.7	3.5	3.6
3. Construction		24.5	23.0	6.0	5.0	4.0
4. Services		4.7	1.8	2.0	1.7	1.9

Table 1f: External sector developments

€ billions, unless otherwise indicated						
		2017	2018	2019	2020	2021
1.Current account balance (% of GDP)	% of GDP	−16.1	−18.1	−17.0	−15.9	−12.5
2. Export of goods	billions in NC or EUR	0.4	0.4	0.4	0.5	0.5
3. Import of goods	billions in NC or EUR	2.2	2.5	2.6	2.7	2.7
4. Trade balance	billions in NC or EUR	−1.9	−2.1	−2.2	−2.2	−2.2
5. Export of services	billions in NC or EUR	1.4	1.5	1.6	1.7	1.8
6. Import of services	billions in NC or EUR	0.5	0.6	0.6	0.6	0.6
7. Balance of services	billions in NC or EUR	0.9	0.9	1.0	1.1	1.2
8. Net interests	billions in NC or EUR	−0.1	:	:	:	:
9. Other net transfers from abroad	billions in NC or EUR	0.2	0.1	0.1	0.1	0.1
10. Current transfers	billions in NC or EUR	0.2	0.2	0.3	0.3	0.3
***11. Of which: from* the EU**	billions in NC or EUR	:	:	:	:	:
12. Current account balance	billions in NC or EUR	−0.7	−0.8	−0.8	−0.8	−0.6
13. Capital and financial account	billions in NC or EUR	:	:	:	:	:
14. Foreign direct investments	billions in NC or EUR	:	:	:	:	:
15. Foreign reserves	billions in NC or EUR	:	:	:	:	:
16. Total foreign debt	billions in NC or EUR	:	:	:	:	:
17. Of which: public	billions in NC or EUR	:	:	:	:	:
18. Of which: foreign currency denominated foreign debt	billions in NC or EUR	:	:	:	:	:
19. Of which: repayments due	billions in NC or EUR	:	:	:	:	:
20. Exchange rate vis-à-vis EUR (end-of-year)	NC or EUR	1.0	1.0	1.0	1.0	1.0
Exchange rate vis-à-vis EUR (end-of-year) % of changes	*% y-on-y*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*
21. Exchange rate vis-à-vis EUR (average)	NC or EUR	1.0	1.0	1.0	1.0	1.0
Exchange rate vis-à-vis EUR (average) % of changes	*% y-on-y*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*
22. Net foreign saving	% of GDP	:	:	:	:	:
23. Domestic private saving	% of GDP	:	:	:	:	:
24. Domestic private investment	% of GDP	:	:	:	:	:
25. Domestic public saving	% of GDP	:	:	:	:	:
26. Domestic public investment	% of GDP	:	:	:	:	:

Table 1g: Sustainability indicators

	Dimension	2014	2015	2016	2017	2018
1. Current account balance	% of GDP	−12.4	−11.0	−16.2	−16.1	−18.1
2. Net international investment position	% of GDP	:	:	:	:	:
3. Total export market share	%, y-on-y	:	:	:	:	:
4. Real effective exchange rate [1]	%, y-on-y	:	:	:	:	:
5. Nominal unit labour cost	%, y-on-y	3.7	−2.7	−3.2	−4.2	−4.6
6. Private [sector] credit	% of GDP	:	:	:	:	:
7. Private [sector] debt	% of GDP	:	:	:	:	:
8. Public sector debt	% of GDP	:	:	:	:	:

Table 2a: General government budgetary prospects

	ESA	2017	2017	2018	2019	2020	2021
		Level	% of GDP				
Net lending (B9) by subsectors							
1. General government	S13	−0.23	−5.28	−2.65	−2.15	0.92	2.90
2. Central government	S1311	−0.24	−5.51	−3.47	−2.97	0.16	2.22
3. State government	S1312	0.00	0.00	0.00	0.00	0.00	0.00
4. Local government	S1313	0.01	0.23	0.82	0.82	0.76	0.68
5. Social security funds	S1314	0.00	0.00	0.00	0.00	0.00	0.00
General Government (S13)							
6. Total revenue	TR	1.79	41.53	42.63	43.02	42.60	41.73
7. Total expenditure[35]	TE	2.01	46.81	45.28	45.17	41.68	38.83
8. Net borrowing/lending	EDP.B9	−0.23	−5.28	−2.65	−2.15	0.92	2.90
9. Interest expenditure	EDP.D41	0.10	2.38	2.01	2.09	1.85	1.73
10. Primary balance[36]		−0.12	−2.90	−0.64	−0.06	2.76	4.63
11. One-off and other temporary measures[37]							
Components of revenues							
12. Total taxes (12 = 12a+12b+12c)		1.01	23.48	24.31	24.33	24.44	24.19
12a. Taxes on production and imports	D2	0.80	18.59	18.98	19.21	19.31	19.14
12b. Current taxed on income and wealth	D5	0.19	4.53	4.86	4.72	4.74	4.66
12c. Capital taxes	D91	0.02	0.35	0.40	0.40	0.39	0.38
13. Social contributions	D61	0.49	11.51	11.39	11.09	10.89	10.61
14. Property income	D4	0.09	2.00	1.90	1.86	1.81	1.77
15. Other (15 = 16−(12+13+14))[38]		0.20	4.54	5.02	5.74	5.46	5.16
16 = 6. Total revenue	TR	1.79	41.53	42.63	43.02	42.60	41.73
p.m.: Tax burden (D2+D5+D61+D91−D995)[39]		1.50	34.99	35.73	35.42	35.32	34.80
Selected components of expenditures							
17. Collective consumption	P32	:	:	:	:	:	:
18. Total social transfers	D62 + D63	0.54	12.53	11.84	11.60	11.54	11.36
18a. Social transfers in kind	P31 = D63	0.00	0.00	0.00	0.00	0.00	0.00
18b. Social transfers other than in kind	D62	0.54	12.53	11.84	11.60	11.54	11.36
19 = 9. Interest expenditures	EDP.D41	0.10	2.38	2.01	2.09	1.85	1.73
20. Subsidies	D3	0.03	0.67	0.69	0.67	0.63	0.62
21. Gross fixed capital formation	P51	0.30	6.93	6.76	7.78	5.52	3.46
22. Other (22 = 23−(17+18+19+20+21)[40]		1.04	24.29	23.97	23.03	22.14	21.66
23 = 7. Total expenditures	TE[41]	2.01	46.81	45.28	45.17	41.68	38.83
p.m. Compensation of public-sector employees	D1	:	:	:	:	:	:

[35] Adjusted for the next flow of swap-related flows, so TR−TE = EDP.B9.

[36] The primary balance is calculated as (EDP.B9, item 8) plus (EDP D41 + FISIM recorded as intermediate consumption, item 9).

[37] A plus sign means deficit-reducing one-off measures.

[38] P.11+P.12+P.131+D.39+D.7+D.9 (other than D.91).

[39] Including those collected by the EU and including an adjustment for uncollected taxes and social contributions (D995), if appropriate.

[40] D.29+D4 (other than D.41)+ D.5+D.7+D.9+P.52+P.53+K.2+D.8.

[41] Adjusted for the next flow of swap-related flows, so the TR−TE = EDP.B9.

Table 2b: General government budgetary prospects

	ESA Code	2017	2018	2019	2020	2021
		Level	Bn NCU			
Net lending (B9) by subsectors						
1. General government	S13	−0.2	−0.1	−0.1	0.0	0.1
2. Central government	S1311	−0.2	−0.2	−0.1	0.0	0.1
3. State government	S1312	0.0	0.0	0.0	0.0	0.0
4. Local government	S1313	0.0	0.0	0.0	0.0	0.0
5. Social security funds	S1314	0.00	0.00	0.00	0.00	0.00
General Government (S13)						
6. Total revenue	TR	1.8	2.0	2.1	2.1	2.1
7. Total expenditure[42]	TE	2.0	2.1	2.2	2.1	2.0
8. Net borrowing/lending	EDP.B9	−0.2	−0.1	−0.1	0.0	0.1
9. Interest expenditure	EDP.D41	0.1	0.1	0.1	0.1	0.1
10. Primary balance[43]		−0.1	0.0	0.0	0.1	0.2
11. One-off and other temporary measures[44]		:	:	:	:	:
Components of revenues						
12. Total taxes (12 = 12a+12b+12c)		1.0	1.1	1.2	1.2	1.2
12a. Taxes on production and imports	D2	0.8	0.9	0.9	1.0	1.0
12b. Current taxed on income and wealth	D5	0.2	0.2	0.2	0.2	0.2
12c. Capital taxes	D91	0.0	0.0	0.0	0.0	0.0
13. Social contributions	D61	0.5	0.5	0.5	0.5	0.5
14. Property income	D4	0.1	0.1	0.1	0.1	0.1
15. Other (15 = 16−(12+13+14))[45]		0.2	0.2	0.3	0.3	0.3
16 = 6. Total revenue	TR	1.8	2.0	2.1	2.1	2.1
p.m.: Tax burden (D2+D5+D61+D91−D995)[46]		1.5	1.6	1.7	1.8	1.8
Selected components of expenditures						
17. Collective consumption	P32	:	:	:	:	:
18. Total social transfers	D62 + D63	0.5	0.6	0.6	0.6	0.6
18a. Social transfers in kind	P31 = D63	0.0	0.0	0.0	0.0	0.0
18b. Social transfers other than in kind	D62	0.5	0.6	0.6	0.6	0.6
19 = 9. Interest expenditures	EDP.D41	0.1	0.1	0.1	0.1	0.1
20. Subsidies	D3	0.0	0.0	0.0	0.0	0.0
21. Gross fixed capital formation	P51	0.3	0.3	0.4	0.3	0.2
22. Other (22 = 23− (17+18+19+20+21)[47]		1.0	1.1	1.1	1.1	1.1
23 = 7. Total expenditures	TE[48]	2.0	2.1	2.2	2.1	2.0
p.m. Compensation of public-sector employees	D1	:	:	:	:	:

[42] Adjusted for the next flow of swap-related flows, so the TR−TE = EDP.B9.

[43] The primary balance is calculated as (EDP.B9, item 8) plus (EDP D41 + FISIM recorded as intermediate consumption, item 9).

[44] A plus sign means deficit-reducing one-off measures

[45] P.11+P.12+P.131+D.39+D.7+D.9 (other than D.91).

[46] Including those collected by the EU and including an adjustment for uncollected taxes and social contributions (D995), if appropriate.

[47] D.29+D4 (other than D.41)+ D.5+D.7+D.9+P.52+P.53+K.2+D.8.

[48] Adjusted for the next flow of swap-related flows, so the TR−TE = EDP.B9.

Table 3: General government expenditures by function

% of GDP	COFOG code	2017	2018	2019	2020	2021
1. General public services	1	19.1	23.9	19.6	20.8	17.9
2. Defence	2	0.9	1.1	1.0	1.0	1.2
3. Public order and safety	3	3.7	3.5	3.3	3.4	3.3
4. Economic affairs	4	8.8	8.5	8.8	6.3	4.1
5. Environmental protection	5	0.0	0.2	0.2	0.2	0.2
6. Housing and community Amenities	6	0.2	0.2	0.2	0.2	0.2
7. Health	7	4.7	5.0	5.0	5.0	4.9
8. Recreation, culture and religion	8	0.9	1.1	1.0	1.0	1.0
9. Education	9	4.2	4.1	4.0	3.8	3.7
10. Social protection	10	12.8	12.2	11.7	11.5	11.3
11. Total expenditures (item 7 = 23 in Table 2)	TE	55.4	59.7	54.9	53.3	47.7

Table 4: General government debt development

% of GDP	ESA code	2017	2018	2019	2020	2021
1. Gross debt [49]		63.2	70.0	67.0	64.6	60.4
2. Changes in gross debt ratio			6.8	−3.0	−2.4	−4.1
Contributions to change in gross debt						
3. Primary balance[50]		2.9	1.0	0.1	−2.8	−4.6
4. Investment expenditures[51]		2.4	2.0	2.1	1.8	1.7
5. Stock-flow adjustment		−5.3	−2.9	−2.2	0.9	2.9
of which:						
- Difference between cash and accrual method[52]						
- Net accumulation of financial assets[53]						
of which:						
- Privatisation proceeds						
- Valuation effects and other[54]						
p.m. implicit interest rate on debt[55]		4.1	3.4	3.1	2.9	2.8
Other relevant variables						
6. Liquid financial assets[56]						
7. Net financial debt (7 = 1 − 6)						

[49] As defined in Regulation 3605/93 (not an ESA concept).

[50] Cf. item 10 in Table 2.

[51] Cf. item 9 in Table 2.

[52] The differences concerning interest expenditure, other expenditure and revenue could be distinguished when relevant.

[53] Liquid assets, assets on third countries, government-controlled enterprises and the difference between quoted and non-quoted assets could be distinguished when relevant.

[54] Changes due to exchange rage movement, and operation in secondary market could be distinguished when relevant.

[55] Proxied by interest expenditure divided by the debt level of the previous year.

[56] AF1, AF2, AF3 (consolidated at market value, AF5 (if quoted in stock exchange; including mutual fund shares)).

Table 5: Cyclical developments

% of GDP	ESA code	2017	2018	2019	2020	2021
1. Real GDP growth (%, y-on-y)	B1g	4.7	4.1	2.8	2.3	2.4
2. Net lending of public sector [general government]	EDP.B.9	−5.3	−2.9	−2.2	0.9	2.9
3. Interest expenditure	EDP.D.41	2.4	2.0	2.1	1.8	1.7
4. One-off and other temporary measures		0.0	0.0	0.0	0.0	0.0
5. Potential GDP growth (%, y-on-y)		3.2	3.7	3.5	3.2	2.7
Contributions:						
- labour		2.4	2.9	3.4	3.1	2.8
- capital		0.7	1.5	1.4	0.7	0.6
- total factor productivity		−0.2	0.3	−0.8	−1.0	−1.1
6. Output gap		1.6	1.9	1.2	0.3	0.0
7. Cyclical budgetary component		0.5	0.7	0.4	0.1	0.0
8. Cyclically adjusted balance (2–7)		−5.8	−3.6	−2.6	0.8	2.9
9. Cyclically adjusted primary budgetary balance		−3.4	−1.6	−0.5	2.7	4.6
10. Structural balance (8–4)		−5.8	−3.6	−2.6	0.8	2.9

Table 6: Divergence from previous programme

	2017	2018	2019	2020	2021
1. GDP growth (%, y-on-y)					
Previous programme	4.0	3.0	2.7	2.6	:
Latest update	4.7	4.1	2.8	2.3	2.4
Difference (percentage points)	0.7	1.1	0.1	−0.3	:
2. Public-sector deficit (GDP)					
Previous programme	−3.1	−1.6	0.1	5.4	:
Latest update	−5.3	−2.9	−2.2	0.9	2.9
Difference (percentage points)	−5.3	−2.9	−2.2	0.9	:
3 Public-sector gross debt (GDP)					
Previous programme	65.5	66.5	66.1	59.7	:
Latest update	63.2	70.0	67.0	64.6	60.4
Difference (percentage points)	−2.2	3.5	0.9	4.9	:

Table 7: Long-term sustainability of public finances

% of GDP	2007	2010	2020	2030	2040	2050	2060
Total expenditures							
of which: age-related expenditures							
- Pension expenditures							
- Social security pensions							
- Old-age and early pensions							
- Other pensions (disability, survivors)							
- Occupational pensions (if in general government)							
- Healthcare							
- Long-term care *(this was earlier included in the health care)*							
Education expenditures							
Other age-related expenditures							
Interest expenditure							
Total revenues							
of which: property income							
of which: from pension contributions (or social contributions, if appropriate)							
Pension reserve fund assets							
of which: consolidated pension fund assets (assets other than government liabilities)							
Assumptions							
Labour productivity growth rate							
Real GDP growth rate							
Participation rate males(aged 20–64)							
Participation rate females (aged 20–64)							
Total participation rates (aged 20–64)							
Unemployment rate							
Population aged 65+ over total population							

Table 7a: Contingent liabilities

% of GDP	2018	2019
State guarantees	13.4	
Of which: linked to the financial sector		

Table 8: Basic assumptions on the external economic environment [1]

	Dimension	2017	2018	2019	2020	2021
Short-term interest rate [1]	annual average	−0.3	−0.3	−0.2	0.2	:
Long-term interest rate	annual average	0.3	0.5	0.7	0.9	:
USD/EUR exchange rate	annual average	1.13	1.18	1.15	1.15	:
Nominal effective exchange rate	annual average	102.1	105	100.6	100	:
Exchange rate vis-à-vis the EUR	annual average	1.00	1.00	1.00	1.00	1.00
Global GDP growth, excluding EU	annual average	3.9	4.0	3.8	3.8	:
EU GDP growth	annual average	2.4	2.1	1.9	1.8	:
Growth of relevant foreign markets	annual average	−0.5	−0.3	0.7	1.7	:
World import volumes, excluding EU	annual average	5.5	4.8	4	3.7	:
Oil prices (Brent, USD/barrel)	annual average	54.8	75.1	80.6	76.7	:
[1] If necessary, purely technical assumption						

Table 9: Selected social and employment indicators[57]

	Data source[58]	2014	2015	2016	2017	2018
1. Labour market participation rate (%) total (15+ years old)	e	52.7	53.7	54.5	54.7	
- male	e	59.5	60.1	61.8	62.2	
- female	e	46.2	47.6	47.6	47.5	
2. Employment rate (%) total (15+ years old)	e	43.2	44.3	44.9	45.9	
- male	e	48.9	49.4	50.5	52.6	
- female	e	37.8	39.4	39.4	39.4	
3. Unemployment rate (%) total (15+ years old)	e	18.0	17.5	17.7	16.1	
- male	e	17.8	17.7	18.2	15.4	
- female	e	18.2	17.3	17.1	16.9	
4. Long-term unemployment rate (%) total	e	14.0	13.6	13.4	12.4	
- male	e	13.8	13.6	13.8	12.2	
- female	e	14.1	13.3	12.8	12.8	
5. Youth unemployment (%) total (15–24 years old)	e	35.8	37.6	35.9	31.7	
- male	e	(36.0)	(39.9)	36.9	30.7	
- female	e	35.4	34.5	(34.6)	33.1	
6. Young people (15–24 years old) not in employment, education or training (NEET), in %		17.7	19.1	18.4	16.7	
7. Early school leavers (18–24 years old), in % (Eurostat definition)		5.1	5.7	5.5	5.4	
8. Participation rate in early childhood education and care	e	5.1	5.7	5.5		
9. GINI coefficient	e	36.5	36.5	36.5	36.7 [p]	
10. Inequality of income distribution S80/S20		7.3	7.5	7.4	7.6 [p]	
11. Social protection expenditures, in % of GDP		26.2 (2013)	n/a	n/a	n/a	
12. Health expenditures, in % of GDP	e	4.3 (2013)	n/a	n/a	n/a	
13. At-risk-of-poverty before social transfers, in % of the population						
- social transfers not included in the income	e	31.1	29.4	28.9	31.4[p]	
- pensions and social transfers not included in the income	e	46.5	45.1	44.1	46.6[p]	
14. Poverty risk rate	e	24.1	24.4	24.0	23.6[p]	
15. Relative gap of poverty risk (Please indicate which data is available for your country)	e	32.8	36.6	35.6	34.0p	

[57]Given the disparate availability of data and variety of definitions used for indicators, countries should use Eurostat data when available. In case of data from national or international sources, a footnote should be added for each indicator indicating how it is defined. In case no data is available for an indicator, please see whether any data would be available for a similar indicator and explain so. It is recommended that year X = 2017. In case that no data is available for 2017, the data available for the previous years (2016, 2015) shall be introduced in the respective columns. For all indicators the values shall be inserted in the table, not the year-on-year change of the values as in some other tables.

[58] For indicators marked "e", Eurostat indicators should be available for all candidate countries.

[p] Preliminary data.

Table 10a: Estimate of additional costs of structural reform measures

Priority Reform Measure No. 1: Improving the ownership, managerial and organisational structure in electrical power companies with state-dominant ownership					
Year	**Salaries**	**Goods and services**	**Subsidies and transfers**	**Capital expenditure**	**Total**
2019	0	100,000.00	0	0	100,000.00
2020	0	15,000.00	0	0	15,000.00
2021	0	15,000.00	0	0	15,000.00
Priority Reform Measure No. 2: Improving the legislative-regulatory and institutional framework for integration into the regional electricity market					
Year	**Salaries**	**Goods and services**	**Subsidies and transfers**	**Capital expenditure**	**Total**
2019	0	0	0	0	0
2020	0	0	0	0	0
2021	0	0	0	0	0
Priority Reform Measure No. 3: Creating efficient and independent rail transport regulatory and safety authorities					
Year	**Salaries**	**Goods and services**	**Subsidies and transfers**	**Capital expenditure**	**Total**
2019	180,000.00	125,000.00	0	10,000.00	315,000.00
2020	180,000.00	110,000.00	0	25,000.00	315,000.00
2021	190,000.00	115,000.00	0	10,000.00	315,000.00
Priority Reform Measure No. 4: Supporting investments in the development and modernisation of the industrial sector					
Year	**Salaries**	**Goods and services**	**Subsidies and transfers**	**Capital expenditure**	**Total**
2019	0	0	743,500.00[59]	0	743,500.00
2020	0	0	1,443,500.00	0	1,443,500.00
2021	0	0	1,793,500.00	0	1,793,500.00
Priority Reform Measure No. 5: Supporting investments in the food production sector in order to reach EU standards					
Year	**Salaries**	**Goods and services**	**Subsidies and transfers**	**Capital expenditure**	**Total**
2019	0	0	20,000,000.00	0	20,000,000.00
2020	0	0	22,000,000.00	0	22,000,000.00
2021	0	0	25,000,000.00	0	25,000,000.00
Priority Reform Measure No. 6: Diversifying tourist products					
Year	**Salaries**	**Goods and services**	**Subsidies and transfers**	**Capital expenditure**	**Total**
2019	0	39,000.00	150,000.00	0	189,000.00

[59] This amount represents funds representing additional costs for implementation of the measure as a difference between 2018 outturn and budget allocation for 2019. The total amount of budgetary allocation for implementation of the measure by year is provided in the text about the measure.

2020	0	22,000.00	10,000.00	0	32,000.00
2021	0	40,000.00	20,000.00	0	60,000.00
Priority Reform Measure No. 7: Strengthening the prudential supervision and bank resolution framework					
Year	**Salaries**	**Goods and services**	**Subsidies and transfers**	**Capital expenditure**	**Total**
2019	0	0	0	0	0
2020	0	0	0	0	0
2021	0	0	0	0	0
Priority Reform Measure No. 8: Adopting and implementing the Law on Public–Private Partnerships and the Law on Concessions					
Year	**Salaries**	**Goods and services**	**Subsidies and transfers**	**Capital expenditure**	**Total**
2019	0	50,000.00	0	0	50,000.00
2020	0	20,000.00	0	0	20,000.00
2021	0	0	0	0	0
Priority Reform Measure No. 9: Adopting and implementing the Law on Administrative Charges					
Year	**Salaries**	**Goods and services**	**Subsidies and transfers**	**Capital expenditure**	**Total**
2019	0	0	0	0	0
2020	0	0	0	0	0
2021	0	0	0	0	0
Priority Reform Measure No. 10: Adopting the Law on Issuing Electronic Fiscal Invoices in the Trade in Products and Services and implementing the electronic fiscal invoices system					
Year	**Plate**	**Goods and services**	**Subsidies and transfers**	**Capital expenditure**	**Total**
2019	0	1,500,000.00	0	0	1,500,000.00
2020	0	1,000,000.00	0	0	1,000,000.00
2021	0	0	0	0	0
Priority Reform Measure No. 11: Improving support for the micro, small and medium-sized enterprise sector					
Year	**Salaries**	**Goods and services**	**Subsidies and transfers**	**Capital expenditure**	**Total**
2019	0	227,299.40	108,620.18	0	335,919.58[60]
2020	0	927,299.40	1,683,620.18	0	2,610,919.58
2021	0	227,229.40	808,620.18	0	1,035,919.58
Priority Reform Measure No. 12: Improving the legislative-regulatory framework in order to reduce the costs of deploying high-speed electronic communication networks					

[60] This amount of €335,919.58 represents the funds that are additional costs for implementation of the measure as a difference between 2018 realisation and planned allocation for 2019. The total amount of planned for implementation of the reform measure for 2019 is provided in the text about the measure.

Year	Salaries	Goods and services	Subsidies and transfers	Capital expenditure	Total
2019	0	0	0	0	0
2020	0	0	0	0	0
2021	0	0	0	10,000,000	10,000,000
Priority Reform Measure No. 13: Strengthening the national innovative ecosystem					
Year	**Salaries**	**Goods and services**	**Subsidies and transfers**	**Capital expenditure**	**Total**
2019	90,000.00	0	2,750,323.00	0	2,840,323.00
2020	90,000.00	0	4,517,323.00	4,000,000	8,607,323.00
2021	90,000.00	0	3,012,500.00	4,000,000	7,102,500.00
Priority Reform Measure No. 14: Implementing the trade facilitation measures set out in WTO Trade Facilitation Agreement and in CEFTA Additional Protocol No. 5					
Year	**Salaries**	**Goods and services**	**Subsidies and transfers**	**Capital expenditure**	**Total**
2019	0	1,179,000.00	0	0	1,179,000.00
2020	0[61]	792,500.00	0	0	792,500.00
2021	0[62]	792,500.00	0	0	792,500.00
Priority Reform Measure No. 15: Development of qualification and education curricula in accordance with the labour market needs					
Year	**Salaries**	**Goods and services**	**Subsidies and transfers**	**Capital expenditure**	**Total**
2019	0	23,920.00	0	0	23,920.00
2020	0	436,272.50	0	0	436,272.50
2021	0	436,272.50	0	0	436,272.50
Priority Reform Measure No. 16: Implementation of apprenticeship with employers					
Year	**Salaries**	**Goods and services**	**Subsidies and transfers**	**Capital expenditure**	**Total**
2019	0	0	12,112.00	0	12,112.00
2020	0	0	50,000.00	0	50,000.00
2021	0	0	50,000.00	0	50,000.00
Priority Reform Measure No. 17: Support for self-employment and strengthening of local employment initiatives					
Year	**Salaries**	**Goods and services**	**Subsidies and transfers**	**Capital expenditure**	**Total**
2019	0	0	0	0	0
2020	0	0	1,144,000.00	0	1,144,000.00
2021	0	0	1,379,000.00	0	1,379,000.00
Priority Reform Measure No. 18: Development of day-care services for the elderly					

[61] Additional funds may be required for this activity; however, it is not possible to make an adequate assessment at present time. Additional analysis will be carried out during 2019.
[62] Additional funds may be required for this activity; however, it is not possible to make an adequate assessment at present time. Additional analysis will be carried out during 2019.

Year	Salaries	Goods and services	Subsidies and transfers	Capital expenditure	Total
2019	0	0	0	0	0
2020	0	0	0	0	0
2021	0	0	0	0	0
Priority Reform Measure No. 19: Incentive for including children in sports activities					
Year	**Salaries**	**Goods and services**	**Subsidies and transfers**	**Capital expenditure**	**Total**
2019	0	0	500,000.00	0	500,000.00
2020	0	0	500,000.00	0	500,000.00
2021	0	0	500,000.00	0	500,000.00

Table 10b: Financing of structural reform measures

Priority Reform Measure No. 1: Improving the ownership, managerial and organisational structure in electrical power companies with state-dominant ownership								
Year	Central budget	Local budgets	Other national public finance sources	IPA funds	Other grants	Project loans	To be determined	Total
2019	0	0	0	0	0	0	100,000.00[63]	100,000,00
2020	15,000.00	0	0	0	0	0	0	15,000.00
2021	15,000.00	0	0	0	0	0	0	15,000.00
Priority Reform Measure No. 2: Improving the legislative-regulatory and institutional framework for integration into the regional electricity market								
Year	Central budget	Local budgets	Other national public finance sources	IPA funds	Other grants	Project loans	To be determined	Total
2019	0	0	0	0	0	0	0	0
2020	0	0	0	0	0	0	0	0
2021	0	0	0	0	0	0	0	0
Priority Reform Measure No. 3: Creating efficient and independent rail transport regulatory and safety authorities								
Year	Central budget	Local budgets	Other national public finance sources	IPA funds	Other grants	Project loans	To be determined	Total
2019	315,000.00	0	0	0	0	0	0	315,000.00
2020	315,000.00	0	0	0	0	0	0	315,000.00

[63] This amount for financing the measure will be provided by the electricity companies.

2021	315,000.00	0	0	0	0	0	0	315,000.00
Priority Reform Measure No. 4: Supporting investments in the development and modernisation of the industrial sector								
Year	Central budget	Local budgets	Other national public finance sources	IPA funds	Other grants	Project loans	To be determined	Total
2019	743,500.00	0	0	0	0	0	0	743,500.00
2020	1,443,500.00	0	0	0	0	0	0	1,443,500.00
2021	1,793,500.00	0	0	0	0	0	0	1,793,500.00
Priority Reform Measure No. 5: Supporting investments in the food production sector in order to reach EU standards								
Year	Central budget	Local budgets	Other national public finance sources	IPA funds	Other grants	Project loans	Private sector participation	Total
2019	3,000,000.00	0	0	19,000,000.00	0	0	8,000,000.00	20,000,000.00
2020	3,200,000.00	0	0	10,000,000.00	0	0	8,800,000.00	22,000,000.00
2021	3,700,000.00	0	0	11,300,000.00	0	0	10,000,000.00	25,000,000.00
Priority Reform Measure No. 6: Diversifying the tourist product								
Year	Central budget	Local budgets	Other national public finance sources	IPA funds	Other grants	Project loans	To be determined	Total
2019	189,000.00	0	0	0	0	0	0	189,000.00
2020	32,000.00	0	0	0	0	0	0	32,000.00
2021	60,000.00	0	0	0	0	0	0	60,000.00
Priority Reform Measure No. 7: Strengthening the prudential supervision and bank resolution framework								
Year	Central budget	Local budgets	Other national public finance sources	IPA funds	Other grants	Project loans	To be determined	Total
2019	0	0	0	Approx. 200,000.00	0	0	0	0
2020	0	0	0	Approx. 100,000.00	0	0	0	0
2021	0	0	0	0	0	0	0	0
Priority Reform Measure No. 8: Adopting the strategic framework for public–private partnerships as an addition to the Strategy for Development of the Public Procurement System in Montenegro								

Year	Central budget	Local budgets	Other national public finance sources	IPA funds	Other grants	Project loans	To be determined	Total
2019	0	0	0	0	0	0	0	0
2020	0	0	0	0	0	0	0	0
2021	0	0	0	0	0	0	0	0

Priority Reform Measure No. 9: Adopting and implementing the Law on Administrative Charges

Year	Central budget	Local budgets	Other national public finance sources	IPA funds	Other grants	Project loans	To be determined	Total
2019	0	0	0	0	0	0	0	0
2020	0	0	0	0	0	0	0	0
2021	0	0	0	0	0	0	0	0

Priority Reform Measure No. 10: Adopting the Law on Issuing Electronic Fiscal Invoices in the Trade in Products and Services and implementing the electronic fiscal invoices system

Year	Central budget	Local budgets	Other national public finance sources	IPA funds	Other grants	Project loans	To be determined	Total
2019	1,500,000.00	0	0	0	0	0	0	1,500,000.00
2020	1,000,000.00	0	0	0	0	0	0	1,000,000.00
2021	0	0	0	0	0	0	0	0

Priority Reform Measure No. 11: Improving support for the micro, small and medium-sized enterprise sector

Year	Central budget	Local budgets	Other national public finance sources	IPA funds	Other grants	Project loans	To be determined	Total
2019	175,009.49	0	0	0	160,910.09	0	0	335,919.58
2020	175,009.49	0	0	2,275,000.00 indicative	160,910.09	0	0	2,610,919.58
2021	175,009.49	0	0	700,000.00 indicative	160,910.09	0	0	1,035,919.58

Priority Reform Measure No. 12: Improving the legislative-regulatory framework in order to reduce the costs of deploying high-speed electronic communication networks

Year	Central budget	Local budgets	Other national public finance sources	IPA funds	Other grants	Project loans	To be determined	Total
2019	0	0	0	0	0	0	0	0
2020	0	0	0	0	0	0	0	0
2021	0	0	0	0	0	0	10,000,000	10,000,000
Priority Reform Measure No. 13: Strengthening the national innovation ecosystem								
Year	Central budget	Local budgets	Other national public finance sources	IPA funds	Other grants	Project loans	To be determined	Total
2019	1,891,500.00	0	0	628,823.50	70,000.00	250,000.00	0	2,840,323.00
2020	6,498,500.00	400,000	0	1,558,823.50	15,000.00	0	0	8,607,323.50
2021	6,023,500	600,000	0	0	470,000	0	0	7,093,500
Priority Reform Measure No. 14: Implementing trade facilitation measures set out in the WTO Trade Facilitation Agreement and in CEFTA Additional Protocol No. 5								
Year	Central budget	Local budgets	Other national public finance sources	IPA funds	Other grants	Project loans	To be determined	Total
2019	139,800.00	0	0	853,200.00	100,000.00	86,000.00	0	1,179,000.00
2020	59,250.00	0	0	533,250.00	200,000.00	0	0	792,500.00
2021	59,250.00	0	0	533,250.00	200,000.00	0	0	792,500.00
Priority Reform Measure No. 15: Development of qualification and education curricula in accordance with the labour market needs								
Year	Central budget	Local budgets	Other national public finance sources	IPA funds	Other grants	Project loans	To be determined	Total
2019	23,920.00	0	0	0	0	0	0	23,920.00
2020	111,272.50	0	0	325,000.00	0	0	0	436,272.50
2021	111,272.50	0	0	325,000.00	0	0	0	436,272.50
Priority Reform Measure No. 16: Implementation of apprenticeships with employers								

Year	Central budget	Local budgets	Other national public finance sources	IPA funds	Other grants	Project loans	To be determined	Total
2019	12,112.00	0	0	0	0	0	0	12,112.00
2020	50,000.00	0	0	0	0	0	0	50,000.00
2021	50,000.00	0	0	0	0	0	0	50,000.00
Priority Reform Measure No. 17: Support for self-employment and strengthening of local employment initiatives								
Year	Central budget	Local budgets	Other national public finance sources	IPA funds	Other grants	Project loans	To be determined	Total
2019	0	0	0	0	0	0	0	0
2020	171,600.00	0	0	972,400.00	0	0	0	1,144,000.00
2021	206,850.00	0	0	1,172,150.00	0	0	0	1,379,000.00
Priority Reform Measure No. 18: Development of day-care services for the elderly								
Year	Central budget	Local budgets	Other national public finance sources	IPA funds	Other grants	Project loans	To be determined	Total
2019	0	0	0	0	0	0	0	0
2020	0	0	0	0	0	0	0	0
2021	0	0	0	0	0	0	0	0
Priority Reform Measure No. 19: Incentive for including children in sports activities								
Year	Central budget	Local budgets	Other national public finance sources	IPA funds	Other grants	Project loans	To be determined	Total
2019	500,000.00	0	0	0	0	0	0	500,000.00
2020	500,000.00	0	0	0	0	0	0	500,000.00
2021	500,000.00	0	0	0	0	0	0	500,000.00

Table 11: Reporting on implementation of the structural reform measures of the 2018–2020 ERP

Priority Reform Measure No. 1: Introducing an e-procurement system		Stage of reform implementation (1–5)[64]
Activities planned for 2018	1. Adoption of the new Law on Public Procurement	**2**
	2. Completion of the tender procedure initiated in 2017 and contract signing with the selected bidder for implementation of the project of introducing an electronic public procurement system.	**2**
	3.	
Description of implementation and explanation if partial or no implementation	2. On 6 December 2018, the kick-off meeting was held at the Directorate for Finance and Contracting of the EU Assistance Funds of the Ministry of Finance regarding the project "Implementation of the Electronic Public Procurement System". The project is funded from the IPA 2014 Annual Action Plan for Montenegro (CAP 2014) within the pre-accession assistance instrument (IPA II) and will last 36 months, i.e. until December 2021. The overall goal of this project is to increase the efficiency, effectiveness and transparency of public procurement procedures in Montenegro in line with European Union standards. The project implementation contract was signed with the company **Belit LLC** from Serbia, in a consortium with INTRASOFT International S.A. from Belgium, B&S Europe S.A. from Belgium and Asseco SEE LLC from Serbia. The total contract value amounts to **€1,400,000**, of which EU financing accounts for 90 percent and national co-financing accounts for 10 percent. The project will be implemented through indirect management of EU funds in Montenegro, whereby the Directorate for Finance and Contracting of the EU Assistance Funds of the Ministry of Finance is a contracting authority.	
Priority Reform Measure No. 2: Improving the legislative-regulatory and institutional framework for integration into the regional electricity market		Stage of reform implementation (1–5)
Activities planned for 2018	1. Transposition and implementation of Regulation (EU) 347/2013 on guidelines for a Trans-European Energy Infrastructure	**2**
	2. Transposition and implementation of Regulation (EU) 2015/1222 establishing a guideline on capacity allocation and congestion	**1**

[64] 0 = no implementation; 1= implementation is in preparation; 2 = initial steps have been taken; 3 = implementation is in progress with some initial results achieved; 4 = implementation is successful; 5 = implementation complete.

	management and Regulation (EU) 2016/1719 establishing a guideline on forward-capacity allocation, and their implementation	
	3. Creating a model for connecting the national market with the neighbouring electricity markets	**2**
	4. Establishing an efficient electricity-balancing market at the regional level	**1**
	5. Certification of electricity transmission system operators	**5**
	6. Selection of the strategic partners for the Electricity Exchange LLC	**2**
Description of implementation and explanation if partial or no implementation	1. Regulation (EU) 347/2013 on guidelines for a Trans-European Energy Infrastructure is planned to be transposed through the Law amending the Law on Cross-Border Exchange of Electricity and Natural Gas. This draft law was prepared by the consultant, under the IPA 2012 project. The working group continued working on transposition of the subject Regulation.	
	3. Transposition of Regulation (EU) 2015/1222 on establishing a guideline on capacity allocation and congestion management is planned through the Decree on establishing guidelines for the allocation of cross-border electricity transmission capacities and congestion management. Work on transposition will continue after adoption of the decision by the Ministerial Council of the Energy Community on adjustment of Regulation 2015/1222 for Contracting Parties of the Energy Community. 4. Transponovanje Regulative (EU) 2016/1719 o uspostavljanju smjernica za dugoročnu dodjelu kapaciteta planirano je kroz Uredbu o utvrđivanju smjernica za dugoročnu dodjelu kapaciteta. Rad na transponovanju će se nastaviti po donošenju odluke Ministarskog savjeta Energetske zajednice o prilagođavanju Regulative (EU) 2016/1719 za Ugovorne strane Energetske zajednice.	
	3. Preparatory activities for creation of the model for connecting national market with the neighbouring electricity markets have been initiated by the Steering Committee which was set up in the framework of implementation of “soft measures” and includes representatives of the competent ministries, regulatory bodies, transmission system operators and market operators; it is coordinated by the Energy Community Secretariat. The analysis of possible models of connecting electricity markets is currently being prepared with additional technical assistance provided by the European Union, and through the Energy Community Secretariat.	
	4. Preparatory activities for establishing an electricity balancing market at the regional level have been initiated by the Steering Committee which was set up on the basis of implementation of “soft measures”, whose composition includes representatives of the competent ministries, regulatory bodies, transmission system operators and market operators; it is coordinated by the Energy Community Secretariat. The analysis of possible models of connecting electricity markets is currently prepared, with additional technical assistance provided by the European	

	Union and through the Energy Community Secretariat.	
	6. Analysis of the possible forms of business cooperation between Electricity Exchange LLC and the strategic partner was carried out with technical assistance from the Energy Community Secretariat. The procedure for selecting the most favourable strategic partner is in progress.	
Priority Reform Measure No. 3: Adopting secondary legislation on a single window for formalities in maritime transport		Stage of reform implementation (1–5)
Activities planned for 2018	1. The necessary IPA funds for implementation of this measure have been approved.	**1**
Description of implementation and explanation if partial or no implementation	The precondition for implementation of this secondary legislation is establishment of the information system, i.e. National Maritime Single Window (NMSW), for which funds were requested and approved from IPA II and these funds are expected to become available in 2019.	
Priority Reform Measure No. 4: Creating efficient and independent rail regulatory and safety authorities		Stage of reform implementation (1–5)
Activities planned for 2018	1. Preparation of the Draft Law on the Railways	4
	2. Public consultation of the Draft Law on the Railways, obtaining all the necessary opinions and verification of compliance of the Law on the Railways with EU legislation	1
	3. Preparation of the new jobs classification of the Railway Directorate	3
Description of implementation and explanation if partial or no implementation	1. The penalty provisions of the Law on the Railways are currently being prepared. 2. The Law on the Railways was submitted for public consultation in the Q4 2018.It is impossible to influence the opinion of the EC, but since the law is highly compliant with the EU legislation, no substantial remarks are expected to be received and, consequently, faster feedback, i.e. a positive opinion on the submitted draft law, is expected. 3. Railway Directorate hired a consultant who will prepare proposal for job classification in line with the new set-up.	
Priority Reform Measure No. 5: Fostering investments in the industrial sector		Stage of reform implementation (1–5)
Activities planned for 2018	1. Monitoring implementation of the investment projects under six contracts concluded in 2016 on the use of funds for fostering direct investments. By 2018, out of the six projects implemented in line with the concluded contracts on the use of funds for fostering direct investments four projects were implemented. The remaining two projects are in the final stage (so far, two instalments of the funds have been paid out amounting to €240,000) and are being implemented in line with the timetable stipulated in the contracts. Since the third	5

	instalment still remains to be paid out, their finalisation is expected in the coming period (at the latest by 1 August 2019). Out of the €1.25 million allocated in the 2018 budget, the amount paid out totalled €330,000 for three instalments for three projects, whereas €120,000 remained for the payment of instalments for two companies.	
	2. Finalisation of the activities under the open call for participation in the procedure for the awarding of funds for fostering direct investments No. 02/2-36/8, of 3 March 2017. In 2018, the assessment of the correctness of applications was carried out and the procedure for analysing compliance of the investment projects specified in the correct applications received for the third call was finalised; decisions were also rendered on rejecting incorrect applications (all nine received applications were rejected as incorrect); therefore, an comprehensive Information on the open call for participation in the procedure for the awarding of funds for fostering direct investments was submitted to the Government and the procedure was formally finalised for the 2017 open call for the award of funds for fostering direct investments.	5
	3. Publication on the Public Call for participation in the procedure for the awarding of funds for fostering direct investments.	1
Description of implementation and explanation if partial or no implementation	The open call was not published in 2018 because of a redesign of the programme which will enable additional simplification of the procedures and criteria. The current activities will be implemented as a programme line for fostering direct investments within the integrated Programme for the Enhancement of Economic Competitiveness, which is to be adopted by the Government in Q1 2019. Amongst other things, the simplified programme line envisages funds for fostering investments in areas of the Capital City and of local government units in the southern region to be awarded for investment projects whose minimum investment value amounts to €250,000, and which enable employment of at least eight newly employed people within three years of the day of filing the application, whereas the minimum investment value for investment projects in the areas of local government units in the northern and central regions, except for the Capital City of Podgorica, amounts to €100,000 and these are to enable employment of at least four newly employed people, within three years of the day of filing the application.	
	After adoption of the integrated programme, the open call for participation in the programme lines will be published, and it will individually set out the participation requirements and criteria, the forms and necessary documentation.	
Priority Reform Measure No. 6: Supporting development and modernisation of the industrial sector		Stage of reform implementation (1–5)
Activities planned for 2018	1. <u>Publishing the open call for the awarding of grants under the Programme for Supporting Modernisation of the Processing Industry 2018–2020, in 2018.</u> On February 18th, 2018 was published the open call for participation in the 2018–2020 Programme for Supporting Modernisation of the	5

	Processing Industry, in 2018, until the available funds are spent(i.e. at the latest by 15 December 2018).	
	2. <u>Filing the application, consideration of documentation and rendering the decision on the awarding of credit funds by the IDF</u> As of the moment of publishing the public call, 10 applications for subsidies were received from business entities operating in the area of the paper industry, timber industry, furniture production and production of construction joinery. After all the necessary requirements were met, in line with the established procedure, and the IDF accepted seven applications, for which €837,800 was placed as loans.	5
	3. <u>Additional verification of the documentation and adoption of the decision on the awarding of grants by the Commission of the Ministry of the Economy</u> After the IDF had submitted documentation, and after additional consideration by the Ministry of the Economy, in line with the rules of theProgramme, seven applications for grant funds were approved, totalling €126,500 for the purchase of machinery and accompanying equipment having a value of €808,250.	5
Description of implementation and explanation if partial or no implementation	After three years of programme implementation, the results achieved so far point to relatively satisfactory effects, and therefore implementation will continue in the period 2019–2020 as well.	

Priority Reform Measure No. 7: Supporting investments in the food production sector in order to reach EU standards		Stage of reform implementation (1–5)
Activities planned for 2018	1. Investments in physical capital of agricultural holdings	2
	2. Investments in physical capital in relation to processing agricultural and fish products	2
	3.	
Description of implementation and explanation if partial or no implementation	The reform measures mentioned above are implemented through public calls. Both pubic calls were published at the beginning of 2018, whereby applications were to be filed until the end of Q2. Administrative and field control on the filed of applications is being carried out at the moment. Next year, the support contracts are expected to be signed and investing is also expected to start.	

Priority Reform Measure No. 8: Diversifying the tourist product	Stage of reform implementation (1–5)

Activities planned for 2018	1. Tourism Incentive Programme 2018/2019	1
	2. Hiking and biking	3
	3. All the Wonders of Montenegro	2
	4. “Durmitor Ring” panoramic route	3
	5. “Crown of Montenegro” panoramic route	1
	6. “Sea and Heights” panoramic route	1
Description of implementation and explanation if partial or no implementation		
Priority Reform Measure No. 9: Encouraging NPL resolution by enhancing the framework for prudential supervision and solvency of banks		Stage of reform implementation (1–5)
Activities planned for 2018	1. Consideration of the possibility of extending the period of implementation of the Law on Consensual Financial Restructuring of Debts to Financial Institutions for one more year.[65]	5
	2. Adoption of a set of secondary legislation for implementation of the Law on Financial Leasing, Factoring, Purchase of Receivables, Microcredit and Credit Guarantee Operations.[66]	5
	3. The Central Bank of Montenegro will continue to exercise more intensive supervision of banks in fulfilling their obligations arising from amendments to the *Decision on minimum standards for credit risk management in banks*, and these refer to monitoring implementation of the established strategies and achievement of goals aimed at the resolution of non-performing loans.[67]	5
	4. Adoption of the Law on Banks Resolution and the Law Amending the Law on Banks which will implement Directive 2014/59 EU (also known as the BRRD Directive);	4
	5. Adoption of the new Law on Banks which will implement Directive 2013/36 EU and Regulation No. 575/2013 EU.	4
Description of implementation and explanation if partial or no implementation	4. According to the plan, the Central Bank of Montenegro prepared working versions of both laws and submitted them in July 2017 to the competent ministry for further procedure. In the meantime, since preparation of the new Law on Credit Institutions had already begun under the Twinning Project, it was deemed rational to prepare the new Law on Credit Institutions	

[65] The Law Amending the Law on Consensual Financial Restructuring of Debt to Financial Institutions was passed by the Parliament of Montenegro on 26 June 2018 and published in the Official Gazette of Montenegro, No. 43/18.

[66] Implementation of this activity in ERP in indicated for 2019, which is a technical error. The Council of the Central Bank adopted the subject pieces of legislation in the session held on 13 April 2018, and these were published in the Official Gazette, No. 24/18.

[67] The measure is continuous.

	and update the existing version of the Law on Banks Resolution at the same time, so that both these laws are adopted at the same time. Under the Twinning Project, the final working version of the new Law on Credit Institutions was planned to be finished in Q4 2018. Within the same timeframe, the existing working version of the Law on Resolution of Credit Institutions was planned to be updated as well, after which these two laws will be submitted to the competent ministry for further procedure. Under the Conclusion of the Government of Montenegro of 26 July 2018, the deadline for establishing proposal for the new Law on Resolution of Credit Institutions was extended until Q4 2019. 5. Under the Conclusion of the Government of Montenegro of 26 July 2018, the deadline for establishing proposal for the new Law on Banks and Law on Credit Institutions was extended until Q4 2019.	
Priority Reform Measure No. 10: Introducing e-services into the work of cadastral offices		Stage of reform implementation (1–5)
Activities planned for 2018	1. Continuation of activities for improving the existing e-services which are related to the availability of data in cadastral records	4
	2. Implementation of the system for the use of e-services in order for e-signed documents to be taken over by notaries public as official documents	4
	3. Improvement of the quality of data of the digital cadastral plan, by providing new updated data	4
Description of implementation and explanation if partial or no explanation	All the planned activities were implemented, while it is worth noting that processing is being carried out continuously due to the type of the data	
Priority Reform Measure No. 11: Adopting the Law on Issuing Electronic Fiscal Invoices and implementing the electronic fiscal invoices system		Stage of reform implementation (1–5)
Activities planned for 2018	1. Draft Law on Issuing Electronic Fiscal Invoices prepared.	2
	2. Public consultation on draft law conducted.	
	3. Preparation of proposal to be submitted to the Government for endorsement and adoption.	
Priority Reform Measure No. 12: Improving support for the small and medium-sized enterprise sector		Stage of reform implementation (1–5)
Activities planned for 2018	In terms of improving financial support for SMEs, the plan for 2018 is to offer credit lines to various beneficiaries, implement factoring arrangements and create new financial instruments (establishment	

	of the Guarantee Fund and micro-credit fund, investing in venture capital, etc.), as well as to provide grant support. 1.1. In the period from 1 January to 31 December 2018, the IDF extended loans worth €209.4 million under 412 arrangements, which is a 19-percent increase compared to the same period in 2017, of which 374 loans were extended amounting to €146.3 million, whereas 38 contracts were executed under factoring financing and claims worth €63.1 million were purchased. Loan funds support creation/preservation of 7,295 jobs. Financial support is provided through 35 credit lines. A novelty compared to 2017 is the engagement of the Investment and Development Fund as an implementing unit under the ADMAS project, which was initiated by the MARD in cooperation with the Abu Dhabi Fund for Development, for which the Investment and Development Fund set up a designated credit line with a US$26 million budget. In addition, for some credit lines, lower interest rates and fees are applied, with the aim of eliminating barriers to starting, maintaining and improving operations. Moreover, the IDF in cooperation with the Employment Office gave four presentations as part of the campaign "A Chance for a Getting a Job", which were attended by 220 participants, and also presented the ADMAS project in two municipalities. 1.2. Adoption of the Law Amending the Law on the IDF and Statute of the IDF created conditions for the IDF to adjust internal acts for the purpose of initiating the pilot project – Guarantee Fund. 1.3. In March 2018, a Loan Agreement was signed between the Council of Europe Development Bank (CEB) and the IDF worth €30 million for support to entrepreneurs and micro, small and medium-sized enterprises through issuing loans amounting to €50,000 (micro loans), which represents a new financial support instrument that will serve the purpose of self-employment and strengthening small businesses. In October 2018, the first tranche was withdrawn to finance 170 projects through micro loans of up to €50,000.	5 3 5
	2. As for grant support for the improvement of the operations of SMEs, the following programmes are implemented: 2.1. Cluster Development Programme in Montenegro for 2018. The first call was open from 10 May to 11 June 2018 and 16 applications were received for it, of which 8 applications met all the conditions and criteria set out by the Programme and open call, and with them the Ministry of Economy signed a contracts on awarding subsidies. Under the second call, open in the period from 11 to 24 September 2018, total 5 applications were received, of which two applications met the conditions and criteria set out by the programme and open call. In 2018, a total of 9 clusters implemented project activities, and the total value of the awarded subsidies was €101,357.50. The total budget allocated for implementation of the Cluster Development Programme for 2018 amounts to €150,000, while	5

	individual cluster projects were supported with the maximum amount of up to €15,000.00, excluding VAT. 2.2. The Programme for Improving Innovation of SMEs 2018–2020, in 2018. Two open calls were published for implementation of the Programme (the first open call in the period from 11 April to 10 May 2018 and the second open call in the period from 25 May to 25 June 2018). Under these two open calls, a total of 19 applications were received from enterprises, of which 9 applications from enterprises were accepted, while the total value of the awarded subsidies was €30,725.00. The total budget allocated for implementation of the programme for Improving Innovation of SMEs for 2018 amounts to €50,000.00, while the amount of the refund per enterprise amounts to a maximum of €3,500.00, excluding VAT. 2.3. The Programme for Increasing Regional and Local Competitiveness through Compliance with Requirements of International Business Standards 2017–2020, for 2018. The open call for participation in the Programme was published on 13 April 2018 and lasted until 14 May 2018, in which 60 applications from enterprises were received. A total of 34 enterprises met all the conditions and criteria set out by the Programme and open call, and the total value of the subsidies awarded was €99,297.32. The total budget allocated for implementation of the programme for financial support to SMEs in introducing standards and accreditation, for 2018, amounted to €140,000.00, whereas the financial support per enterprise amounted to a maximum of €5,000.00, excluding VAT.	
	3. Implementation of the Loan Guarantee Facility for SMEs through COSME Loan Guarantee Facility within COSME programme is implemented by CKB bank which extended a total of €14.5 million in loans to 696 SMEs (from 07.2015 to 30 June 2018), without the need for enterprises to secure a mortgage. Moreover, the IDF is in the process of implementing the COSME Loan Guarantee Facility (LGF). The application met the formal requirements, it was assessed positively, and the finalisation of the administrative procedure and the contract signing are expected. The beginning of implementation is expected in Q1 2019.	5
	4. Promotion of the financial instrument of investing in equity capital through the WB EDIF–ENIF for innovative enterprises. The investors on behalf of Montenegro within the ENIF are the IDF and one natural person. At the end of February 2018, in Podgorica, innovative start-ups were given the possibility to present their ideas to the representatives of the ENIF management at a special event	4

	which preceded the PODIM conference for start-ups (organised by "Digitalizuj.me"). At the moment, two potential beneficiaries, i.e. start-ups, are being considered for possible financing in equity capital, of which one start-up is expected to be financed by the end of 2018.	
Description of implementation and explanation if partial or no explanation	**1.1.** Aiming at **further implementation of the activities of the Guarantee Fund within the IDF, it is expected that board members will be appointed and that necessary funding of €1 million will be allocated in the budget.**	3
Priority Reform Measure No. 13: Improving non-financial support for the small and medium-sized enterprise sector		Stage of reform implementation (1–5)
Activities planned for 2018	**1. Implementation of the Financial Literacy and Investment Readiness and Mentoring Programme** The process of providing mentoring services for 17 enterprises, beneficiaries of the mentoring services on the territories of the Municipalities of Podgorica, Bar, Cetinje, Danilovgrad, Berane and Mojkovac, selected at the public call in December 2017 is complete. Mentoring is being carried out by 8 certified mentors from local/regional business centres and local self-government units from these municipalities, using the JICA methodology. A total of 13 enterprises that met all the conditions and criteria apllied the public call for providing standardised mentoring services for 2018 for micro, small and medium-sized enterprises and entrepreneurs for the territories of the Municipalities of Podgorica, Cetinje, Bar, Danilovgrad, Nikšić, Mojkovac, Bijelo Polje, Pljevlja, Berane, Rožaje, Kotor and Tivat, which was open from 4 July to 4 August 2018. Implementation of mentoring services in 13 enterprises is currently under way.	5
	2. Updating the on-line database of business advisory service providers (consulting services) Continuous updating of the on-line database of business advisory service providers published on the website of the Ministry of the Economy. The database contains more than 300 service providers.	5
	3. Implementation of activities in the area of internationalisation of SMEs in provision of services under EEN (business advisory services, organisation of business events and training). Total 7 business events were organised at which a total of 40 enterprises participated (events organised as part of the conference EU–Serbia 2018: Investment, Growth and Employment in Belgrade, Serbia and as part of the EUSAIR Forum in Catania, Italy, ITB Berlin – tourism fair, 2nd Conference of Female Entrepreneurship held in Banja Luka, International Business Forum Sarajevo, Regional Business Forum Novi Sad, International Business Forum Novi Sad). Advisory support was provided for 11 enterprises, while one enterprise was provided with an international business agreement. A workshop was organised with the topic of *Entrepreneurship and Innovation for Growth,* which was held in Podgorica in May 2018.	5
	4. Strengthening clusters capacities, their managerial abilities, marketing activities In order to provide technical support for preparing applications under the Programme for Supporting the Development of Clusters for 2018, UNDP hired a consultant to provide support in preparation of applications for 16 clusters.	5

Description of implementation and explanation if partial or no implementation		
Priority Reform Measure No. 14: Introducing a single information system in the area of planning and building construction		Stage of reform implementation (1–5)
Activities planned for 2018	1. The tender for development of an information system for electronic communication in the process of issuing urban-development and technical requirements, issuing of consent by the chief state/city architect, obtaining copies of the plan and immovable property certificate from the body in charge of technical requirements, permissions, opinions and other evidences set by the law from the reviewer; issuing of the building permit and use permit for complex engineering projects and obtaining permissions for the execution of preparatory works for construction of complex engineering projects by the Government of Montenegro; and improving the Register of Technical Documentation, was launched on 7 August 2018.	
	2. The decision on the selection of the most favourable bid was made on 15 October 2018.	
	3. On 22 October 2018 an appeal was brought by the second-ranked bidder and the documentation was referred to the State Commission.	
Description of implementation and explanation if partial or no implementation		
Priority Reform Measure No. 15: Establishing a Science and Technology Park (STP) in Podgorica		Stage of reform implementation (1-5)
Activities planned for 2018	1. Selection of the conceptual design for reconstruction and refurbishment of the STP building (March 2018)	1
	2. Tender for development of the Main Design (April 2018)	1
	3.	
Description of implementation and explanation if partial or no implementation	At the Government session held on 8 June 2017, the Government issued permission to the Conclusion of the Governing Board of the University of Montenegro (UCG) for a change of the designated use for the existing building "Building 1" – designated use – university type activities, on Urban Parcel No. 12 in the coverage of the DUP "University Centre – Amendments and Supplements", Immovable Property Certificate No. 974, Cadastral Municipality Podgorica I, for establishment of the STP in Podgorica, as a business organisation form, where the founders will be the Government of Montenegro and the University of Montenegro. To that end, in cooperation with the Ministry of Sustainable Development and Tourism (Opinion No. 010-2428/01 of 14 August	

	2018), a much faster and cost-effective solution was found to finalise the subject building and conform it to the designated use, i.e. the needs of the STP. Under such a solution, in accordance with Article 98 of the Law on Spatial Planning and Construction of Structures (Official Gazette of Montenegro, Nos. 64/17 and 44/18) which governs changes to the revised Main Design, due to other circumstances (for example better functionality), where there is no need to launch a new public competition for the conceptual design of a building with an existing building permit, but instead a conceptual design may be finalised as part of the design for reconstruction and to directly contribute for consent to the chief architect on the central or local level, which is "submitted along with the application with a revised amended main design". Therefore, even though the impression is that the implementation pace was slower than expected, all this will lead to a faster and cost-effective realisation of the STP, for which the conditions were met only on 26 December 2018, because only then did the Rectorate of the University of Montenegro grant permission for the Draft Contract on Founding a Business Undertaking "Naučno-tehnološki Park Crne Gore" (Scientific and Technological Park of Montenegro), which is a core legal assumption, as only after ownership relations are precisely governed, including the entities and core principles of future operations, may the further project implementation commence. At the beginning of 2019, immediately after the permission of the Government of Montenegro is received for the Draft Contract on Establishment of LLC, this business undertaking will be established, and immediately following that, a tender for the design for reconstruction of the building (with an integrated conceptual design) will be launched, for which both the Terms of Reference and the tender documents have already been prepared. The tender procedure for the execution of works, as well as the execution of works itself could commence during 2019.	
Priority Reform Measure No. 16: Improving the legislative and regulatory framework to reduce the cost of deploying high-speed electronic communications networks		Stage of reform implementation (1–5)
Activities planned for 2018	1. Work on harmonising the Law on Accessing and Deploying High-Speed Electronic Communications Networks and the new Law on Spatial Planning and Building Construction.	3
	2.	
	3.	
Description of implementation and explanation if partial or no implementation	In 2018, further harmonisation of the Proposed Law on Accessing and Deploying High-Speed Electronic Communications Networks and the new Law on Spatial Planning and Building Construction commenced. The infrastructure mapping process is on-going. The implementation was in line with the planned schedule.	
Priority Reform Measure No. 17: Implementing CEFTA Additional Protocol No. 5 and adopting CEFTA Additional Protocol No. 6		Stage of reform implementation

		(1–5)
Activities planned for 2018	1. Following ratification in the Parliament of Montenegro in December 2017, in 2018 Montenegro will undertake activities on implementing CEFTA Additional Protocol No. 5.	3
	2. In 2018, the adoption of CEFTA Additional Protocol No. 6 was expected, which has been agreed upon at the technical level.	
	3. Intensified negotiations are expected on CEFTA Additional Protocol No. 7 on the settlement of trade disputes.	2
Description of implementation and explanation if partial or no implementation	CEFTA Additional Protocol No. 5 came into force in April 2018. In line with the above-mentioned, the 2018–2022 Trade Facilitation Strategy has been prepared and adopted to specify measures and activities for trade facilitation. The Customs Administration has commenced several projects directed towards the fulfilment of obligations under CEFTA Additional Protocol No. 5 – enhancement of risk management and post-clearance audit, pre-arrival processing for expedited shipments, drafting of the Authorised Economic Operator Programme, and others. The CEFTA parties have taken the decision to commence negotiations on an additional protocol on the settlement of disputes (Additional Protocol No. 7). Additionally, the obligation of adopting the Protocol on Enhancement of the Mechanism for Settling Bilateral Disputes between CEFTA 2006 signatories is envisaged in the Multiannual Action Plan (MAP) which was adopted by the prime ministers of the Western Balkan countries on 12 July 2017 in Trieste, within the Berlin Process. Currently, the appointment of negotiating teams is under way. At the session held on 27 September of this year, the Government of Montenegro adopted the basis for leading negotiations and appointed the negotiating team. After all the parties have appointed their teams, the negotiating process will begin.	
Priority Reform Measure No. 18: Developing qualifications in accordance with the labour market needs		Stage of reform implementation (1–5)
Activities planned for 2018	1. Developing qualifications and educational curricula in line with the labour market needs	5
Description of implementation and explanation if partial or no implementation	The preparation of qualifications in cooperation with employers, and the consequent modernisation of the educational curricula for all levels in vocational education will facilitate linkage between education and the labour market. The development of qualifications implies the development of vocational standards and qualifications standards. These standards are the basis for the development of educational curricula, which are modularised and credit-valued.	

	For the school year of 2018/2019, 48 vocation standards and 15 educational curricula have been developed. Two hundred and sixty members of working groups for qualifications and curricula development have been trained and 250 teachers for curricula implementation.	
Priority Reform Measure No. 19: Implementation of apprenticeships with employers		Stage of reform implementation (1–5)
Activities planned for 2018	Implementation of apprenticeships with employers	5
Description of implementation and explanation if partial or no implementation	In the school year 2017/2018, in the dual education form there were 276 students with 101 employers, in 12 municipalities and in 18 vocational schools. The dual-education-form students received education in respect of 14 educational curricula.	
Priority Reform Measure No. 20: Implementing legal provisions in the field of the labour market		Stage of reform implementation (1–5)[68]
Activities planned for 2018	1. The text of the Draft Labour Law is being harmonised with the comments of the European Commission and, after the final review by the EC has been received, the proposed law will be forwarded to the Government procedure. 2. There were no comments by the European Commission on the text of the Draft Law on Employment Intermediation and Benefits during Unemployment. Specific comments and suggestions submitted by the MSD were considered on the occasion of finalising the text, and a relevant report was prepared. The report will be submitted to the EC, and thereafter the proposed law will be forwarded to the Government procedure.	3
	The Employment Office of Montenegro is implementing active employment policy measures. In the period from 1 January to 1 November 2018, the following programmes were (or are being) implemented: **Public Works Programme** is implemented for long-term unemployed people through: - The public works programme "Elderly care" – 112 unemployed people included; - The public works programme "Personal assistant"– 507 unemployed people included; - The project "Let it be clean" – 80 unemployed people included; - Other public works programmes – 633 unemployed people included.	4

[68] 0 = no implementation; 1 = implementation under preparation; 2 = initial steps have been made; 3 = implementation is under way with some initial results; 4 = implementation is successful; 5 = full implementation.

	Education and training of adults is implemented for 1,212 unemployed people, through: - The Educational Curriculum for Acquiring Vocational Qualifications for 473 people - Curriculum for acquiring key skills for 739 people; **Programme for job-skills training and employment of young people in jobs related to the prevention of informal work "Stop the grey economy"** for 180 unemployed people; **Pilot programme for support for hard-to-employ people** in preparing for and activation in the labour market - "Strengthen me and I'll succeed" for 925 people. Under the awarding of grants – grant schemes – **for implementation of projects for the professional rehabilitation and employment of disabled people** a public invitation amounting to €1.5 million has been completed, which enabled the inclusion of 182 disabled people, of whom 138 will be employed during the period of the project, and 60 disabled people are planned to be employed after the completion of the project. - in the reporting period 360 employers exercised the right to a wage subsidy for 472 disabled people; - 18 employers exercised the right to a subsidy for participation in the financing of the personal costs of assistants (helpers at work) for disabled people for 21 employed disabled people; - 21 employers exercised the right to grants for adjusting work places for disabled people for 23 employed disabled people; **Through the support for self-employment** 77 self-employment loans were extended in the reporting period, which are intended for the creation of 96 new jobs. In the reporting period, the Employment Office **intermediated** (recruitment, pre-selection, selection) for the needs of seasonal employment for 4,229 people, and a total of 9,140 unemployed people were employed on a seasonal basis. **The programme of job-skills training for people with acquired high education** for 3,055 users	
Description of implementation and explanation if partial or no implementation	Following the submission of comments by the European Commission on the text of the Proposed Labour Law, the text is being adjusted to them. At the same time, the report for the International Labour Organisation is also being prepared with regard to the submitted comments and suggestions. There have been no comments by the European Commission on the Proposed Law on Employment Intermediation and Benefits during Unemployment, while a report has been prepared with regard to the comments and suggestions by the International Labour Organisation, and this was submitted to the EC too.	

	For the above reasons, the implementation of the measure is partial.	

Annex 3: External contributions to the 2019–2021 Economic Reform Programme

Comments on the draft programme

1. Contribution of stakeholders during the consultative process and during the roundtable discussion held on 24 December 2018, as well as comments in written from stakeholders

Representatives of trade union organisations
The Union of Free Trade Unions of Montenegro, represented by its secretary general, made comments during the roundtable talks held on 24 December 2018, which were later submitted in writing. The comments and responses to the comments of the ERP drafters are provided in the text below.

Union of Free Trade Unions of Montenegro: Increase the minimum wage from €193 to €250 with the aim of reducing poverty

Response of the drafter: Increasing the minimum wage is an initiative that has been put forward by trade unions representatives for many years. While drafting the 2018 ERP, a detailed analysis of the effects of this was carried out. The IMF has also carried out an analysis which has shown that an increase in the minimum wage without undertaking other measures could result in an increase in unemployment, and particularly in informal employment, as well as a feature of the Montenegrin economy being low labour productivity coupled with a wage increase. The World Bank analysis indicated that an increase in the minimum wage would have a direct impact on an increase in budgetary expenditures, and that is the reason why this measure must be carefully considered. Pursuant to the above-mentioned, while taking into account the initiatives of the trade union and the Social Council, the Government is preparing an additional analysis on the indicated possibilities for amending the minimum wage during the implementation of the 2019–2021 ERP.

Therefore, the ERP proposal has commenced looking into an optimal scenario for a possible increase in the minimum wage, starting from the above-mentioned recommendation.

Union of Free Trade Unions of Montenegro: Increase the corporate tax on profits or only on profits above a certain level. The corporate profit tax rate in EU countries is two, three or four times as high. On the other hand, the corporate profit tax has not resulted in the expected increase in investments, in particular in higher-quality investments.

Response of the drafter: The drafter does not agree with the position that the low corporate profit tax rate has not contributed to an inflow of foreign direct investments, which were for years in excess of 10 percent of GDP, while contributing to economic growth and an increase in employment. Increasing the corporate profit tax rate could represent one of the obstacles to increasing competitiveness and broadening the tax base, which is not the objective of the Economic Reform Programme and overall economic policy of the Government.

Union of Free Trade Unions of Montenegro: Stop a further increase in the tax debt. In the period from 2013 to 2017, the average growth of the tax debt was €100,000,000 annually. This means that by preventing the occurrence of new tax debt in 2019, the expected revenues in the budget would be at least €100,000,000. Therefore, we expect the tax administration to carry out efficient and regular collection of taxes and contributions, and to sanction a departure from the statutory deadlines. To that end, when the payment of taxes and contributions on the wages of employees is concerned, it should be stipulated that the tax liability is due at the end of each month for the previous month, in other words, an employer is obliged to pay wages under the Labour Law. In order

to enable this, the employer should be obliged to lodge an IOPPD (the report on calculated and paid taxes and contributions), return by the 15th of the month for the previous month.

Response of the drafter: The drafter of the document responded to this in the ERP for the previous year, in the part referring to the previous recommendation through the adoption of the Law on the Rescheduling of Tax Receivables, and its implementation is still under way. Therefore, measures for collection of the tax debt have been undertaken and €42 million of the tax debt has already been collected in 2017 and 2018, which was rescheduled over a period of 60 months. All this is described in Chapter 3 of the 2018 ERP. The working group for drafting the ERP certainly agrees with the proposal of the Union of Free Trade Unions of Montenegro and this comment was taken into account in Chapter 3, when addressing measures for strengthening fiscal discipline and combating the informal economy, or projections of the budgetary revenues resulting from taxes. The Tax Administration is currently implementing a project of Modernisation of the Finances of the Tax Administration with a World Bank loan. Implementation of this project will improve the capacity of the Tax Administration for increased collection of tax revenues, which is in accordance with the recommendation of the Union of Free Trade Unions of Montenegro.
Moreover, during deliberation on the ERP at the Parliamentary Committee for the Economy, Finance and the Budget, which was held on 27 December 2018 and attended by a representative of the Union of Free Trade Unions of Montenegro and based on its proposal, the Parliamentary Committee stated that it will initiate a review of amendments to secondary legislation, whereby the employer is obliged to report the taxes and contributions on wages each month by filing an IOPPD return, regardless of whether a wage can be paid or not. This has had the effect of partly accepting the proposal of the Union of Free Trade Unions of Montenegro.

Union of Free Trade Unions of Montenegro: Increase the level of founding capital when establishing limited liability companies or of the liability itself when establishing them.

Action/opinion of the drafter: The process of amending the Law on Business Organisations is under way in accordance with European directives and best practices. These comments will be reviewed in the process of amending this law. Moreover, the importance of small and medium-sized enterprises in the country and the ease of doing business will be taken into account in order to further improve competitiveness and accelerate economic growth. In any case, application of any new provisions in the Law on Business Organisation could not be a subject matter for implementation of the 2019 ERP.

Union of Free Trade Unions of Montenegro: Introduce a tax on the financial transactions of legal persons and entrepreneurs in excess of a certain limit

Action/opinion of the drafter: The drafter of the document considered this recommendation during drafting of the 2018 ERP, but it is not included in the document since the analysis of the Central Bank regarding the introduction of a tax on financial transactions indicated that it would have a negative impact on the financial environment, since the entire cost would be transferred to the client (the banking sector has already protected itself from this measure). Furthermore, the analysis carried out by the Government in reviewing this recommendation shows that an additional tax would have a negative impact on the overall competitiveness of the economy and its liquidity.

Union of Free Trade Unions of Montenegro: Abolish tax and other incentives for companies, in particular since many of these leave room for manipulation of the budget (this refers to incentives like those for VAT, reductions of taxes and contributions, reduced oil prices, etc.).

Action/opinion of the drafter of 2019 ERP: This suggestion of the Union of Free Trade Unions of Montenegro was also given during the drafting of the 2018 ERP. At that time, the Government, as a drafter, emphasised that tax incentives in Montenegro are an important aspect of the country's competitiveness as an investment destination. This comment from the Union is addressed in Chapter 3 of the 2018 ERP, under the analysis of tax exemptions. Bearing in mind that these tax exemptions are mainly directed towards investments, as the primary growth driver of the Montenegrin economy, it could be concluded that the existence of these exemptions has a positive effect on the attractiveness of the Montenegrin investment environment and overall economic activity. Certainly, over the medium term, pursuant to EU recommendations, the possibility of abolishing certain tax exemptions, pursuant to Montenegro's obligations for EU membership negotiations and precise alignment with certain directives, will be considered. In 2019 the Government has envisaged the preparation of a detailed analysis of all tax exemptions, their fairness, compliance with directives and impact on the budget, and after that will consider the possible abolition of certain exemptions through the amendment of certain laws, such as the Law on VAT.

Union of Free Trade Unions of Montenegro: Introduce people working informally into the legal framework. According to unofficial data, there are 40,000 people working informally in our country. Concrete, and not declarative, activities are required in order for part of this population to be transferred into legal employment, which necessitates a committed and well-designed comprehensive action on the part of the state.

Action/opinion of the drafter of the 2019 ERP: The drafter of the document has included the mentioned recommendation through Measure No. 18 relating to active employment policy measures, as well as the reform area relating to improvement of the business environment by suppressing the informal economy, which is similar to the previous year, and is in line with the recommendation of the Union of Trade Unions, which emphasises the unofficial estimate of 40,000 informally employed, dating from several years ago.
In addition, the proposed measures in the area of education in the 2019 ERP will contribute to the strengthening of fiscal discipline and the fight against the grey economy, in accordance with the recommendation of the Union of Trade Unions. The effects on the labour market of the overall measures of strengthening fiscal discipline and the fight against the grey economy are also demonstrated by the strong growth in the number of registered people employed in 2018, which was 16,678 higher in November 2018 than in November 2017.

Union of Free Trade Unions of Montenegro: Ensure that budget funds are spent with the diligence of a good businessman in such a way that the level of responsibility will increase for all budget beneficiaries through sanctioning of every irresponsible and illegal action.
Action/opinion of the drafter: The drafter of the document has considered the above recommendation and concluded that it is part of Chapter 3 of the 2019 ERP, which is related to strengthening of governance responsibility in the public sector. Strengthening of governance responsibility in the public sector is part of Public Finance Governance in Montenegro, which is in line with the recommendation of the Union of Free Trade Unions of Montenegro.

Union of Free Trade Unions of Montenegro: Be more efficient in detecting and confiscating illegally acquired property
Action/opinion of the drafter: The efficiency in detecting illegally acquired property is under the scope of other branches of power, not the Government. Definitely, progress has been made in that area too, which is important from the aspect of improving the overall functioning of the system.

Union of Free Trade Unions of Montenegro: Abolish the privilege of public officials to receive wage compensations from the budget for one or two years, if that is the period remaining until their retirement.

Action/opinion of the drafter: This is the same recommendation given on the occasion of drafting the 2018 ERP. According to the Law on the Wages of Public-Sector Employees, public officials are entitled to compensation for a period of one year following the expiry of their public function. It is not deemed a privilege, given that, pursuant to the Law on Prevention of Corruption, for the two years after termination of the public function, a public official must not enter into a contractual relationship with any organisation or institution that the state administration authority/local self-government authority has cooperated with during their term in office. Therefore, this comment by the Union of Free Trade Unions would require the amending of several laws, and there is no clear justification for that from the aspect of the right to work as a constitutional category and principle of equity.

2. Contribution by the Parliament of Montenegro

In addition to the roundtable discussion organised under the public consultations and the comments received from the Union of Free Trade Unions, the draft of the 2019 Economic Reform Programme was the subject of discussion **in the Parliamentary Committee for the Economy, Finance and the Budget on 27 December 2018** in line with the recommendations from the Guidance for the 2019–2021 Economic Reform Programmes, on which occasion the possibility was discussed for mandatory monthly submission of IOPPD forms, as a measure to be considered in the ERP for the purpose of regular payment of wages.

The Parliamentary Committee for the Economy, Finances and the Budget accepted the draft of the 2019 ERP as a document significant for pursuing of the economic policy of the Government.