



GOVERNMENT OF MONTENEGRO

MONTENEGRO ECONOMIC REFORM PROGRAMME

2015 - 2017

Podgorica, January 2015.

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LIST OF ABBREVIATIONS

CEFTA - Central European Free Trade Agreement

CGES - Crnogorski Elektroprenosni Sistem AD (Montenegrin Electricity Transmission Company)

COSME - EU programme for the Competitiveness of Enterprises and SMEs

EBRD - European Bank for Reconstruction and Development

EIB - European Investment Bank

EIF - European Investment Fund

EEN - Enterprise Europe Network

EFP- Economic and Fiscal Programme

EC - European Commission

EPCG - Elektroprivreda Crne Gore (National Electric Power Company)

IPA - Instrument for Pre-Accession Assistance

IPARD - IPA Rural Development

IDFM - Investment and Development Fund of Montenegro

PE - Public Enterprise

PPP - Public-Private Partnership

KfW - German Development Bank

SME - Small and Medium Enterprises

ERP/NERP - (National) Economic Reform Programme

NQF - National Qualifications Framework

OECD - Organisation for Economic Development and Cooperation

PEP - Pre-Accession Economic Programme

MDD 2013-2016 - Montenegro Development Directions 2013-2016

RCC - Regional Cooperation Council

SEETO - South East Europe Transport Observatory

FDI - Foreign Direct Investments

SEE Strategy 2020 - South East Europe 2020 Strategy

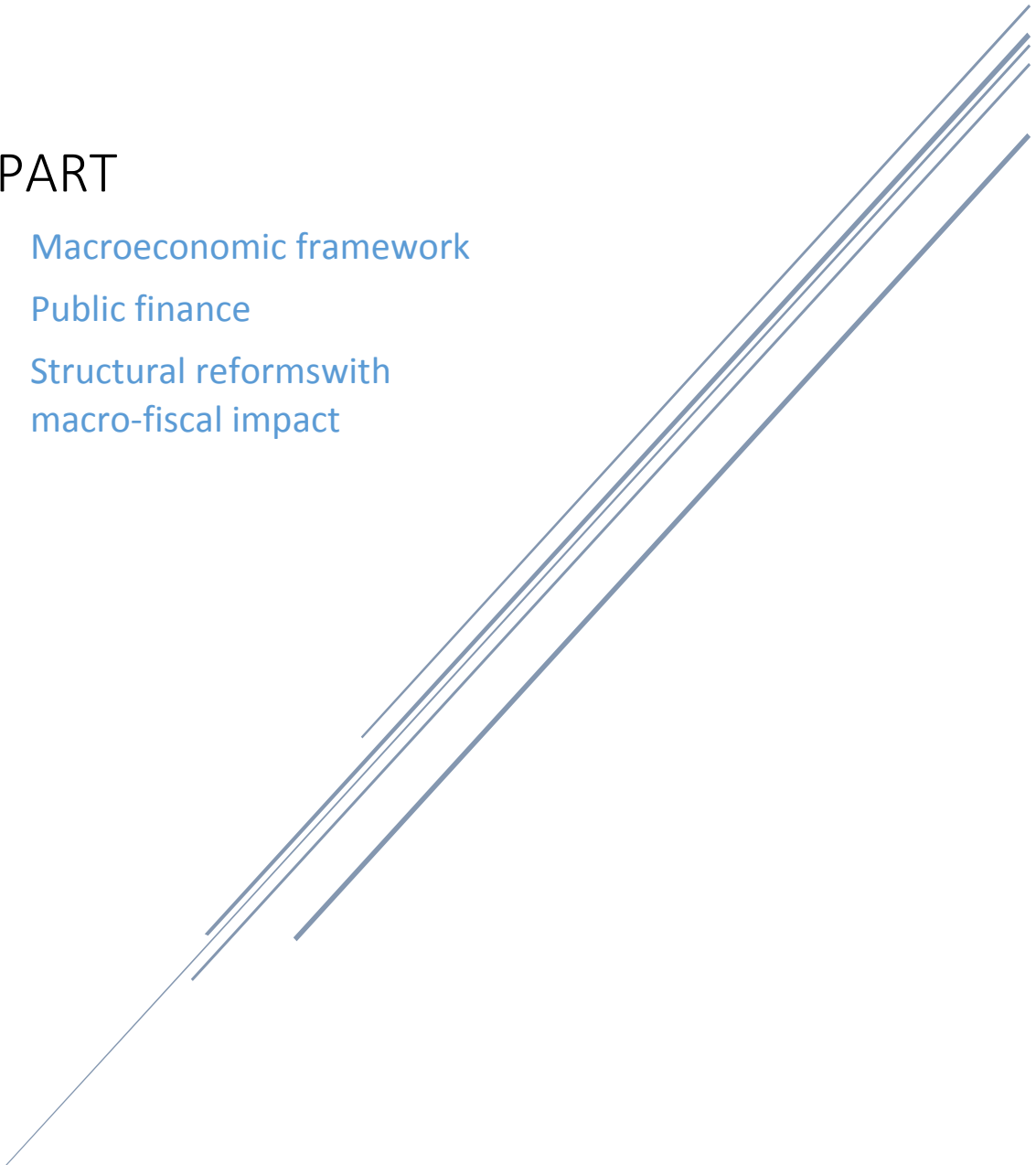
WTO - World Trade Organisation

I PART

Macroeconomic framework

Public finance

Structural reforms with
macro-fiscal impact



I.1 Economic framework

The development model of Montenegro in the first years after independence was based on the growth of domestic consumption that was allowed by the high inflows of foreign accumulations in the form of foreign direct investment and bank loans. The outbreak of the crisis caused a decline in the economic growth of the country. Montenegro, as most economies after the global economic and European debt crisis, had a hard, but relatively successful recovery period. There was due to the economic policy of fiscal consolidation and improvement of investment environment. The results of this policy are foreign direct investment at an average level of 13% of GDP after the crisis outbreak and cuts in public spending to 44% of GDP in 2014. However, although the economic growth has been recovering, the new reality in the international environment clearly indicates that the pre-crisis development model is no longer able to provide the rate of economic growth that Montenegro recorded in the pre-crisis period and which it aims to get closer to in the coming period. The crisis that Montenegro underwent in recent years has not been reflected only in slowing down its real economic growth (at an average of 0.5% since 2009), but also in the reduction of its long-term potential growth to 2.5%.

A key challenge for Montenegro, similar to all the other countries in the region, is how to again increase economic growth and to reduce or even completely eliminate those key obstacles that prevent the country from developing its potentials. The framework for the advancement is the Euro-Atlantic integration. The concept of economic policy of Montenegro, as a candidate country, in addition to the measures by which we strive to achieve fiscal stability and sustainability, is supported by a package of structural reforms which will have a direct impact on increasing the competitiveness of the Montenegrin economy, will be monitored and will accelerate the economic growth.

The focus of economic policy in 2015 and in the medium term will be removing obstacles to economic growth and development and, consequently, increasing the competitiveness of the economy. The primary goal of economic policy is to create new jobs and raise living standards of all inhabitants of Montenegro.

In accordance with the new requirements of the European Commission in the economic dialogue with countries candidates for EU membership, the Government has undertaken, seriously and responsibly, the preparation of economic policy for the period 2015-2017 through the *Economic Reform Programme 2015-2017* instead of the former *Pre-Accession Economic Programme*, which dealt with fiscal policy as the main instrument of economic policy in Montenegro and structural reforms with macro-fiscal impact. Economic governance will, since this year, put the emphasis on sectoral and structural reforms. The Economic Reform Programme will be a document prepared on an annual basis and recognized as the Work Programme of the Government.

In accordance with the Guidance of the European Commission for NERPs for 2015, this document comprises two parts. Part I provides an overview of medium-term macroeconomic framework and fiscal policies and structural reforms that have macro-fiscal impact. Part II covers structural reform measures which are sectoral in nature and are of most concern for improved competitiveness of Montenegro and consequently strengthened growth. In accordance with this division, the work on this report was divided: coordination was assigned to the Office of the Deputy Prime Minister for Economic Policy and Financial System; Part I of ERP was coordinated by the Ministry of Finance, and Part II by the Ministry of Economy. Short time for the preparation, given by of the European Commission, did not diminish the responsibility of the coordinators and team members in presenting consistent economic governance.

Apart from the highway project, most of the started development projects will experience expansion starting from next year. This primarily refers to the construction of tourist complexes of Kumbor, Lustica and Blue Horizon, connection of Montenegro to Italy by submarine power cable, construction of a marina at Porto Montenegro, hotels in Podgorica, Petrovac and Igalo and in other coastal cities. Investments in tourism infrastructure will encourage winter tourism in the northern region. In the

coming year, investment related activities of the state will focus on the choice of investors and creation of optimum conditions for the implementation of the projects such as the second block of the thermal power plant, a new block of the thermal power plant, exploration of oil and gas in Montenegro (off shore and on shore), tourism projects such as Queen's Beach in Dubovica and privatization of the Park Hotel in Bijela, and full utilization of a number of tourism sites.

Macroeconomic framework

At the end of 2013, we projected the beginning of investment cycle in 2014 and, in accordance with that, the economic activity that would not only mean recovery of Montenegrin economy after the crisis, but also higher growth rates. The real GDP growth of 3.5% projected in the base scenario was based on the implementation plan for initiated development projects. Inherited structural problems in the country, caused by lack of adaptability to new market conditions after the crisis, as well as reduced economic activity in the international context, influenced the non-realization of planned investments. The dependence of the Montenegrin economy on, among other things, weather conditions proved to exist in 2014 again. Hydrological conditions did not provide the growth of electricity production as in 2013, but their occurrence in the summer months resulted in the weaker growth in the number of tourists and overnight stays. On the other hand, reduced final consumption caused by the lower disposable income, along with low bank lending activity, influenced the slowdown of economic activity and consequently the emergence of 12-month deflation. The result of these trends was the estimate of real economic growth at the rate of 2% in 2014.

Montenegro will have a faster economic growth at a rate of 3.5% in 2015 and 3.8% in the medium term. The main assumptions of the projected growth are: the credit growth of 4.5% driven by lower lending interest rates, high level of FDI at 13.4% of GDP, a slight increase of household consumption at 2.3%, the growth of investment in fixed assets at 11.1%, mostly from the capital budget, and the growth of exports of goods and services of 5.1%.

Fiscal policy

For several years now, the Government of Montenegro has been planning the public finances not only for the next year, but also, through indicative plans, over a medium term, thereby taking account of the consistency of public finance policy. In addition, instability of the economic environment and structural adjustments of the Montenegrin economy have imposed the need for a low-growth scenario, ie. the scenario involving the outturn of identified economic and political risks.

The objective of the Government in the period 2015-2017 is to conduct fiscal policy of reducing current spending, but increasing investment in infrastructure, so that the public debt could be financed from economic growth, and in the interests of establishing its downward trend.

The largest capital expenditure, but also a development opportunity, is the construction of the highway. Start of construction of the highway will impact negatively on the public finance balance in the medium term. Public finance deficit is projected at its highest of 5.3% in 2015 when public spending would reach 48.2% of GDP, and by 2017 it would slightly drop to 4% of GDP. The deficit would in the first few years be financed from loans and borrowings, and the government debt would increase to 69.1% of GDP in 2017. The government was fully aware of the consequences when bringing such a big decision. However, the highway represents not only cost, but also the involvement of all the factors of the economy, which encourages a more intensive investment cycle and had a positive impact on the competitiveness.

The highway is a project that can change the course of economic growth and development of Montenegro for the better and for the benefit of present and future generations. The highway will solve the problem of missing and safe road infrastructure, create a better connection of the northern, underdeveloped and central/southern developed regions, build a better connection with the rest of Eastern Europe, connect the port of Bar to the Danube region, foster the growth of the tourism sector,

agriculture and trade. That is enough reason for the government to believe in the benefits of the highway, but also enough obligations and responsibilities for the consolidation of public finances and structural reforms that need to create preconditions for the growth that can bear the burden of this important decision.

The growing pressure on public finances has been put by pension and health systems. Aging population, increased life expectancy at birth, early-retirement benefits and preferential conditions for retirement have resulted in worsening dependency rates and led to the growth of pension expenditure up to 11.3% of GDP. Such trends are evidence that pension reforms in 2004 and 2010 are not sufficient and that the sustainability of the pension system must be worked on continuously. The government is considering several aspects of pension reform, primarily with respect to parameters towards stipulating stricter conditions and reviewing a list of tasks eligible for the privileged and early retirement. However, at this point, any systemic pension reform would carry high transition costs, and, in a situation of growing debt, such decision must be responsibly and profoundly considered.

On the other hand, on the revenue side, significant efforts are made to increase fiscal discipline. The primary goal is to reduce informal economy as a barrier to economic growth. The increase in revenue collection is also necessary in order to maintain competitive tax rates and a positive impact on the budget balance. Revenue growth in the medium term is projected on a conservative basis (lower than GDP growth) and in accordance with the intention of the Government to maintain competitive basic tax rates.

Structural reforms

As fiscal policy measures in Montenegro are crucial, but not sufficient, structural reforms set forth in 2015 ERP will become a priority on the economic policy agenda in the medium term. The goal of structural reforms, macro-fiscal and sectoral, is to increase the competitiveness of the Montenegrin economy. Structural reforms were part of the economic policy agenda since the period of transition. However, a consistent approach to systemic change and fiscal consolidation in the context of overall economic policy has been intensified in the ERP 2015-2017.

The first part of the ERP provides a detailed overview of obstacles to the economic growth of Montenegro which are of national or horizontal character. In accordance with the identified barriers, structural reforms are identified in the areas of production market and business environment, financial stability, labor market and public finances.

In addition, the economy is facing a number of obstacles that can be categorized as obstacles of sectoral character. These are obstacles arising both from a relatively narrow economic structure of Montenegro and the existing characteristics of human resources and physical infrastructure. In line with this, the Government has recognized the areas within which it is possible to implement measures that will have a direct impact on the growth of competitiveness: (1) Transport policy, (2) Growth and development of SMEs, (3) Education and structural unemployment, (4) Business environment, (5) Strengthening the country's external position, (6) Spatial planning and environment protection, (7) Development of rural infrastructure and (8) the development of electronic services.

Choice of measures that (i) correspond to the priorities of the Government of Montenegro and (ii) are structured in accordance with the requirements of the European Commission will fully align national priorities and recommendations of the European Commission in order to increase the competitiveness of the Montenegrin economy as a precondition for growth:

I Physical capital

1. Priority measure no. 1: Construction of a priority Smokovac-Matesevo section of the Bar-Boljare highway;
2. Priority measure no.2: Preparation of spatial-planning documents for the Adriatic-Ionic Highway;
3. Priority measure no. 3: Modernisation of the railway network;

4. Priority measure no. 4: Connection of energy systems of Montenegro and Italy by undersea cable;
5. Priority measure no. 5: Utility infrastructure enhancement;
6. Priority measure no. 6: Construction and reconstruction of infrastructure in rural areas (water supply and road infrastructure);

II Human capital

7. Priority measure no. 7: Enrolment policy reform at university education institution;
8. Priority measure no. 8: Program of Professional Training of Persons with Acquired Higher Education
9. Priority measure no. 9: Construction of Tehnopolis Innovation and Entrepreneurship Centre in Niksic;

III Better industrial structures

10. Priority measure no. 10: Financial support to SME sector;
11. Priority measure no. 11: Enhancement of institutional and administrative capacities for the support of SMEs;
12. Priority measure no. 12: Enhancement of tourist offer in the North of Montenegro through construction of required ski infrastructure;

IV Good business environment

13. Priority measure no. 13: Strengthening institutional framework for contract enforcement;
14. Priority measure no. 14: Improvement of building permit issuance process through the upgrading of existing IT solutions;
15. Priority measure no. 15: Online accessibility of public services and implementation of information system for the exchange of data from state authority registers;

V Trade integration

16. Priority measure no. 16: Increase of competitiveness of companies through harmonization with the international standard and improved quality requirements;
17. Priority measure no. 17: Promotion of agricultural and food products: Project EXPO 2015;
18. Priority measure no. 18: Improvement of institutional framework for the promotion and encouraging investments with the emphasis on manufacturing industry;

The aim of implementation of the reforms is to increase the competitiveness of the economy, primarily in areas that Montenegro identified in the Montenegro Development Directions 2013-2016, namely: tourism, energy, agriculture and industry. Consistent implementation of measures that remove obstacles to growth opens up opportunities for new jobs, and thus employment growth and wage growth based on productivity. Although the first part of the ERP offers a package of structural reforms with direct fiscal impact, this does not exclude that the package of sectoral "priority" measure has no fiscal impact. Consistency in designing ERP policies is reflected precisely in the measurability of the cost of implementation of selected measures and their impact on the accelerated growth in the medium term.

I.2 Macroeconomic framework

The world economy recorded a growth rate of 3% in 2013 . The projected growth rates are slightly changed in comparison to the previous ones, so the projected growth rate for 2014 is 3.6% and for 2015 it is 3.9%. The envisaged strengthening of economic activity in the world is based on the growth of advanced economies. The main risks facing the world economy are related to: instability in the markets of emerging economies, deflationary tendencies and weak economic growth in the European Union, lower inflation than expected in developed economies, as well as geopolitical risks (Ukraine, Middle East).

For emerging markets, which make up two thirds of the total world growth, projections have been reduced compared to the previous ones, due to a weaker performance in 2014 (China, Brazil, Russia) and weaker prospects for the coming period. The drop in oil prices by about 40% since June 2014 will act as a powerful stimulus for growth in importing countries, as it will increase the disposable income of households and reduce the cost of production companies. On the other hand, the oil price will decrease the level of income in producing countries (OPEC and Russia), and thus have a negative impact on the projected growth rates in these countries.

The growth projections for the EU and the Eurozone are particularly uncertain, due to need for further fiscal consolidation and debt reduction in the most heavily indebted countries, combined with low growth rates or stagnation, high unemployment and strong deflationary tendencies.

The SEE region had a weaker growth than expected, which is partly a result of heavy floods in the first half of the year and the specific problems of the countries. Montenegro has also recorded lower growth than expected, primarily due to the delay of the announced investment cycle, but also the spillover impacts from closer and wider environment.

Table 1 GDP growth projections for SEE countries

	2012	2013	2014	2015
South East Europe - EU	0,1	2,3	1,7	2,1
Bulgaria	0,6	0,9	1,4	2,0
Croatia	-2,2	-0,9	-0,8	0,5
Romania	0,6	3,5	2,4	2,5
South East Europe – non-EU	-0,6	2,3	1,0	2,4
Albania	1,1	0,4	2,1	3,3
Bosnia and Herzegovina	-1,2	2,1	0,7	3,5
Kosovo	2,8	3,4	2,7	3,3
FYR Macedonia	-0,4	2,9	3,4	3,6
Montenegro	-2,5	3,5	2,3	3,4
Serbia	-1,5	2,5	-0,5	1,0

Source: IMF

This document took into account (technical) assumptions about the movement of main parameters from the projections of the European Commission, which are given in Table 2:

Table 2 External macroeconomic environment

	2013	2014	2015	2016
USD/EUR exchange	1,3281	1,3324	1,2678	1,2678
Nominal exchange rate	8,4	4,5	-2,6	0,0
Global GDP growth, excluding EU	3,6	3,7	4,3	4,5
EU GDP growth	0,0	1,3	1,5	2,0
World import volumes, excluding EU	3,1	2,9	4,9	5,6
Oil prices (Brent, USD/barrel)	108,8	102,6	91,0	92,8

Source: European Commission

1.2.1 Recent economic developments

1.2.1.1 Gross domestic product

After Montenegro had the economic growth of GDP of 3.3% in 2013, the growth trend continued in 2014. According to preliminary MONSTAT data, in the first quarter of 2014, GDP grew at a real rate of 1.5%, in the second quarter recorded a slower growth of 0.3%, while in the third quarter the growth amounted 1.3%. According to these data the growth rate for three quarters was 1.1%, which is significantly lower than the annual rate of 3.5% projected in the previous PEP. This reduction in growth rates was caused by the delay of the biggest investment relating to the construction of the highway, which in addition to other investments was the key assumption of the previous scenario. According to estimates by the Ministry of Finance, given the growth of economic activity in the second half of the year of around 2.8%, the GDP growth rate for 2014 should reach 2%. It is estimated that, at an annual level, the growth will be favourably influenced by the sectors of construction (although there was a decline in the value of completed construction works in the third quarter), retail trade, real estate, and adversely influenced dominantly by electricity production. Maintenance of production in Aluminium Plant (KAP), with the growth in aluminium prices and a drop in value of the euro (growth in aluminium prices in euro amounted to almost 24%) will reduce the negative contribution of the industrial production sector. Decreased production of electricity caused by the high base from the previous year, will lead to lower GDP between 1 and 1.2%, which will depend on the dynamics of production in the last quarter of 2014.

MONSTAT still does not follow GDP from the expenditure side on a quarterly basis. However, based on available indicators, we estimate that household consumption will slightly go up by about 1.1%, due to increased real wages (by 0.4%) and pensions (0.2%), with growth in loans to individuals for approximately 1% and stable level of transfers from abroad, and employment growth.

Estimated government's spending had a slight increase of 1.5% induced by increasing expenditure on gross earnings, other income and material and services.

We estimated investment growth to be around 3.5%, based on the significant growth in the construction sector.

Net exports of goods and services will have a favourable contribution to GDP of 0.3%, based on reduced exports of goods, stable imports of goods and growth in revenues from services, which will set off the adverse contribution of the reduced exports of goods.

On the supply side, the most important influence on the GDP formation comes from the following sectors:

Tourism (20% of GDP together with related sectors in 2014); Cumulative indicators of tourism turnover in the period January-October 2014 point to slightly weaker growth in this sector compared to the previous year, with a registered growth of 1.4% for both indicators y-o-y. Slightly lower growth rates were affected by adverse weather conditions in July, in which 25% of total revenues on an average are normally achieved. Tourists from Russia, which have the largest share in the total number of overnight stays (27.1%), recorded an increase of arrivals and overnight stays of 6.0% and 8.9%, respectively. Second in importance, tourists from Serbia (21.7% share) had a decreased number of arrivals (5.4%) and overnight stays (2.6%), while tourists from Ukraine (with a share of 5.2%) recorded a drop in arrivals of 1.2%, but the growth in overnight stays of 5.7%.

Industrial production (9.8% of GDP in 2014); In the period January-October 2014 it decreased by 11.0% compared to the same period last year, primarily due to the decline in production of electricity. By sectors, growth was recorded in the sector of "mining and quarrying" (8.6%), while a fall was recorded in "manufacturing industry" (3.3%) and "electricity, gas and water supply" (21.6%). The fall in electricity production is the result of several factors: the high base from the previous year; long overhaul of Pljevlja Thermal Power Plant.

Retail sales (trade accounted for 12.9% of GDP in 2014); For ten months of 2014 retail sales recorded a low but stable growth during the entire period. Total turnover (current prices) for the ten months was higher by 2.7% y-o-y. In terms of constant prices, real growth was 4.2%. Although growth in retail sales does not correspond to the stagnation of pensions and wages, it can be attributed to growth in the tourism sector, as well as a slight increase in loans to individuals. The fall in sales was recorded in non-specialized stores, which have the largest share in total retail sales, while in all other activities, sales increased compared to the same period last year, such increase being dominantly influenced by the growth of retail sales in specialized stores.

Transport (4.2% of GDP for 2014); According to Monstat preliminary data, for the period January-September 2014, an increase was recorded in transport of passengers at the airports by 2.5%, an increase in transport of goods and passengers by rail of 1.2 and 27.4%, respectively, an increase of passengers in road transport by 14.7%, the growth of goods in maritime transport by 18.4% and growth of provided mobile telephony services by 10.9%. The decline was recorded in the number of passengers in maritime transport by 0.2% and transshipment of goods in ports by 21.9%.

Construction (4.6% of GDP for 2014); Indicators for construction sector indicate growth in activity in the first half of the year, but a decline in the third quarter of 2014. The value of construction works in January-September 2014 increased by 6.3% compared to the same period last year, while executed effective hours of work decreased by 5.4%.

1.2.1.2 Inflation

Price trends in the period January-October 2014 were marked by deflationary trend. The decline in the annual rate of inflation, which started in 2013, continued in 2014, primarily as a result of falling prices of food from high levels in 2013, while energy prices recorded milder oscillations and a slight decline over the period. Deflation is a result of imported inflation combined with weak growth in disposable income. The annual inflation rate, measured by the consumer price index (CPI) in October 2014 was -0.5%, while the average rate for the period January-October amounted to -0.8%. The movement of the main CPI categories (food, fuel, electricity), which make up about half of total household consumption, showed mild fluctuations during the period, with only food and fuel prices recording a continuous decline compared to last year. The price of electricity decreased in the third quarter, while fuel prices rose in the second quarter due to the higher crude oil prices on world markets. Producer prices in October 2014 increased by 1.0% compared to October 2013, while in January-October remained at the same level as in the previous year.

By the end of the year, slight slowdown in deflationary trend is expected, with the annual inflation rate in December of -0.5%.

I.2.1.3 Salaries and unemployment

According to data from the Labour Force Survey, in the second quarter of 2014, the activity rate for the population aged 15-64 was 62.8% and it was higher by 3.9 percentage points than the average for 2013, i.e. by 3.1 percentage points compared to the second quarter last year. At the same time, increasing employment trend continued so that, according to the same source, the number of employees increased by 6.7% compared to the same quarter in 2013, while the employment rate increased from 47.4% in 2013 to 51.1% in 2014. Unemployment rate for the population of 15-64 amounted to 18.6% in the second quarter of 2014 and was by 1 percentage point lower than the average for 2013. Youth unemployment rate, for those aged 15-24, remains high, and, in the second quarter of 2014, amounted to 32.5%, which was by 1.9 percentage points lower than in the comparative period (34.4%). According to the Employment Agency of Montenegro, at the end of the third quarter of 2014, the number of unemployed stood at 31,584 (women 48.3%), i.e. 1.9% more than in the same period of 2013. This is explained by the fact that a certain number of inactive persons registered at the Employment Agency with a view to getting included in active employment policy programmes (Professional Training Programme for University Graduates: Let's Employ Our Young Ones Up To 24, etc.).

The average salary in October 2014 amounted to € 724, while in the period January-October it declined by 0.3% y-o-y. The average wage without taxes and contributions in September 2014 amounted to € 478, which is a decrease of 0.8% y-o-y. The average net salary in October 2014 compared to September 2014 grew by 0.3% in real terms, while in annual real terms it increased by 0.4%. The average pension in October amounted to € 274.1 (57.3% of average earnings) and was lower by 0.6% y-o-y. Number of pensioners in September 2014 amounted to 109,320 and was higher by 1.2% than in September 2013.

I.2.1.4 Banks' lending activity

The banking sector preserved stability for the first ten months, although a high level of non-performing loans and the lack of bank lending continue to be an issue. Banking business is characterized by the growth of capital and deposits on an annual basis, and the absence of reviving lending due to high credit risk, as well as weak growth in economic activity. Total deposits in October amounted to € 2,251.5 mil., which represents an increase of 7.3% compared to the end of 2013, or 7.0% at an annual level. The structure of deposits remains to be dominated by retail deposits with a share of 57.7% and a growth of 6.7% per annum. Total loans and other receivables amounted to € 2,424.1mil. in October and decreased by 0.8% compared to the previous month, while on an annual basis the decline amounted to 2.0%. Non-performing loans amounted to € 398.9 mil. (16.46% of total loans) in October, which is 5.7% lower compared to the end of 2013, or 9.1% at an annual level. At the end of October 2014, there were 13,819 insolvent entities, out of 62,419 legal entities and entrepreneurs with total debt of € 482.7 mil., which is 10.5% more than in December 2013.

I.2.1.5 Balance of payments

Current account; During the nine months of 2014 the current account deficit increased by 16.4% due to increase in foreign trade deficit and decrease in surplus in the accounts of primary and secondary incomes. Exports of goods decreased by 10.3% due to the decrease of production, and this entailed the export of electricity and aluminium. Exports of electricity decreased by 65% y-o-y, while at the same time the export of aluminium and aluminium products fell by 15.8%. Imports of goods remained at the same level. The coverage of imports by exports of goods amounted to 20.7%, which is 2.4 percentage points lower than the same period in 2013.

The surplus in the services account increased by 5.4% compared to the same period in 2013, as a result of growth in service revenues by 2.8% but also the fall in expenditure by 3.5%. Service revenues

increased primarily due to revenue growth achieved in the field of tourism. Estimated revenues from tourism amounted to € 658.0 mil. or 2.4% more than in 2013.

Table 3 Balance of payments

	january - september 2013.	january-september 2014.
A. CURRENT ACCOUNT (1+2+3+4)	-229.935	-267.562
1. Goods**	-996.182	-1.027.738
1.1. Export, f.o.b.	298.952	268.172
1.2. Import, f.o.b.	1.295.134	1.295.910
2. Services	632.540	666.477
2.1. Revenues	887.108	912.152
2.2. Expenditures	254.568	245.675
3. Primary income	44.466	15.094
3.1. Revenues	160.445	166.398
3.2. Expenditures	115.980	151.304
4. Secondary income	89.242	78.605
4.1. Revenues	136.275	130.671
4.2. Expenditures	47.033	52.067
B. CAPITAL AND FINANCIAL ACCOUNT	39.828	-43.441
B1. Capital account	475	-6
B2. Financial account	39.353	-43.434
1. Direct investments – net	275.619	256.408
2. Portfolio investments – net	-27.089	110.062
3. Other investments – net	-188.142	-299.734
4. Change in CBM reserve	-21.034	-110.170
C. NET ERRORS AND OMISSIONS	190.107	311.003

Izvor: Centralna banka Crne Gore

Accounts of primary and secondary incomes had surpluses. The surplus on the account of primary incomes is 66.1% lower y-o-y. The main reason for reducing the surplus is the increase in total expenditures by 30.5%, due to higher outflow arising from dividends and employee compensations, compared to 2013. Outflow arising from dividends amounted to € 49.1 million, or three times more than in 2013. The surplus on the account of secondary incomes was 11.9% lower due to lower inflow of transfers to Montenegro by 4.1%, but also higher outflow of transfers by 10.7%, in relation to 2013.

Capital and financial account; In January-September¹ 2014, the net inflow of foreign direct investments amounted to € 256.5 mil. In the period January-October² 2014, the net inflow of foreign direct investment rose by 12.4% compared to the same period last year. Monthly FDI inflow was extremely high in September (€ 55.6 mil.) and October (€ 59.4 mil.).

The account of portfolio investments saw a net inflow of € 110.1 mil. in the first ten months of 2014, as a result of government borrowing by issuing Eurobonds in the international capital market. The source of significant growth of the asset position in other investments is related to the increase in deposits: about € 137 mil. refers to the estimated cash held by residents, coming from tourism revenue and seamen's earnings, while about € 125 mil. refers to the cash and deposits with banks. Movements on the other investments account are characterized by decreased liabilities of the government sector and banks under borrowings, and increased liabilities of other sectors (economy). The outflow of funds under portfolio investments amounted to € 156.6 mil., and was related to the refinancing and the purchase of part of bonds issued in 2010 and 2011.

The item net errors and omissions is the residual between the current account and the financial and capital account.³ The value of net errors and omissions in the nine months of 2014 reached € 311.0 mil., which is an increase of 63.6% y-o-y.

¹ Balance of payments data for the first three quarters of 2014, CBM

² Data from monthly statements on FDI issued by CBM.

³ Capital and financial account shows the source of funding the current account deficit.

1.2.2 Macroeconomic projections for the period 2015-2017

The macroeconomic projections for the period 2015-2017 anticipate real GDP growth of 3.5% in 2015, 3.8% in 2016, and 4.0% in 2017. Montenegro's economy is expected to pick up growth momentum over the period 2015-2017 due to increased investment activity and engagement of the domestic potential, primarily from the construction sector. We estimate that the implementation of investment projects worth 100 million euro would have a positive effect on GDP growth rate of 1.7% - 2.0% through direct, indirect, and imputed effects. It is also expected that tourism and complementary sectors such as trade, transport, and mining and quarrying, will strongly contribute to growth over the projected period, with reliance on agriculture as the substitution factor for food import and increased exports. The sine qua non for enhancing the economic activity is expected moderate increase of credit support. The average projected GDP rate of growth over the period is 3.8%, which is above the current potential GDP growth of 2.5%).

1.2.2.1 Real sector

The 2015-2017 macroeconomic scenario is based on the following components:

- Household consumption will be affected by a slight increase in salaries and an increase in the number of employees, reinforced by positive impetus from tourism income; however, real growth will be lower than the real rate of GDP; Estimated growth in household consumption will be 2.3%, but it is expected to pick up in the last two years of the cycle.
- Gross fixed capital formation will grow at an average rate of 11.1% over the medium term, in line with the pace of implementation of investment projects. Strong contribution will come from the capital budget that will be used for financing the highway section project. We estimate that the impact of construction of the highway section on the formation of GDP will be at the level of at least 10% of GDP, which will reflect not only on an increased contribution of gross fixed capital formation, but also on household consumption.
- The share of government spending will rise slightly, coupled with the implementation of fiscal consolidation measures. An average growth of 1.5% is based on fiscal projections that anticipate that there will be no increase in expenses for salaries and other allowances, and that there will be a slight increase in expenditure for material and services and other components of government spending.
- Foreign direct investments (in companies, banks, and real property) will average around 13.4%⁴ of GDP over the period 2015-2017; such a high FDI rate is based on the implementation of a part of the announced investments in infrastructure, tourism, energy and agriculture projects.
- Corporate and retail credits will grow at the average rate of 4.5%, in accordance with the nominal GDP growth and taking into account strong multiplication effects that the investment cycle will have on other sectors. Credit growth will be primarily driven by lower lending rates, the declining trend of which was recorded towards the end of 2014⁵.
- The export of goods and services will rise at the average rate of 5.1% over the period 2015-2017, and it is projected that the growth in export of services (foreign tourists spending) will outpace the growth in export of goods, and the latter should be driven by the recovery of the metal industry, as well as a growing export of agricultural products and a stable electricity generation.
- The import of goods and services will grow at the average rate of 5.0% over the medium-term, with an increase in merchandize imports due to investment needs (import of building material and equipment) and an increase in the import of construction-related services (the highway

⁴ Overview of investment projects, as identified by relevant ministries on the principles of certainty and conservative estimates, was made in January 2015 and is given in annex to this document.

⁵ Credit growth of 3.9% in 2015, or the average annual growth of 4.5% by 2017, was seen as realistic by the CEOs of major banks in Montenegro and the Bankers' Association of Montenegro at a meeting with government representatives on 22 January 2015.

construction and other projects). These projections have excluded the one-off impact of food imports that relates to re-export in 2014, but they have also taken into account a significant decline in the value of import of oil derivatives due to lower oil prices in the world market. These adjustments reduced the growth rate of imports that would otherwise be higher.

- Employment will gradually increase throughout the period (1% a year, on average) as a result of growth in economic activity.
- Unemployment, as measured by the ILO methodology, will progressively decline from 19.4% in 2014 to 17.2% in 2017, as a result of growth in economic activity, especially in the sectors of construction and mining and quarrying (necessary material for the highway purposes).

Table 4 Macroeconomic projections 2015 - 2017

Montenegro: Macroeconomic projections, 2015-17					
	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>
Nominal GDP in million €	3.327	3.393	3.547	3.737	3.964
Nominal growth	5,7	2,0	4,5	5,4	6,1
Real growth	3,3	2,0	3,5	3,8	4,0
Inflation (at year-end)	2,2	-0,5	1,0	1,5	2,0
			(u % BDP-a)		
Core items:					
Current account deficit	-14,6	-14,2	-13,3	-13,8	-14,6
Export	41,8	41,1	41,3	41,2	40,8
Import	62,1	60,4	59,5	59,7	59,9
Other	5,7	5,1	4,9	4,7	4,4
Household consumption	80,6	80,3	78,8	77,9	77,0
Gross investments	18,1	19,2	20,1	21,7	23,6
Governments spending	21,6	19,7	19,3	18,9	18,5
GDP deflator	2,2	0,0	1,0	1,5	2,0
			(realne stope rasta %)		
Real GDP growth	3,3	2,0	3,5	3,8	4,0
Domestic demand	2,9	1,1	2,6	4,0	4,5
Household consumption	0,8	0,5	1,6	2,6	2,7
Gross investments	0,3	3,5	8,0	12,1	13,3
Governments spending	-4,9	1,5	1,3	1,5	1,8
Export	-2,1	0,4	4,0	3,5	3,1
Import	-6,8	-0,7	2,0	4,0	4,4
			100,0 godišnji rast u % ako nije drugačije naznačeno)		
Core assumptions:					
Employment growth	3,0	0,8	1,5	1,2	0,8
Unemployment (LFS)	19,5	19,4	18,2	17,6	17,2
FDI % GDP	9,7	10,7	11,6	14,7	13,9
Domestic loans (corporate)	5,0	1,7	3,9	4,6	5,2
Export growth	0,1	0,4	5,0	5,0	5,2
Import growth	-4,7	-0,8	3,0	5,6	6,5

Source: Ministry of Finance, Montenegro

The projected GDP growth includes the following components on the production side:

- Projected growth in the agricultural sector in the period 2014-2017 will average 3.8%. Such a significant projected growth is based on the assumption of increased investment in agriculture and growth of credit support to this sector over the projected period, as well as a gradual substitution of imports by increased domestic production.
- The mining and quarrying sector will grow at an average annual rate of 6.3% over the medium term as a result of increased activity due to increased demand for materials necessary for the highway project (stone, gravel separations, and road base material).
- Manufacturing industry will experience weak growth of 1.5% in the upcoming period, assuming that KAP production has remained at the 2013 level.
- Electricity production will have a slight increase of 3.0%, whereby hydro power plant production will increase due to the low base in 2014 and a stable power generation from the thermal power plant.
- Construction will experience the strongest growth due to the expected investment boom, averaging around 16%. Participation of domestic construction companies will have multiplication effects on the related industries: trade, transport, financial and insurance services, small manufacturing services, and the like.
- This scenario envisages a growth in the accommodation and food services that account for 5.0% of the tourism industry. Completion of tourism investments will increase the offer of high category accommodation facilities, which is the prerequisite for the strengthening of contribution of this sector to GDP growth.

Table below gives an overview of real rates of growth, contributions to growth, and share in GDP over the medium-term, by the aggregate production sector:

Table 5 Production sectors

	Real growth rate in %			Share in GDP growth in %		
	2015	2016	2017	2015	2016	2017
Agriculture	3,0	4,0	4,5	0,2	0,3	0,3
Industry	1,5	3,2	2,9	0,1	0,3	0,3
Construction	12,0	20,0	16,0	0,5	1,0	0,9
Services	3,2	2,6	2,9	2,0	1,6	1,8
Taxes-subsidies	4,0	4,0	4,2	0,7	0,7	0,7
GDP	3,5	3,5	3,8	3,5	3,8	4,0

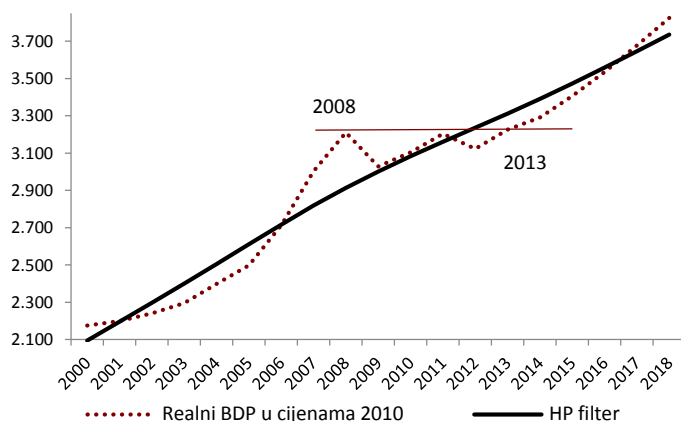
1.2.2.2 Potential growth

Montenegro's economy went through a boom period in the recent past (growth in the period 2006-2008 averaged 8.7%) and a double-dip recession caused by the financial crisis (a decline of 5.7% in 2009) and the euro area crisis impact and spillover to peripheral countries (a decline of 2.5% in 2012, with growth of economic activity in 2013 and 2014). Montenegro's economy did not rerun the 2008 GDP level before 2013, which means that the double-dip recession in this period annulled the economic growth that had been made during the boom period.

Such volatile movements in a relatively short period of time make it difficult to determine a precise position of the economy in the business cycle. These restrictions are amplified by short series or the lack of data although the results and analyses reflect essential trends. An analysis of the position in the business cycle was performed based on the HP filter. Owing to the projected growth rates over the period 2015-2017, Montenegro's economy will slowly approach the potential GDP after a fall in 2009

and 2012 and moderate growth rates in 2010, 2011, and 2013. Risks that could emerge and materialize on this journey are a negative impact of a weak economic activity in the euro area and countries in the region, internal structural weaknesses, and a need for fiscal adjustments.

Figure 1 Potential GDP - HP filter, 2010 = 100



In the period 2001-2014, the average rate of growth amounted to 3.1%, while potential growth rates displayed noticeable declining trends. These trends were the result of problems with failed privatisations and delayed construction of hotel facilities that have been privatised but not yet in operation, then the closing of unsuccessful manufacturing companies, and problems in the repro-chain in the metal industry. The current rate of potential growth stands at some 2.5%.

Another important factor of the potential decline is the reduced funding sources, particularly from the EU-based parent banks. Less funds available for financing in parent banks immediately reflects in reduction or withdrawal of capital from their subsidiaries. Reduction in funding resources manifests through rigid funding conditions. We expect strong investment activity in transport, tourism, energy, and agriculture in the future period will increase capital stock and thus influence on an increase in potential rates of economic activity. Additional impetus to the potential growth will come from the implementation of structural reforms in the labour market and the removal of bottlenecks to stronger economic growth that involve various types of business barriers.

Growth factor of economic activity that relates to the workforce has several limiting elements. The long-term problem is the aging of the population, and consequently the availability of workforce for the growth of economic activity, and a potential pressure on the sustainability of the pension and health insurance systems because there is a significant problem of sustainability of these two subsystems at this point.

Structural unemployment is also a significant problem that reflects in the mismatch of labour supply and demand in the sense that the supply of occupational and educational profiles does not match the employers' demand. Structural unemployment is visible through a high youth unemployment that have been on the records of the Employment Agency for more than one year, which reduces their chances of re-employment. The unemployed over 40 years of age account for 44% of the total number of unemployed people, while those aged over 50 make up 30%. The unemployed that have been on the records of the Employment Agency for more than one year account for 58% of the total unemployed people.

The main source of growth on the demand side is linked to the growth of domestic demand, especially gross fixed capital formation related to a strong impetus involving the implementation of announced investments, primarily the construction of the highway section. A smaller contribution to growth will come from growth in household consumption and government spending.

Net exports will have a negative share in growth due to a stronger growth and a higher share of imports in relation to exports.

1.2.2.3 Inflation

Euroised economies have limited possibilities for leading monetary policy due to the lack of emission function, influence on reference interest rates and exchange rate. In such limited circumstances,

objective of monetary policy of the Central Bank is the maintenance and promotion of financial stability, including the maintenance and promotion of a healthy and stable banking system. The instruments for implementing monetary policy have been significantly strengthened and expanded following the adoption of the Law on the Central Bank of Montenegro in July 2010. In addition to the reserve requirement instruments and short-term liquidity loans, and open market operations and institute of a lender of last resort were introduced. The resources for this purpose are significantly restricted, however, the Central Bank widened the room for manoeuvre, both for preventive and routine activity, and for acting in times of crisis.

During 2014, the Ministry of Finance, with the expert assistance of Slovakia and UNDP, developed a model for the projection of inflation, which is based on the historical data on the movement of inflation and includes exogenous variables which are mentioned in Table 2:

The index of food prices and their projections for the future period,

- Oil prices in 2014, price growth projections for 2015.
- Euro/dollar rate projections.
- Dinar/euro projections and historical trends.

By the end of the year, slight slowdown in deflationary trend is expected, with the annual inflation rate in December of -0.5%, although even lower rates of inflation can be expected due to the reduction in prices of petroleum products both in 2014 and 2015. In such unstable conditions, based on the assessment results, we corrected the model and projected slightly lower inflation rates. Inflation rates have been corrected due to a much stronger fall in oil prices in 2014 than that provided for under the technical details in the introductory part of the document, as well as analysts' forecasts of prices for the next year.

Initial assumptions of inflation forecasts for 2014 are:

- Crude oil prices dropped below \$ 90/bbl in October this year, with a tendency to fall in the medium term.
- The euro exchange rate is about 1.25 USD/EUR. The effects of the adoption of new measures by the ECB, related to quantitative and credit support, could influence the further depreciation of the euro in the coming period.
- The stabilization of food prices, with potential slight increase due to the natural disasters that have befallen the region, as well as the impact of the announced redirection of exports of agricultural production from Serbia to Russia.
- By the end of the year, increases in administratively controlled prices or new tax burdens are not expected.

For the period of 2016-2017, inflation projections are based on the projection of inflation trends in the EU, so we have projected a gradual rise in prices that should stabilize in 2017 at around 2%.

I.2.2.4 External sector and its mid-term sustainability

Current account balance of a country reflects competitiveness that economy of the country has in international trade. High current account balance, measured by its participation in GDP, points to weak competitiveness of the Montenegrin economy, as coverage of import by export shows that there is no offer of imported goods or its price is more favourable than the one produced in Montenegro. Current account deficit is also a difference between savings and investment in the national economy and its high-level shows that investment level is financed from external sources either through indebtedness of the country, corporate industry or banks. Main negative contribution to the current account deficit refers to the balance of goods but it has been partially adjusted by surplus on the account of services, primary and secondary income. On the sub-account of primary income we expect increased outflows related to payments of salaries and non-resident dividends depending on the ownership structure,

owner's business policy and dynamics of net foreign investments. Current account deficit is largely covered by foreign direct investments and country borrowing at international capital market. Existence of years-long deficit points to deep external imbalance where deficit funding by foreign direct investments inflow, sovereign indebtedness or private sector indebtedness represents only a temporary solution.

Structure of FDI inflows per country and type of investment shows that major part of investments relates to real estate acquisition (42%) and inter-company transactions (39%) while only a small part relates to investments in companies and banks (19%). These patterns should be changed in the mid-term as a consequence of strengthened investment cycle and structural reforms, which are addressed both in chapter 3 of Part I of ERP and in the whole Part II. FDI structure per countries shows that participation of Russia in inflows makes 28% of overall investments, while the major part (79%) relates to real estates. High participation of real estates in FDI clearly indicates vulnerability in financing current account deficit due to the change in external environment and possibility for funds withdrawal as well as availability of real estate for sale. Amount of foreign exchange provisions is not a restricting factor for goods import considering the quantity of money in circulation as Montenegro economy belongs to euro area and companies do not buy out foreign exchange from the Central Bank. The amount of international reserves of Montenegro covers for three months value of import.

However, the structure of current account deficit and its financing represents a risk that may lead to deterioration of payment balance position due to the following events:

- Decrease in tourism income due to decrease in tourist arrivals from countries either affected by crisis or being in war conflicts (Russia, Ukraine), or decline in economic potential of the region. This would lead to current account deficit deterioration.
- Decrease in FDI inflows due to political or financial instability in countries from which capital originates (Russia), which would have impact on deterioration and decrease in sources for current account deficit financing.
- Instability on world financial markets that may lead to increase in price of sovereign borrowing and decrease in demand for riskier securities which would also decrease sources of current account deficit financing.

Materialization of all these risks at the same time, or their combination, would lead to the need for sharp adjustments of the public sector, along with decreased import and multiplying negative effects (decrease in public revenues), as well as decrease in economic activity growth rates.

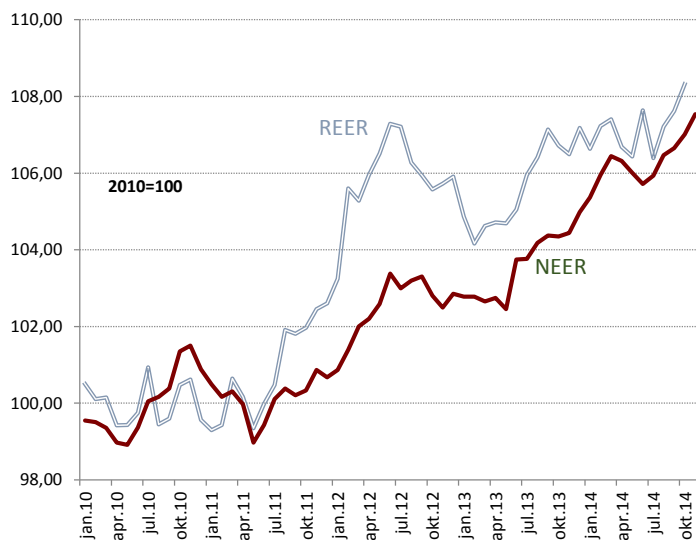
Macroeconomic scenario for the period 2015-2017 envisages high current account deficit and it would amount to about 14.6% of GDP at the end of the period caused by stronger growth in import of goods necessary for carrying out investments in infrastructure along with simultaneous growth in service revenues and mild fall in surplus on the accounts of primary and secondary incomes.

Base mid-term scenario envisages stable income from salaries of employee with non-residents and remittances of non-residents, and potential increase in transfers from Montenegro related to dividends and employee salaries. Although balance of payment position is deteriorating, it is primarily the consequence of cyclic movements caused by strong investment cycle.

Basic macroeconomic scenario for the period 2015-2017 envisages strong FDI inflow that will, in the medium term, amount to 13.4% of GDP in average, which will be sufficient to cover imbalance on the current account. Sources of such a strong investment inflow are projects in the sector of energy, tourism and infrastructure.

Competitiveness of Montenegrin economy measured by real effective exchange rate shows deterioration of the position due to fall in the value of currency basket of the main Montenegrin trade partners and strengthening of competitiveness measured by unit labour cost. REER analysis was

Figure 2 Real and nominal effective euro exchange rate in Montenegro



developed based on weight for 26 countries with which Montenegro has foreign trade exchange and that encompass 93,8% of foreign trade exchange and revenues from tourism and represent real value of the basket of currencies in which Montenegro performs foreign trade exchange and tourist services. This year's analysis was made on a monthly level and the matrix showing participation of individual countries was supplemented by contribution of tourism sector due to its importance for the Montenegrin economy. Deficiency of the matrix is in the contribution of tourism which is of seasonal nature and does not fully reflect relations during the year. The applied

model uses weighted geometrical average for calculating nominal effective exchange rate in exchange (NEER), while inflation is calculated based on a weight where:

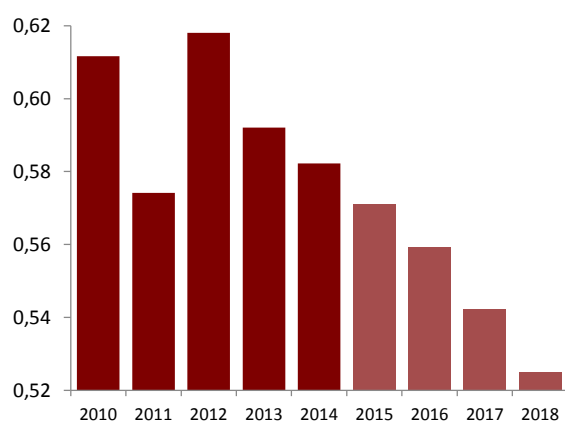
$$REER = \frac{NEER_t * CPI_t}{CPI_t(strani)},$$

$$a NEER = \prod_{i=1}^N S(i)_t^{w(i)}.$$

The biggest effect on nominal and real effective exchange rate is exerted by Serbia, Russia and Ukraine as they are using their own currencies. The graph shows that the beginning of conflicts in Ukraine led to sharp fall in the value of ruble, hryvnia and dinar and that had a significant impact on decrease of competitiveness expressed by this indicator. Fall of dinar has double impact as it reduces available income representing the source of tourist expenditures, while, on the part of goods export, increases the value of goods and, on the part of import decreases the value of imported goods. Since there is no significant decrease in food prices, it is assumed that this theoretical pattern is modified in a way that the value of import and export is calculated in euro and does not affect the changes in goods prices.

Since increase in competitiveness is not possible to reach through currency devaluation (use of common currency), necessary adjustments must be achieved through slow process of »internal devaluation«, through salary reduction and structural reforms although stagnation of salaries is obvious in the European environment as well.

Figure 3 Unit labor cost - coefficient



Analysis of competitiveness that is made based on unit labour cost (ULC) shows that price competitiveness is improving although reliability of analysis is limited due to change in data source for the number of employees (2010) and fight against grey economy i.e. legalization of employment⁶. Projected increase in competitiveness will be achieved through a growth of GDP in the medium term, which will be faster than the combined

⁶ Coefficient shows the share of gross wages in GDP outturn, thus the coefficient of 0.62 indicates that for each euro of GDO gross wages have share of 0.62 euro

growth of employment and salaries. Employment growth will be encouraged in the medium term (1%) through increase in demand caused by stronger investment cycle, while low growth of salaries is caused by high unemployment rate and thus significantly higher supply than demand.

Table 6 Indicators in tourism industry

Year	2006	2007	2008	2009	2010	2011	2012	2013	2014
Real growth rate of tourism revenues	18,6	62,3	8,6	-6,0	4,5	8,8	-0,3	0,4	2,4
Average tourist spending in €	285	405	455	435	437	451	447	444	449
Average tourist stay (days)	6,2	6,4	6,6	6,3	6,3	6,4	6,4	6,3	6,4
Average daily spending in euro	45,8	62,9	69,4	69,6	69,3	70,6	70,3	70,4	70,2
Average tourist spending in 2010 prices	346	478	514	451	437	437	416	404	408

One of sectors in which Montenegro may increase competitiveness and which may be one of sources of faster growth in the future period is tourism sector. Previous results and their analysis have shown that average spending by tourists is decreasing since 2008 as a consequence of the double-dip recession in source countries for Montenegrin tourism. In 2014, expenditures by tourists have slightly increased. The improvement in the tourism supply relates to construction of new attractive facilities, reconstruction of the existing and construction of new infrastructure, along with higher quality supply of complementary tourist services and facilities. Construction of facilities in Porto Montenegro and Lustica Bay represent an example that building of high category capacities not only attracts high-end clientele but contributes to broader development of local communities (Tivat). Previous trend of fall in average income per tourist shows that it is necessary to continue with the implementation of measures and policies directed towards modifying growth models from mass to elite tourism in order to ensure strengthening of participation of this industry in total economic activity.

In business environment, price competitiveness is an important element that determines the level of competitiveness of tourism in a country. The tax rates are one of the key factors that determines the price competitiveness in tourism. VAT rate, as well as other taxes in Montenegro, are competitive compared to neighbouring countries. On the other hand, the need to strengthen the stability and sustainability of public finances does not allow the reduction of tax rates, at this stage of the economic cycle.

Research shows that the most developed tourist countries (best practices) have a competitive level of taxation since they create favourable conditions for businesses operating in the tourism industry and provide affordable offer of hotel and hospitality services.

According to the report, "Competitiveness Index of travel and tourism in 2013", (WEF - World Economic Forum) the steady growth of tourism is significantly driven by price competitiveness in the travel industry and tourism. According to the same report, Montenegro is positioned on the 40th place out of 140 countries measured. Since the last ranking in 2011, it fell on the list by 4 places.

Another segment that represents an obstacle to faster growth of this industry is its reliance on a smaller number of source markets, and in recent years these were the countries of our region and Russia. In order to diversify demand, it is necessary to reduce transportation cost through engagement of low-cost airlines, with the application of incentive pricing policy for airport fees and passenger services and incentive measures in tourism, especially in the period outside the main tourist season, which would make Montenegro more attractive destination due to increased price competitiveness and remove vulnerability of relying on a small number of destinations.

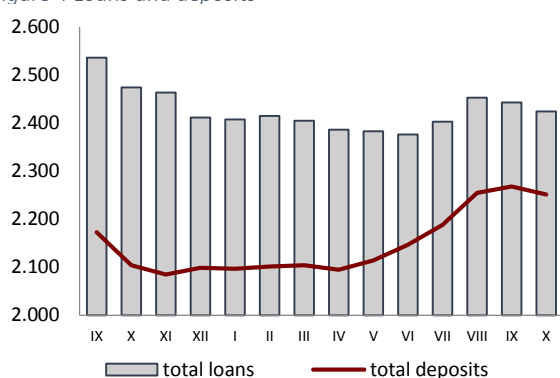
Improvement of fiscal position by running cautious expenditure policy will reduce negative prospects of risk materialization related to financing the current account deficit.

It is not possible to analyse the net international investment position since CBM does not have necessary data for such assessments.

1.2.2.5 Financial sector

Persistently high level of non-performing loans is still one of potential risks for the financial stability that, due to its complexity, has become a problem of systemic character. In the period 2009-2014, banks transferred and/or sold non-performing assets in the value of € 670.0 mil. In September, non-performing loans amounted to € 398.9,2 mil, which is by 5.7% lower compared to the end of 2013, i.e. by 9.0% on the annual level. Since the reduction of the volume of NPLs represents key challenge in the following period, of particular importance will be the implementation of the solutions stipulated by the Law on Voluntary Financial Restructuring of Debts to Financial Institutions. With adoption of this Law, which is in parliamentary procedure, implementation of specific strategy for reduction of NPL level is expected, which will contribute to the revival of lending activity and consolidation of real economy.

Figure 4 Loans and deposits



Source: CBCG

Restrictive lending policy of banks led to an increase in general liquidity level, which had an impact on the liquidity and solvency parameters trend above the prescribed level. However, these funds were not in the function of lending aimed at development projects as banks based their lending activity on their own perception of the general operating risk and client credibility and they have been largely oriented towards the state sector as a less risky client.

An increasing rise in inter-company debts and increased illiquidity in economy is obvious, so that

22.1% of all registered economic entities have blocked accounts. Compared to October last year, the number of blocked accounts increased by 8.8%. In the continuous blockade up to one year were 2,335 debtors, whose blocked funds amount to € 66.5 mil, which makes 13.78 % of the overall amount of blocked funds, while 11.484 judgment debtors were blocked for longer than a year, for the amount of € 416.1 mil., which makes 86.2% of the total blocked amount.

In October, weighted average effective interest rate on total loans amounted to 9.28%, which is by 0.29 p.p. lower compared to the previous month. This means that the banks started to follow the recommendation of the Central Bank, to a certain extent. The Council of the Central Bank of Montenegro appealed to banks to continue decreasing interest rates and concluded that it would continuously monitor the interest rates developments and take appropriate measures when needed. Additionally, the Central Bank again submitted a recommendation to the Government of Montenegro for prescribing the maximum contracted interest rate to prevent concluding of usurious contracts.

Considering the increase in lending activity of banks in September and October and decrease in weighted average effective lending rates on newly approved loans as well as potential entry of three more banks on the market, growing lending activity of banks can be expected, and under more favourable terms, in 2015. Namely, strengthened competition on the banking market should result in further fall in lending interest rates and more versatile offer of loan products mostly to corporate clients. Under the present macroeconomic conditions, and the present and announced large-scale investment projects, there is enough room for the development of better cooperation between banks and businesses under much more favourable conditions and at a higher level.

I.2.3 Low-growth scenario

Alternative scenario forecasts moderate growth in economic activity of 2.1% in 2015, followed by a growth similar to the central scenario but from a lower base, as follows: 3.1% in 2016 and 3.3% in 2017. As with the central scenario, there will be a moderate growth of the Montenegrin economy in the period 2015-2017, due to increased investment activity and engagement of local resources, primarily in the construction sector, with positive effects in indirectly related sectors. In this scenario, it is anticipated that there will be no significant implementation of other investments in tourism and energy or that this contribution will be well below the one foreseen by the base scenario. In relation to the central scenario, it is anticipated that the tourist industry will have a weaker growth due to a significant reduction in tourist arrivals from Ukraine and Russia, due to the crisis in that region. This would have a negative impact on the related sectors of trade and transport. Agriculture will be positioned as a factor of food import substitution and increased exports, but to a lesser extent than in the central scenario. The average projected GDP growth rate for the period 2015-2017 would amount to 2.9%, which is close to the current potential GDP growth rate.

The scenario assumptions and external factors:

- Strong impact of the largest investment project in Montenegro relating to the construction of the highway section will have a dominant influence on economic activity developments in Montenegro in the medium term. The value of the project exceeds 20% of GDP in 2014 prices. Construction phase, which will last four years, is financially covered with a grace period of six years. Bearing in mind the impact of implementation of such a project on the growth of economic activity and the fact that the financing has been ensured the assumptions on GDP impact are the same as for the central scenario.
- The current situation in financial markets is favourable with respect to interest on borrowings and demand, although instabilities in 2015 may lead to disturbances in the form of rapid increases in the cost of borrowing and risk aversion by investors. This scenario implies the low likelihood of materialization of this risk for macroeconomic and fiscal stability in the medium term.
- The unstable situation in Ukraine and the economic crisis experienced by Russia because of sanctions from western countries combined with a strong decline in revenue due to lower oil prices, result in a significant reduction in tourist arrivals from these countries, so the tourism sector in this scenario would record a fall in tourist arrivals from these countries by over 20% in the following year. Certain substitution would occur in the form of diversification of the market and increase in the number of tourists from other countries. According to our estimate, this reduction in tourist arrivals would cause a drop in tourism revenues by over 6%.
- Investors' caution due to instability related to the strong drop in oil prices and the impact on exporting countries would delay the start of announced investments in tourism and energy, or completion of the started projects.

Table 7 Macroeconomic projections – low-growth scenario

Montenegro: Macroeconomic projections under low-growth scenario 2015-17

	2013	2014	2015	2016	2017
Nominal GDP in million €	3.327	3.393	3.483	3.634	3.807
Nominal growth	5,7	2,0	2,6	4,4	4,8
Real growth	3,3	2,0	2,1	3,3	3,2
Inflation (at year-end)	2,2	-0,5	0,5	1,0	1,5
			(u % BDP-a)		
Core items:	-14,6	-14,2	-14,7	-15,4	-16,5
Current account deficit	41,8	41,1	40,9	41,2	41,2
Export	62,1	60,4	60,6	61,4	62,4
Import	5,7	5,1	5,0	4,8	4,6
Other	80,6	80,3	78,8	77,9	77,0
Household consumption	18,1	19,2	21,5	23,3	25,7
Gross investments	21,6	19,7	19,3	18,9	18,5
Governments spending					
	2,2	0,0	0,5	1,0	1,5
GDP deflator			(realne stope rasta %)		
	3,3	2,0	2,1	3,3	3,2
Real GDP growth	2,9	1,1	2,5	3,7	4,0
Domestic demand	0,8	0,5	0,3	2,1	1,9
Household consumption	0,3	3,5	14,5	11,9	13,6
Gross investments	-4,9	1,5	0,0	1,0	1,0
Governments spending	-2,1	0,4	1,6	4,0	3,3
Export	-6,8	-0,7	2,5	4,5	4,9
Import					
			godišnji rast u % ako nije drugačije naznačeno)		
Core assumptions:					
Employment growth	3,0	0,8	1,2	0,9	0,8
Unemployment (LFS)	19,5	19,4	18,5	18,0	17,7
FDI % GDP	9,7	10,7	11,8	11,0	10,5
Domestic loans (corporate and retail)	5,0	1,7	2,2	3,7	4,0
Imports growth	0,1	0,4	2,1	5,0	4,8
Exports growth	-4,7	-0,8	3,0	5,6	6,5

Low-growth scenario includes the following elements:

- Household consumption will be influenced by the slight increase in salaries and increase in the number of employees, with negative contribution of a weaker tourist season. The average real growth rate would be around 1.4%.
- Gross investments in fixed assets will grow at an average rate of 13.3% in the medium term, in accordance with the implementation timeframe of investment projects. Strong contribution will come from the capital budget through which the highway project will be financed.
- The share of government spending will stagnate, and at the same time fiscal consolidation measures will be implemented due to weaker revenues caused by the decline of tourism earnings, and thus lower revenue collection.
- The current account deficit would be worsened as a result of strong imports for the purposes of the highway construction and weaker growth in revenues from tourism. The average rate of deficit would amount to 15.5% of GDP.

- The export of goods and services will rise at an average rate of 3.0% in the period 2015-2017, and it is projected that the growth in export of services (foreign tourists spending) will stagnate while the export of goods will grow.
- The import of goods and services will rise by 4.0% in the medium term, due to increased imports of goods related to investments (import of building materials and equipment).
- Foreign direct investments (investments in companies, banks and real estate) in the period 2015-2017 will be around 11.1% of GDP on an average. These rates of FDI are based on the assumption that investments in infrastructure will be activated, but also that other investment projects will be delayed or slowed down.
- Employment will gradually increase throughout the period (by 1.0% per year on an average) as a result of growth in economic activity, primarily that related to the construction sector and related sectors.
- Unemployment, measured by the ILO methodology, shall be progressively reduced, from 19.4% in 2014 to 17.7% in 2017, as a result of growth in economic activity, especially in the sectors of construction and mining and quarrying (necessary materials for the purposes of the highway).
- Inflation would have slightly lower values than in the base scenario and would amount to about 1.5% at the end of the period.

1.2.4 Differences between the scenarios

The importance of the infrastructure investment project and its definite start, and conservative projections of growth in the base scenario made the differences between the base and low-growth scenarios not significant. The current situation in financial markets is very favourable in terms of demand and the level of interest rates that are significantly lower for Montenegro (200-300 points or 2-3%) than those applicable at the time of borrowing (around 7.5%). Other risks mentioned would not be able to produce effects that would significantly lessen the impact of the investment cycle.

The following table gives the basic differences between the scenarios:

Table 8 Differences between scenarios

	2015	2016	2017
Nominal GDP in € mil.	64,4	102,7	157,3
<i>Nominal growth</i>	1,9	1,0	1,3
<i>Real growth</i>	1,4	0,5	0,8
<i>Inflation (end of year)</i>	0,5	0,5	0,5
GDP deflator	0,5	0,5	0,5

- The low-growth scenario would cause the reduction of nominal GDP level by € 324 mil. in the period 2015-2017.
- In the same period, the nominal rate would be reduced by 4.2% and the real rate by 2.6%. The fall in the real rate would be lower than the nominal due to lower inflation and lower deflator in the low-growth scenario than in the base scenario.

I.3 Fiscal Framework

I.3.1 Fiscal policy strategy and medium-term objectives

For Montenegro, as a small, Euroised and extremely open economy, the number of possible combinations of economic policies is limited. Under the conditions where a country has not all monetary policy instruments available, the significance of fiscal policy is even greater given that it is the only one from the set of policies that may actively contribute to the achievement of economic and general social goals. Responsible fiscal policy management has been and remains a strategic goal of Montenegro. Fiscal stability is not only a precondition of the overall economic stability and long-term economic growth, but availability of international financial markets also depends on it. Finally, stable public finance of Montenegro is also significant in the context of EU membership negotiations.

The strategic long-term goal of Montenegro in the area of public finance still remains the reduction of public debt, i.e. its share in GDP. This strategic goal may be achieved through the mixture of trends of these two macroeconomic categories. The Government of Montenegro is confident that this goal is targeted in a more qualitative way through creation of conditions for and encouragement of accelerated economic growth, which under Montenegrin conditions implies significant infrastructure investments. The fact is that in the medium term such investments may have adverse effects on fiscal indicators such as deficit and public debt, but in the long run through higher economic growth rates they also affect increase of public revenues, which creates conditions for stabilisation of public finance and share of public debt in GDP.

In this context it is necessary to interpret the decision of Montenegro to implement the strategically significant high-way construction project, which will together with other large-scale investments that are already on-going and financed by private capital, not only increase the economic growth but also change the course of the overall development of the country.

The fact is that the construction of the high-way will temporarily increase deficit, which in the scenario not implying the construction of the high-way would record surplus already in the next year, and this is therefore an indicator of responsible fiscal policy management. As a result of the project implementation, the government debt will go up too. Expressed as a GDP share it will reach its peak in 2018 (69.9% GDP), and thereafter it will have a descending trend. In the alternative scenario (without the construction of the high-way) the debt does not exceed the Maastricht limit of 60%, but even with the borrowings for high-way construction it remains lower than the average debt in the EU and Euro area.

In order to limit the consequences of the envisaged one-off fiscal effect of the high-way construction, additional efforts are made to consolidate public finances on one side, and create fiscal space for additional investment spending on the other. In this context, the Government will pursue the following basic fiscal policy goals in the coming medium-term period:

- implementation of restricted spending measures, particularly with regard to current expenditures;
- reduction of expenditures, through implementation of rationalisation policy regarding the number of public sector employees, the modalities of which are under consideration;
- further improvement of fiscal framework in view of developing business, new investments and harmonious economic development;
- continuation of intensive fight for reduction of grey economy and reduction of tax receivables; and
- increase of transparency of public finance and its adjustment to the EU Acquis, with special focus on introduction of ESA2010.

Relevant regulatory framework has already been adopted for the purpose of achieving the mentioned goals. The key legal document in that direction is the *Law on Budget and Fiscal Responsibility* adopted in April 2014. Among other things, the Law defines planning and executing of the budget in the way that public debt does not exceed the limit of 60% GDP. Although the basic logic of the Law is that budgetary expenditures should be covered by revenues, it still provides the possibility of exceeding the limit in the situations when the funds are used to finance projects of national interest and if they are approved by the Parliament. The high-way construction meets the set criteria through creation of assumptions for more rapid development of the North, better use of natural and economic potentials, as well as better connecting of the Port of Bar with regional markets.

Another significant fiscal strategy pillar of Montenegro is tax reform. The basic conceptual solutions are included in the document titled *Analysis of specific tax policy aspects – reform outlooks* adopted by the Government in December 2014. The document envisages amendments to a set of laws in view of (a) increasing the level of public finance sustainability and restricting the public debt growth, (b) distributing tax burden in the way to support the growth to a larger extent and (c) underpinning and improving investment ambiance and competitiveness of Montenegrin economy. Proposals included in this Analysis address some of the key fiscal goals that Montenegro has set as priorities for the coming medium-term period, and detailed description and quantification of measures are presented in the sub-section 4.3. Proposed measures are not a part of fiscal scenarios, given that they imply amendments to the specific pieces of legislation, which is envisaged for 2015.

Budget revenue side measures will also be accompanied by systemic measures on the expenditure side. The basic goal is to regulate public sector wage system and establish long-term sustainability of the pension system. In the context of EU joining, the Government will continue to pay special attention to the costs directly incurred by the harmonisation with the Acquis.

Similarly to previous years, this year two fiscal scenarios have been prepared based on macroeconomic scenarios presented in section 2. The following table shows the basic data from both macroeconomic and fiscal scenarios:

Table 9 Fiscal mid-term framework

Macroeconomic framework		Execution	Estimate	Base scenario			Low growth scenario		
		2013.	2014.	2015.	2016.	2017.	2015.	2016.	2017.
Macro-economic indicators	GDP nominal (in million €)	3.327,0	3.393,0	3.547,0	3.737,0	3.964,0	3.482,7	3.634,4	3.807,0
	GDP, nominal growth	5,7	2,0	4,5	5,4	6,1	2,6	4,4	4,8
	GDP, real growth	3,3	2,0	3,5	3,8	4,0	2,1	3,3	3,2
	Inflation	2,2	-0,5	1,0	1,5	2,0	0,5	1,0	1,5
	Employment growth (%)	3,0	0,8	1,5	1,2	0,8	1,2	0,9	0,8
	Current account deficit (% GDP)	-14,6	-14,2	-13,3	-13,8	-14,6	-14,7	-15,4	-16,5
Fiscal framework (in % GDP)		Execution	Estimate	Base scenario			Low growth scenario		
		2013.	2014.	2015.	2016.	2017.	2015.	2016.	2017.
Fiscal indicators	Source public revenues	43,0	44,0	42,9	41,4	40,3	42,7	41,8	41,4
	Public expenditures	48,3	44,7	48,2	46,4	44,3	49,1	47,7	46,1
	Deficit/Surplus	-5,3*	-0,7	-5,3	-5,0	-4,0	-6,4	-5,9	-4,7
	Interest	2,1	2,2	2,3	2,2	2,0	2,3	2,2	2,1
	Primary deficit/surplus	-3,2	1,5	-3,1	-2,8	-1,9	-4,1	-3,7	-2,5
	Government debt (% GDP)	58,0	57,7	63,2	67,0	69,1	65,2	70,6	74,1

*in line with the methodology used in the Law on Budget Final Account, explained in footnote 7.

I.3.2 Public Finances 2014

Public finances, after the third quarter of the current year, are in the zone of mild surplus amounting to 0.3% of annual GDP.⁷ Public sector revenues⁸ record an extremely good collection and are by 2.8% higher than planned, and 6.4% than the ones generated in 2013. On the other hand, public expenditures were below the plan by 3.3%.

In 2014, the application of the higher VAT rate of 19% and “crisis tax” on the portion of the salary exceeding average of 15% continued, while pensions were not adjusted in line with the established formula in the current year.

At the same time, additional efforts were made to suppress grey economy and increase tax discipline. In spite of good collection of revenues in this year and significant exceeding of the plan (which is also reasoned by substantially prudent approach in revenue planning, as explained in the last year’s Program), revenue side of the budget would have had even better performance had there not been delay in the announced investment cycle, somewhat slower economic growth, or deflationary trend of prices in the first half of the year.

I.3.2.1 3.2.1 Public finances in the period January – September 2014

Public revenues for the first 9 months of this year amounted to €1,072.4 million or 31.6% of annual GDP. Revenue increase was mostly contributed by revenues in respect of value added tax, personal income tax and contributions that exceeded the plan by 3.4%, 9.0% and 7.9% respectively. These data indicate that, in addition to the growth due to higher VAT rate and introduction of the “crisis tax”, there has been significant reduction of grey economy in the domain of labour market (improved collection of contributions and income tax), as well as in the domain of general consumption (value added tax). Lagging behind in relation to the plan is recorded with regard to revenues in respect of excise (6.8%), which causes doubt that there has been increase in grey economy in the excise goods market.

Public expenditures were lower than planned by around €40.0 million or 3.3%, and amounted to €1,061.9 million or 31.3% of annual GDP. In the structure of expenditures the greatest share is still related to gross wages and social care transfers amounting to 9.2% GDP and 10.8% GDP, respectively. Thus narrowed fiscal space in the consumption domain signals that significant changes are required in the social care system and public sector employment. In addition to the mentioned, 2.1% of estimated GDP has been invested so far through capital expenditures of public sector, and interest on current debt has been paid in the approximate amount of around 1.9% GDP.

In the relevant period, **public finances have generated surplus of €10.5 million or 0.3% GDP.** Primary surplus (taking away interest expenses) amounted to 2.3% of estimated GDP.

The following Table shows public finance outturn after the third quarter of 2014.

⁷ Deficit estimate is related to cash deficit and as such, in methodological terms, it has not been adjusted to the deficit that is adopted through the Law on the Budget Final Account. The difference in cash and modified deficit arises in the item *repayment of liabilities from previous period* which in the process of budget consolidation is divided into the portion that is calculated as current budget expenditure (portion of expenditure that increases cash basis deficit) and the portion that belongs to the Debt Repayment, and as such is not included in the deficit calculation. In this document only cash basis deficit is used, except for 2013, which is in accordance with the Law on Final Account of the Budget for 2013.

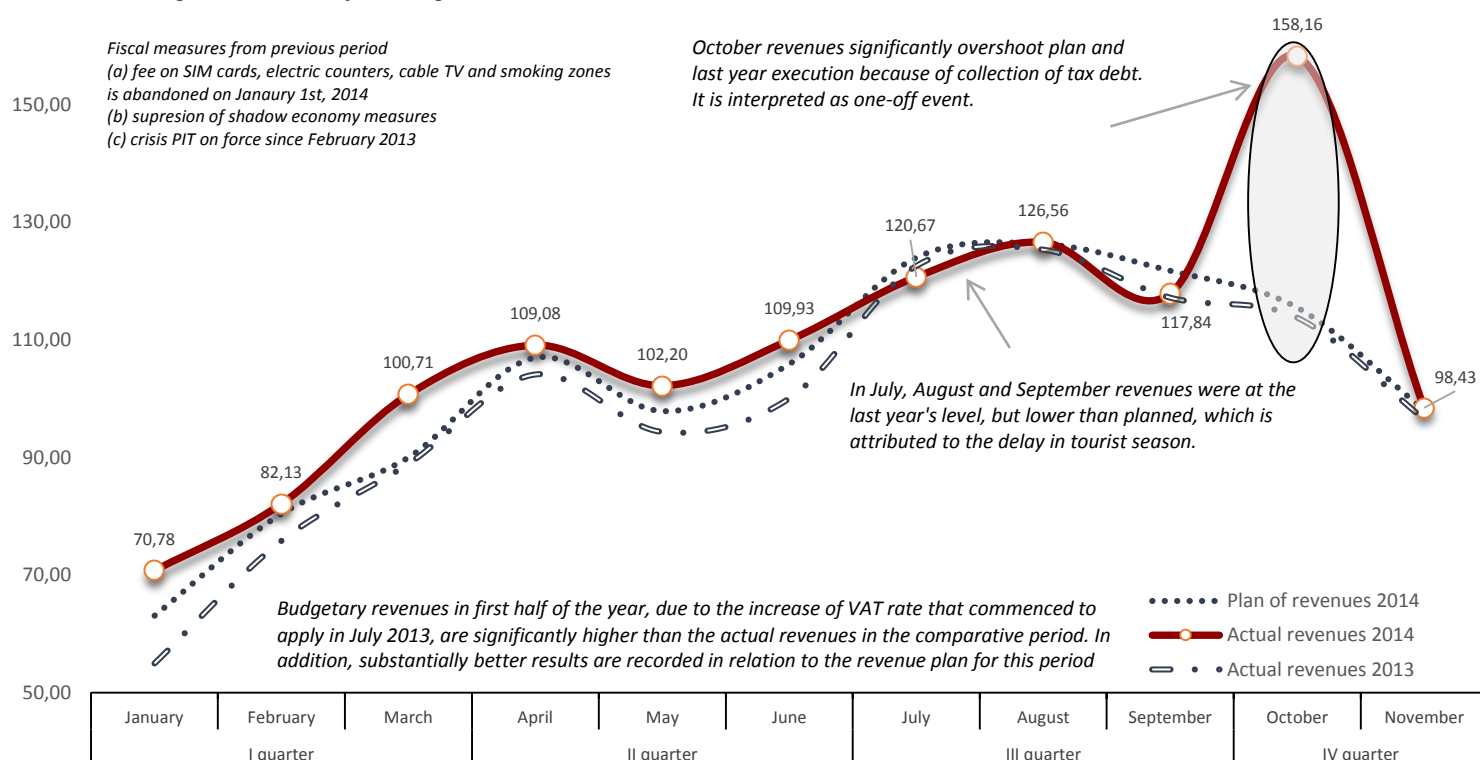
⁸ In methodological terms, public sector, in sense of public finances, is defined as a consolidated account of the central and local government levels, i.e. revenues and expenditures of the central budget increased by the revenues and expenditures of local self-governments, and reduced by transfers between these two government levels (central budget transfers to municipalities). After the completion of the procedure and full implementation of ESA 2010 methodology, the coverage of public sector will change, so public enterprises on local and state levels, companies under majority ownership of the state, etc. will be included.

Table 10 Public finance execution after third quarter 2014

Annual (in million €)	3.393,2				3.327,0					
Public finances – after 3rd quarter	2014		Plan		Deviation		2013		Deviation	
	€ mill.	% GDP	€ mill.	% GDP	€ mill.	%	€ mill.	% GDP	€ mill.	%
Public revenues, of which:	1.072,4	31,6	1.043,4	30,8	28,9	2,8	1.008,0	30,3	64,4	6,4
Personal income tax	93,6	2,8	85,9	2,5	7,7	9,0	81,5	2,4	12,1	14,9
Value added tax	352,0	10,4	340,4	10,0	11,6	3,4	317,8	9,6	34,1	10,7
Excise	117,8	3,5	126,5	3,7	-8,7	-6,8	120,6	3,6	-2,8	-2,3
Local tax	47,4	1,4	40,8	1,2	6,6	16,3	45,6	1,4	1,8	4,0
Contributions	284,8	8,4	263,9	7,8	20,9	7,9	264,3	7,9	20,5	7,8
Public expenditures, of which:	1.061,9	31,3	1.098,1	32,4	-36,2	-3,3	1.106,2	33,2	-44,3	-4,0
Gross wages	311,2	9,2	315,1	9,3	-3,9	-1,2	302,9	9,1	8,3	2,7
Interest	66,0	1,9	57,3	1,7	8,7	15,2	63,1	1,9	2,9	4,7
Subsidies	12,3	0,4	14,7	0,4	-2,3	-15,9	10,3	0,3	2,0	19,8
Social care transfers	368,1	10,8	374,1	11,0	-6,0	-1,6	357,0	10,7	11,1	3,1
Capital budget	72,7	2,1	100,9	3,0	-28,2	-28,0	56,6	1,7	16,1	28,4
Guarantees	15,3	0,4	0,0	0,0	15,3	...	103,1	3,1	-87,8	-85,2
Surplus/deficit	10,5	0,3	-54,6	-1,6	65,1	-119,2	-98,1	-3,0	108,7	-110,7
Primary surplus/deficit	76,5	2,3	2,7	0,1	73,8	...	-35,1	-1,1	111,6	-318,3
Debt repayment	243,4	7,2	167,8	4,9	75,6	45,1	181,1	5,4	62,2	34,4
Financing, of which:	232,9	6,9	222,4	6,6	10,5	4,7	279,3	8,4	-46,4	-16,6
Borrowings from abroad	99,9	2,9	4,8	0,1	95,1	...	129,6	3,9	-29,7	-22,9
Borrowings in the country	194,4	5,7	171,0	5,0	23,4	13,7	104,6	3,1	89,8	85,9

Taking into account that the central budget makes almost 90% of public finances, and that revenues of such segment of the state are available on monthly level, available data for eleven months show that the revenues of the central budget amount to €1,196.5 million and are by 5.9 % higher in relation to the planned. Revenue growth trend continued in 2014 too, so the revenues are higher by 8.9%, or €8.1 million in relation to 2013. The achieved result may also be partly attributed to the one-off effect from October of the current year, as emphasised in Figure 5 and is related to the implementation of the Parliament conclusion based on which non-financial assets of the state and the share in the ownership of the Elektroprivreda Crne Gore A.D. (Montenegro Power Plant) have increased, and concurrently the receivables of this company due from the state that were incurred at the time of difficulties in Kombinat Aluminijuma (Aluminium Company) have been settled.

Figure 5 Overview of the budget execution



I.3.2.2 Public finance outlooks by the end 2014

Public revenues in 2014 are estimated in the amount of €1,492.9 mill. or 44.0% GDP⁹, which is by 3.5% higher than in 2013 and by 4.3% in relation to the plan. Estimated public expenditures will amount to €1,515.1 mill. and will be higher by 2.7% in relation to the planned. Estimated cash basis deficit of public finances will amount to €22.3 mill. and make 0.7% GDP, while estimated primary surplus is at the level of 1.5% GDP.

Increase of revenues will result from:

- increase of revenues in respect of value added tax in 2014 by 0.8% in relation to the planned and will amount to €459.7 mill., which is concurrently an increase by 7.1% in relation to the execution in 2013. The reason of higher collection is the increase of VAT rate from 17% to 19%, economic activity growth and intensive fight against grey economy;
- increased collection of contributions, which will amount to €428.4 mill. or 12.6% GDP, and will be higher by 7.7% in relation to the planned, or by 7.5% in relation to 2013;
- increase of revenues in respect of personal income tax by 12.1% in relation to the plan, so it will amount to €135.8 mill. or 4.0% of estimated GDP.

Adverse effect on revenues will result from:

- revenues in respect of excise, which will amount to €162.5 mill. and will be lower by 5.1% in relation to the planned level;
- fees, which will amount to €16.6 mill. and will be lower by 17.4% in relation to the plan.

The amount of public expenditures in 2014 is estimated to the level of €1,452.9 mill., or 44.7% GDP. In relation to the plan for 2014, expenditures will be higher by 2.7%, mostly due to the repayment of guarantees in the amount of €15.3 mill. (0.4% GDP) and increase of the amount of social care transfers by 1.7%, which is the consequence of increased number of persons entitled to social care benefits during this year, and also increased expenses in respect of the social program for former employees of the Kombinat Aluminijuma (Aluminium Company). At the same time, subsidy item has increased too, because based on the conclusion of the Government the allocation for financially threatened families has increased through settlement of electricity bills. On the other side, the total expenditures will be lower by 4.5% in relation to 2013, mostly as a consequence of the large base from previous year (expenditures in the previous year are significantly higher due to called guarantees for Kombinat Aluminijuma (Aluminium Company).

Public finance deficit for 2014 is estimated to €22.3 mill. or 0.7% of estimated GDP (€3,393.2 mill.). In relation to the plan the deficit is lower by €10.4 mill.

Given the time of adoption of the Program (January 2015), it is certain that the central budget cash basis deficit in 2014 amounted €103.4 mill. or 3.0% of estimated GDP, which incorporates in its calculation the overall expenses for repayment of liabilities from the previous period. During the development of the Final Account Law, the deficit will be adjusted by the amount of repayment of outstanding liabilities and net increase of liabilities.

In 2014 the debt repayment is planned to amount to €311.2 mill., which if estimated deficit is added indicates the need for borrowings in the amount of €333.5 mill. or 9.8% GDP. Out of this, €194.2 mill. will be related to borrowings from abroad, while €102.4 mill. will be domestic borrowings, and the remaining amount are the proceeds from privatisation in the amount of €11.0 mill. and use of deposits.

⁹ Revenues have been estimated based on revenues generated in the period January – August 2014 and this amount does not include payment of around €45 mill. of tax debt in October of the current year.

Table 11 Public finance estimate for 2014

Annual GDP (in million €)	3.393,2				3.327,0					
Public finance estimate for 2014	2014		2013		Odstupanje		Plan 2014		Odstupanje	
	mil. €	% BDP	mil. €	% BDP	mil. €	%	mil. €	% BDP	mil. €	%
Public revenues, of which:	1.492,9	44,0	1.431,9	43,0	61,0	4,3	1.442,2	42,5	50,7	3,5
Personal income tax	135,8	4,0	124,2	3,7	11,6	9,4	121,1	3,6	14,6	12,1
Value added tax	459,7	13,5	429,2	12,9	30,5	7,1	455,9	13,4	3,7	0,8
Excise	162,5	4,8	161,4	4,9	1,0	0,6	171,1	5,0	-8,7	-5,1
Local tax	64,7	1,9	66,6	2,0	-1,9	-2,9	51,0	1,5	13,7	26,8
Contributions	428,4	12,6	398,5	12,0	29,9	7,5	397,8	11,7	30,5	7,7
Public expenditures, of which:	1.515,1	44,7	1.586,5	47,7	-71,4	-4,5	1.474,9	43,5	40,3	2,7
Gross wages	423,3	12,5	407,0	12,2	16,3	4,0	422,5	12,5	0,8	0,2
Interest	74,6	2,2	71,3	2,1	3,3	4,6	76,7	2,3	-2,1	-2,7
Subsidies	21,4	0,6	18,2	0,5	3,3	17,9	19,6	0,6	1,8	9,2
Social care transfers	507,1	14,9	483,4	14,5	23,7	4,9	498,8	14,7	8,3	1,7
Capital budget	143,8	4,2	124,4	3,7	19,4	15,6	136,8	4,0	7,0	5,1
Guarantees	15,3	0,4	107,2	3,2	-92,0	-85,8	0,0	0,0	15,3	...
Surplus/deficit	-22,3	-0,7	-176,5	-5,3	154,3	-87,4	-32,7	-1,0	10,4	-31,9
Primary surplus/deficit	52,3	1,5	-105,2	-3,2	157,6	-149,7	44,0	1,3	8,3	19,0
Debt repayment	311,2	9,2	225,5	6,8	85,7	38,0	220,4	6,5	90,8	41,2
Financing, of which:	333,5	9,8	402,0	12,1	-68,5	-17,0	253,1	7,5	80,4	31,8
Borrowings from abroad	102,4	3,0	151,3	4,5	-48,9	-32,3	6,0	0,2	96,4	...
Borrowings in the country	194,2	5,7	191,4	5,8	2,7	1,4	228,0	6,7	-33,8	-14,8

I.3.3 Public Finance Outlooks in the Period 2015 – 2017

I.3.3.1 Fiscal policy directions for the period 2015 – 2017

Public debt also remains in the focus of fiscal policy in the coming medium-term period, while the needs for funding of projects that ensure economic growth in the long run are taken into account. In this view, reduction of public finance deficit is set as the primary fiscal policy goal, including spending rationalisation mechanisms and increase of budgetary revenues.

In 2013, systemic fiscal consolidation measures were introduced, and their implementation continues in the following period too. The collection of tax forms has improved, but tax debt is still high.

In that direction, fiscal policy will continue to implement, which will be adjusted to the principles of predictability and responsibility, as well as fiscal rules set in the Law on Budget and Fiscal Responsibility. The tax system reform model envisages the change in the taxation structure, which implies transition towards the taxes with a weaker adverse effect on economic growth.¹⁰ In this way the growth potential will be released, which together with reforms in other areas would undoubtedly contribute to efficient commercialisation of domestic resources, strengthening of competitiveness of economy, and achieving of higher economic growth rates and increasing standard of living of citizens.

Taking into consideration the macro-economic assumptions from the previous section, a set of additional fiscal assumptions is envisaged which serves as the base for the estimate of public finances for the period 2015 – 2017:¹¹

¹⁰ In line with the conclusions of the Economic Policy Reforms – Going to Growth, 2009, OECD

¹¹ The solutions from the recently adopted document “Analysis of specific tax policy aspects – outlooks for reform” have not been taken into consideration during the development of these projections because they imply amendments to the current legislative solutions, then subsequent public consultations and adoption in the Parliament. The adoption of legislative bases for implementation of tax reform is envisaged for 2015.

- continuation of intensive fight against grey economy, with the focus on labour market and excise goods market;
- “crisis tax” remains in effect in 2015 too;
- value added tax will amount to 19% in the coming three-year period, while lower tax rates (0% and 7%) on specific goods will be retained;
- the measures of reduction of discretionary spending will continue to implement for all items where savings are possible to be achieved;
- the measure of non-adjusting pensions will cease to be in effect. According to the current and projected macro-economic indicators having effect on the pension amounts (average wage and inflation), in 2015 pensions should be adjusted downwards (reduced), due to somewhat lower average wage in relation to the previous year and negative inflation rate. However, in 2015 there will be no adjustment of pensions, as to protect the standard of pensioners;
- abolishing the practice of “retirement under favourable conditions”;
- currently the most important infrastructure project in the state, the high-way section Smokovac – Mateševo, will be executed during the time horizon of the projection, and will be funded through capital budget, the borrowings from Chinese Exim Bank in the value of 85% of investment and contributions of Montenegro amounting to 15% of the project value.

Following high nominal revenue growth rates in the previous years, in the coming medium-term period their stable growth is expected. The designing and adopting process of the budget for 2015 has been prepared in accordance with the principles prescribed by the Law on Budget and Fiscal Responsibility implying medium-term fiscal framework and setting the spending ceilings for spending units, and also observing of introduced fiscal rules (Maastricht rules regarding debt and deficit and two national rules related to the obligation of creating primary surplus and growth of current and capital expenditures related to growth rates in real sector of economy).

Proposal of the central budget for the following year envisages smooth financing of all commitments of the state, including expenditures for the high-way and repayment of liabilities in respect of Eurobonds issued in 2010. Simultaneously, the central budget for the following year will finance structural reform processes in the areas of pension system, labour market, health system, social care system, tax policy, transport, etc. Reform processes related to the EU accession, reforms in the areas of education and labour market, as well as regional and rural development will be also supported through European projects and funds amounting to around € 113 mill. in the period 2014-2017.

The Government of Montenegro has adopted *Analysis of specific tax policy aspects – outlooks for reform*, which envisages amendments to the policies and regulatory framework that regulate public finances and tax system. Through implementation of the adopted analysis, the Ministry of Finance will address two out of four fiscal policy goals – fiscal framework will be improved for development of business, new investments and harmonious economic development, and it will also affect reduction of grey economy and reduction of tax receivables. In this direction, models are considered for subsidising interest rates for loans of development nature that are placed by the Montenegro Investment Development Fund in cooperation with commercial banks.

The activities that the Ministry of Finance undertakes also target other fiscal policy goals mentioned in the first part of the section. Current expenditures are reduced, while capital investments increase and such efforts can be also seen in the medium term through the Budget Law for 2015 which follows the established fiscal rules. Tax system transparency and predictability are ensured through publication of all relevant information, medium-term analysis and plans for sector reform. In parallel with the mentioned, the Ministry of Finance, together with the Central Bank and Statistical Office, is actively working on applying ESA 2010 methodology in the statistical system, including public finance as its integrated part.

Table 12 Comparison of fiscal scenarios

Annual GDP (in million €)	3.327,1		3.393,2		3.547,0		3.737,0		3.737,0		3.482,7		3.634,4		3.807,0	
	estimate				baseline scenario						low growth scenario					
Comparison of fiscal scenarios	2013		2014		2015		2016		2017		2015		2016		2017	
	€ mill.	% GDP	€ mill.	% GDP	€ mill.	%	€ mill.	% GDP	€ mill.	%	€ mill.	%	€ mill.	% GDP	€ mill.	%
Public revenues, of which:	1.431,9	43,0	1.492,9	44,0	1.520,8	42,9	1.547,8	41,4	1.596,7	40,3	1.487,4	42,7	1.520,0	41,8	1.577,3	41,4
Personal income tax	124,2	3,7	135,8	4,0	139,9	3,9	133,3	3,6	137,2	3,5	137,8	4,0	131,7	3,6	136,3	3,6
Value added tax	429,2	12,9	459,7	13,5	480,2	13,5	492,3	13,2	508,5	12,8	463,1	13,3	476,9	13,1	496,0	13,0
Excise	161,4	4,9	162,5	4,8	167,7	4,7	171,9	4,6	177,6	4,5	164,5	4,7	169,4	4,7	176,2	4,6
Local tax	66,6	2,0	64,7	1,9	66,6	1,9	68,0	1,8	69,3	1,7	66,6	1,9	68,0	1,9	69,3	1,8
Contributions	398,5	12,0	428,4	12,6	417,5	11,8	427,9	11,5	442,1	11,2	409,5	11,8	421,8	11,6	438,7	11,5
Public expenditures, of which:	1.608,4	48,3	1.515,1	44,7	1.709,4	48,2	1.733,7	46,4	1.754,5	44,3	1.709,4	49,1	1.733,7	47,7	1.754,5	46,1
Gross wages	407,0	12,2	423,3	12,5	415,4	11,7	417,8	11,2	421,0	10,6	415,4	11,9	417,8	11,5	421,0	11,1
Interest	71,3	2,1	74,6	2,2	79,9	2,3	80,4	2,2	80,9	2,0	79,9	2,3	80,4	2,2	80,9	2,1
Subsidies	18,2	0,5	21,4	0,6	21,8	0,6	22,3	0,6	21,5	0,5	21,8	0,6	22,3	0,6	21,5	0,6
Social care transfers	483,4	14,5	507,1	14,9	505,5	14,3	516,2	13,8	526,3	13,3	505,5	14,5	516,2	14,2	526,3	13,8
Capital budget	124,4	3,7	143,8	4,2	324,1	9,1	333,6	8,9	338,9	8,6	324,1	9,3	333,6	9,2	338,9	8,9
Guarantees	107,2	3,2	15,3	0,4	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0
Surplus/deficit	-176,5	-5,3	-22,3	-0,7	-188,6	-5,3	-185,9	-5,0	-157,8	-4,0	-222,0	-6,4	-213,7	-5,9	-177,2	-4,7
Primary surplus/deficit	-105,2	-3,2	52,3	1,5	-108,7	-3,1	-105,5	-2,8	-76,9	-1,9	-142,1	-4,1	-133,3	-3,7	-96,3	-2,5
Debt repayment	286,0	8,6	311,2	9,2	455,7	12,8	436,3	11,7	245,0	6,2	455,7	13,1	436,3	12,0	245,0	6,4
Financing, of which:	462,6	13,9	333,5	9,8	644,3	18,2	622,2	16,7	402,8	10,2	-677,7	-19,5	-650,0	-17,9	-422,2	-11,1
Borrowings in the country	151,3	4,5	102,4	3,0	5,0	0,1	15,0	0,4	15,0	0,4	677,7	19,5	650,0	17,9	422,2	11,1
Borrowings from abroad	191,4	5,8	194,2	5,7	637,0	18,0	607,9	16,3	391,1	9,9	5,0	0,1	15,0	0,4	15,0	0,4

I.3.3.2 Baseline Fiscal Scenario

On the bases of medium-term fiscal policy directions described in the previous section and base macro-economic growth scenario, the Ministry of Finance has designed the base fiscal scenario for medium term, which will be legalised i.e. become operational through the annual Budget Law.

Public finance source revenues, in the medium term will range from €1,520.8 mill. in 2015 to €1,596.7 mill. in 2017, or from 40.3 to 42.9% of estimated GDP. The main budgetary revenue pillars remain value added tax and contributions, and significant portion will remain to be related to personal income tax, as well as excise which will record constant growth, as a result of the obligation of Montenegro to harmonise its excise policy with the European Union members.

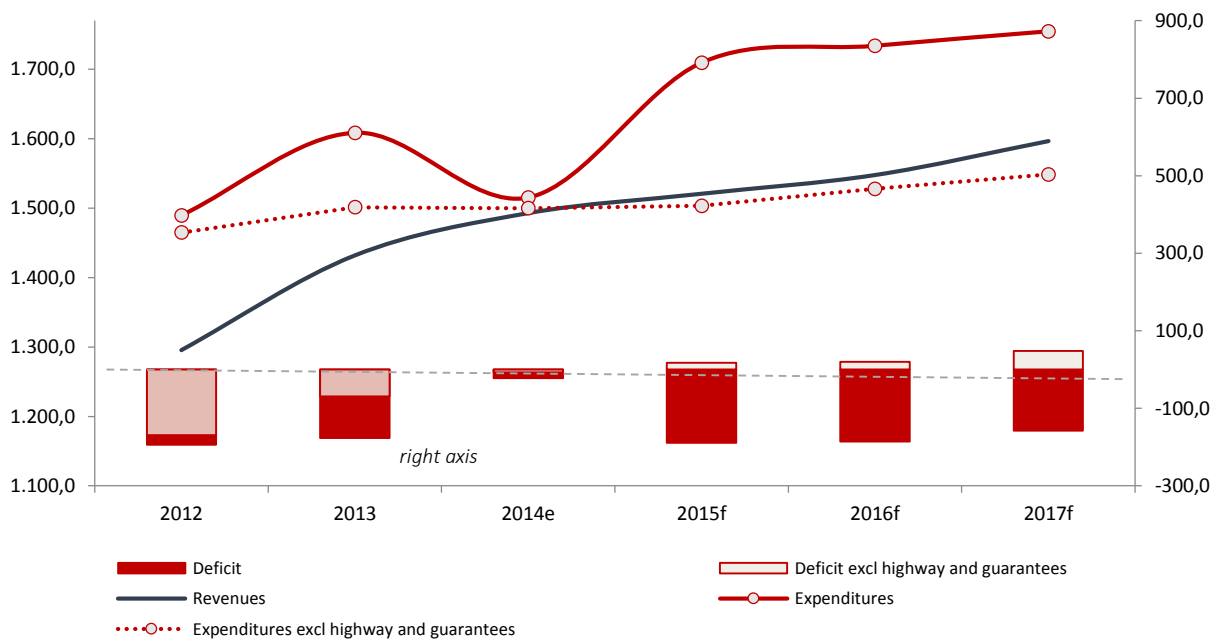
Public expenditures, in the coming three-year period will be relatively high, taking into account that the construction of the high-way section Smokovac – Mateševo will be financed through the capital budget of the central government. In nominal terms, expenditures will range from €1,709.4 mill. in 2015 to €1,754.5 mill. in 2017, i.e. from 48.2% to 44.3% of GDP estimated for 2015 and 2017 respectively. It is evident that with the exception of expenses for the high-way, residual expenditures record stagnation or only insignificant increase of nominal expenditures, which is in line with the principles of rationalisation at all government levels. During this period **capital budget** will amount to around 9% GDP on average in each individual year, and, with the exception of expenses for the high-way, they will remain on almost the same level as in 2014.

Responsible spending of budgetary funds still remains the leading paradigm of the government budget management, and therefore, in the coming period everything will be done so the discretionary spending would be rationalised and finally reduced.

Public finance deficit will be relatively high in the coming period, as a result of investments into the fixed capital of the state, as described in the previous paragraphs. With the exception of these expenditures, as it can be seen in the Figure, public finances would already in the next year transit to the zone of positive operating and generate surplus. In 2014, public finance will record deficit of 0.7%.

Public finance trends are presented in the Figure below:

Figure 6 Public finances projection 2014 - 2017

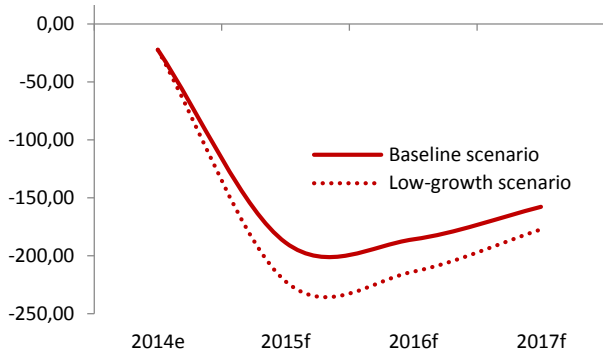


1.3.3.3 Fiscal low-growth scenario

Fiscal low growth scenario is based on the macro-economic low growth scenario the main assumption of which is the deterioration of foreign political situation that would result in the delay in foreign investments, the stagnation of the remaining economy, whereas the execution of the high-way project would continue due to already defined arrangement.

On the other side, fiscal resilience ratios show that in the fiscal scenario the revenue side is subject to external impact, while on the expenditure side of the budget, particularly under Montenegro conditions where the budget dominantly serves to finance non-resilient expenditures like wages and pensions, adverse external trends have no major impact. The expenditures pattern where the signs of the crisis are identified includes automatic fiscal stabilisers (subsidies and unemployment transfers), which do not make a significant portion of expenditures (around 1% GDP), and abortion of individual infrastructure projects. In the coming period, due to its commitments, and the need to invest in the infrastructure and thus facilitate preconditions for development of its potentials, Montenegro will not stop the construction of the high-way, not even in the case of the low growth scenario.

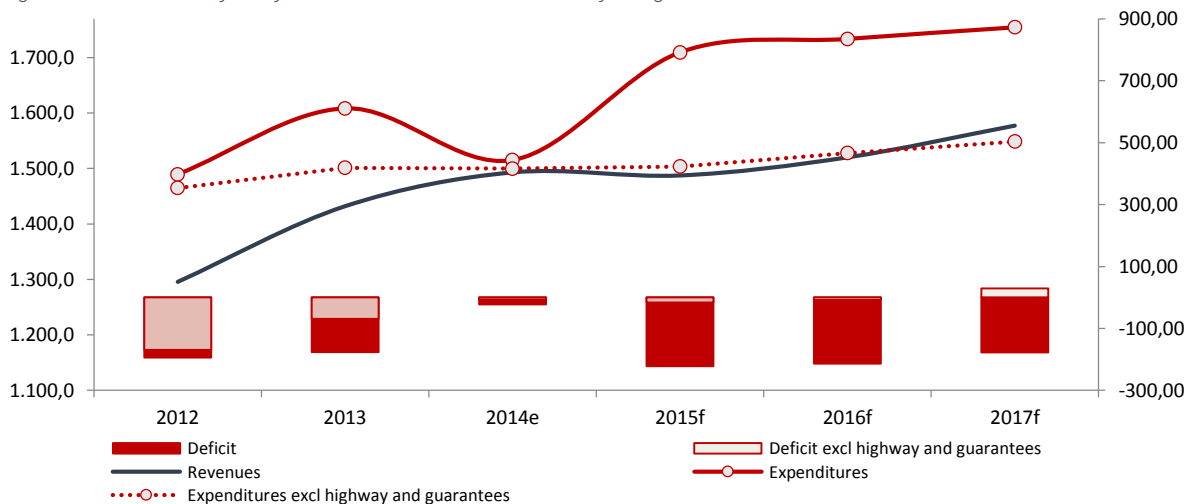
Figure 7 Public finance deficit, comparison of scenarios



In case of macro-economic low growth scenario, the revenue side will be adjusted by around 2% in relation to the base scenario, which would be the result of overflow of the mentioned adverse impact from real sector. Simultaneously, there will be adjustment of deficit by the same amount (given the described characteristic of expenditures implying their marginal resilience to the impact of the cycle). In the scenario of low economic growth, the shortage in public finances would amount to around 6.4% GDP, with the note that the increase of this indicator also results from the reduction of nominal GDP. Such small difference between the base and low growth scenarios is the result of prudential approach in revenue planning in the base scenario, which was also the methodological commitment in the previous Program particularly taking into account the size of economy and distinctive subjection to various external and internal factors.

Medium-term public finance framework, in case of low growth scenario, would look like in the Figure where it can be clearly seen that public finance surplus is to be achieved only in 2016, excluding the effect of high-way construction, while according to the base scenario balancing is projected in 2015:

Figure 8 Medium term fiscal framework under the conditions of low growth scenario



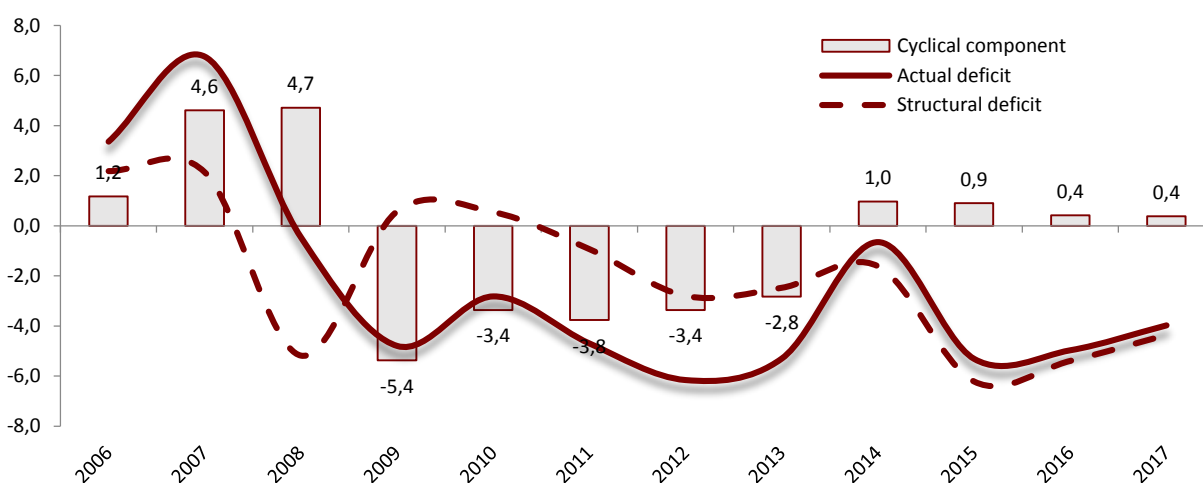
1.3.4 Structural balance¹²

Potential gross national product of economy has been calculated using *Hodrick–Prescott* filter. Such estimate is quite unstable due to (a) short series of data which do not enable a high level of correlation of fiscal and macro-economic parameters and (b) significant fluctuations of indicators. Instability in economic growth caused a large number of fiscal adjustment measures and one-off events the exact effect of which was to be estimated, while they were to be excluded from structural deficit calculation given that they make a cyclical and one-off event component.

On the revenue side, cyclical components representing the measures of fiscal adjustment on the side of direct and indirect and other revenues have been exempted. Noted should be corrections to indirect revenues, given that major changes took place in this category – change of excise rates every year, change of VAT rate, and in addition to this, reduction of grey economy, which was first effected through increase of VAT revenues. During the period of economic growth the revenues were higher than the structural ones, while in the so called business cycle low side they were lower, which is an expected result taking into account the previous trends where public revenues in the periods of economic expansion grow higher than the growth rate of economy. After 2013 significant amendments to the regulation framework were made – a set of fiscal measures for recovery of public finances commenced to apply. In addition to this, grey economy was reduced, i.e. the number of regular payers of tax liabilities increased, which certainly had a positive impact on public revenues in spite of the slowdown in economic growth. In the medium term, projected revenues will be higher than the structural ones, as a result of further application of introduced fiscal measures.

When expenditures are taken away from revenues, corrected by one-off budgetary events such as payment of guarantees, and also other cyclical components/automatic stabilisers (subsidies, unemployment transfers, and the like) a picture is obtained where structural deficit is nominally lower than the generated deficit, which corresponds to relevant macro-economic projections that show that since 2008 economy has been below its potential performance. Although the calculation of potential GDP outturn shows that only at the end of the projection horizon we will be above the economy potential (which is explained by the investment cycle that will give a new momentum to our economy like in the period 2006 – 2008), because of the application of temporary fiscal measures and fight against economy, outturn in public finances exceeding the structural will be achieved already in this year, and also in the years to follow.

Figure 9 Structural deficit (% GDP)



¹² Structural deficit calculation methodology is adjusted to the methodology published in the document Mourre, Isbasoui, Paternoester and Salto, The cyclically-adjusted budget balance used in the EU fiscal framework: an update, European Commission, March 2013 and implies top-down approach, with adjustment of one-off events.

1.3.5 Government debt and guarantees

1.3.5.1 Government debt in 2014

The Law on Budget and Fiscal Responsibility introduces the rules that government debt should be published quarterly within 90 days following the end day of the fiscal year. The Law also sets out that government debt, in addition to the central government debt includes the debt of state-owned enterprises, while public debt, in addition to the mentioned government debt, includes the debt of municipalities together with the debt of municipal enterprises.

The mentioned Law also sets out fiscal rules in the area of public debt, i.e. it envisages that budget planning and executing are carried out in the way that public debt does not exceed 60% GDP. At the same time, the Law envisages activities that need to be undertaken in case that public debt exceeds such amount.

Budget Law 2014 envisages borrowings in the amount up to €240 million, which have been carried out within the envisaged framework. During the year, the Government of Montenegro carried out two issues of bonds in the total amount of €323.1 million, of which €43.1 million in the local, and €280 million in the international market. The issue of bonds in the international market was partly used to refinance around €83.3 million of the outstanding 2010 and 2011 bonds. The mentioned bonds were issued at the interest rate of 5.375%.

In addition, in 2014 the funds were disbursed in the amount of around €30 million for different infrastructure projects, which are financed from loan facilities with international financial institutions (EBR, EIB, KfW, WB). The mentioned funds have been used for improvement of water supply and other utility infrastructure, road infrastructure, areas of agriculture, land administration and energy efficiency. In 2014, a facility was signed with the World Bank amounting to €50 million for the Industrial Cleaning and Waste Management Project.

At the end of October 2014, the total government debt amounted to €1,964.9 million or 57.9% GDP. According to the projections of further debt repayment, and disbursement of funds, the government debt is expected at the end of 2014 to amount to around €1.96 billion or 57.7% GDP. Around 11.8% of the mentioned debt will be related to the domestic debt, while foreign debt will amount to around 45.9% (Table 11).

In October 2014, a loan facility was signed with the Chinese Exim Bank in the amount of US\$ 944.0 (around €688 mill.), for funding 85% of the value of the construction of the high-way section. The remaining 15% of the total project value (around €809.0 mill.) will be provided through budget revenues or arrangements with financial institutions, issue of bonds or bills.

The mentioned loan is concluded for the period of 20 years, with interest rate of 2% and grace period of 6 years. As regards the disbursement of funds, taken is the projection that the funds will be disbursed in the amount of €200 million a year. The exact projection of disbursement of funds will be known at the beginning of 2015, when the commencement of works is expected.

Government debt structure analysis has identified that around 9.4% of the total debt is denominated in foreign currencies. The mentioned liabilities are related to debt repayment in the amount of US\$ 33million to the Paris Creditors Club (mostly the debt assumed from the SFR Yugoslavia), CHF 22.3 million (CHF1.8 mill. to the Paris Club and CHF20.5 mill. to the Eurofima – Railroad Transport), and NOK0.3 mill. Also, the state has liabilities towards the World Bank, expressed in special drawing rights (SDR), and they amount to around SDR 51.6 mill.

Given that in the previous period there has been significant rise of dollar (around 7%) and Swiss frank (around 15%) in relation to euro, the liabilities denominated in these currencies have gone up too. SDR

debt has also recorded growth (euro has weakened by 3.5%), but this 'currency' has been very stable given that it is calculated in relation to the selected world currencies basket.

EXIM Bank loan currency risk related to financing of the high-way section has a more complex timetable. The loan, although not yet in effect, has been signed as a dollar amount – equivalent to 85% project value amounting to €809 mill. or around €699 mill. The Agreement has been concluded in the amount of US\$944.0 million.

As regards the value of performed works, the Design and Construct Agreement, entered into by the Montenegro Ministry of Transport and Maritime Affairs and Chinese CRBC, establishes that payments will be made according to the fixed exchange EUR/USD rate, so it excludes currency risk from the works execution stage.

Currency risk may arise at the beginning of loan repayment. Although grace period of this loan is 6 years, the Ministry of Finance has already commenced active enquiry of the possibility of hedging in respect of this risk, which will be specified by the moment of repayment commencement.

1.3.5.2 Base scenario of government debt trends in the period 2015-2017

Budget Law 2015 envisages borrowings for the mentioned year in the gross amount of €635 mill. Most of the mentioned amount (€399 mill.) is related to debt repayment, whereas high-way section will be funded in the amount of €206 mill., and the remaining €30 mill. will be used for deficit financing.

In addition to the mentioned borrowings for 2015, according to the repayment schedule of liabilities, significant funds, for debt servicing, will be required in 2016 too, around €380 mill., while in 2017 this amount is reduced to €180 mill. Simultaneously, deficit is expected to be reduced so the need for additional financing will be reduced too.

Exim Bank loan will be implemented up to the level of execution, i.e. depending on the dynamics of project implementation, and each disbursement of funds during the year will be recorded as a part of debt stock. In the period 2015 – 2017 envisaged is disbursement of around €40 mill. for financing of other infrastructure projects.

Disbursement of funds for implementation of the Bar – Boljare high-way project, priority section Smokovac – Mataševo will significantly affect public debt trend in the period 2015 – 2017. According to the initial projection, it is envisaged that the funds will be disbursed in the amounts of €200 mill.

Table 13 Government debt trend in the period 2014 - 2019, baseline scenario

Year	2014	2015	2016	2017	2018	2019
GDP	3.393,0	3.547,0	3.737,0	3.964,0	4.205,00	4.440,00
Domestic debt	360,90	283,75	209,39	148,55	159,09	139,09
Foreign debt	1.558,00	1.908,15	2.245,51	2.539,35	2.728,81	2.728,81
State-owned companies	40,00	50,00	50,00	50,00	50,00	50,00
Total government debt	1.958,90	2.241,90	2.504,90	2.737,90	2.937,90	2.917,90
Total government debt/GDP	57,73%	63,21%	67,03%	69,07%	69,87%	65,72%

As shown in Table 13, government debt is expected to increase to 63.2% at the end 2015. In the period until 2018 the debt is expected to achieve its peak, and then the government debt is anticipated to amount to around 69.9%. The highest pressure on debt trend will be exerted by disbursement of funds for high-way construction financing. After the construction period, the debt is expected to have a descending trend.

Because of the size of funds required for budget financing in 2015 and 2016, financing will be provided through issue of bonds, while the borrowing procedure for 2017 and 2018 will be considered. In 2019,

taking into account the repayment of bonds issued in 2014, it is likely that there will be a new issue of bonds.

Due to high leap of debt, in the period 2015 – 2018 it will be necessary to have fiscal policy that will not allow additional burdens and will lead to surplus generating. As to that, particularly important will be economic growth and inflow of foreign investments, as well as execution of large projects that will ensure dynamic growth in view of mitigating high level of debt and deficit.

Taking into account the financing level of public finance demands, the Ministry will be additionally exposed to internal and external risks as regards successful implementation of the mentioned plans. One of the most important risks is that the state will have restricted possibility to access international market, i.e. funding sources. In this sense, the greatest risk is borne by escalation of the Russian – Ukrainian crisis, potential significant financial crisis in some of the European countries, specific measures by the European Central Bank or FED or disruptions in the financial market due to the current oil price trend.

Viewing the current situation based on the analysis of the mentioned risks, i.e. the communication with financial institutions that took part in the issue of bonds, major changes are not expected that would lead to closing of the market, or preventing of Montenegro to access market and issue bonds. The mentioned situation might take place only in case of large scale conflicts or crisis to the extent that would bring about financial crisis of several European Union countries.

The mentioned is also supported by the fact that Montenegro successfully issued bonds in the international market in 2010 and 2011 in spite of economic and financial crisis that dominated the world. The situation was even more difficult due to weak fiscal and economic situation in the country at that time, and the fact that the country for the first time appeared in the market which caused additional risk that the issue might fail. Additional circumstance that made the situation difficult was the borrowings value (€200 and €180 mill., respectively), which was not interesting to international market. Of course, taking into account the above reasons the price of issued bonds was proportionally high, but the funds for timely settlement of obligations were provided, and thus such activities are considered successful.

In line with the mentioned, the currently existing risks might lead to an increase of the borrowing price and potentially would increase the costs of bond issuance by 1% to 2%, but it is unlikely that they would have such effects to disable the country to provide funds in the market.

At the same time, in view of reducing exposure to the situation in the international market, negotiations are on-going with international banks regarding bilateral arrangements, as well as the analysis of the domestic market, as a plan B should the adverse scenario take place.

1.3.5.3 Debt profile under low growth scenario

Should the low growth economic scenario take place and revenues reduce in line with the fiscal low growth scenario, the mentioned changes will have significant impact on debt trend. Reduction of revenues, on one side will require additional means of borrowing, for the purpose of providing funds for deficit financing, and on the other side the mentioned reduction of economic growth will reflect on GDP trend by years, which will affect additional increase of debt viewed at as GDP percentage.

In that case, as shown in Table 14, according to the projections the debt will go up to 74% GDP by the end of 2017 while expecting its peak in 2018, like in base scenario.

Table 14 Government debt trend for the period 2014 - 2014, low growth scenario

Year	2014	2015	2016	2017
GDP	3.393,0	3.482,7	3.634,4	3.807,0
Domestic debt	360,90	283,75	209,39	148,55
Foreign debt	1.558,00	1.937,15	2.304,51	2.620,35
State-owned companies	40,00	50,00	50,00	50,00
Total government debt	1.958,90	2.270,90	2.563,90	2.818,90
Total government debt/GDP	57,73%	65,21%	70,55%	74,05%

1.3.5.4 State guarantees

Stock of state guarantees as of 30 September 2014 amounted to around €308.8 million or 8.8% GDP. Out of the mentioned amount foreign guarantees were around €291.2 million (around 8.6% GDP), while domestic guarantees amounted to €8.9 million (around 0.3% GDP).

After the guarantees were called in the previous period, the risk of contingent expenditures in this respect, particularly those that might cause fiscal disruptions, is significantly reduced. In 2014, three guarantees were called and paid for companies Rudnik Boksita (Bauxite Mine) - Nikšić, Melgonija - Bar, and publishing company Pobjeda - Podgorica. The total amount of paid guarantees amounted to €15.3 mill.

Of all the guarantees shown in Table 13, the highest risk is related to the guarantees issued to the Željeznička Infrastruktura (Railway Infrastructure Company). The total disbursed funds in respect of the arrangements for which the state issued guarantees amount to around €19.9 million or around 0.6% GDP. If Željeznička Infrastruktura fails to meet its obligations, given that the arrangements are entered into with EBRD and Czech Export Bank, there is relatively small chance that guarantees will be called, and in that case the state would assume the loan arrangements and repayment according to the already specified conditions.

Loan facilities entered into by Montenegro Airlines, for which the state issued guarantees, have not been an issue so far, given that the company rescheduled the current obligations and postponed the repayment period.

As regards the above, it is estimated that the domestic guarantees balance at the end 2014 will not significantly change and will amount to around €8 mill., and foreign guarantees are also anticipated to remain at the same level.

In 2014, guarantees are planned in the amount of €25 million, of which €20 million has been applied to the loan facility between the Crnogorski Elektroprenosni Sistem (Montenegrin Electricity Transmission System) and European Bank for Reconstruction and Development (EBRD) for the project of constructing cable between the municipalities of Tivat and Pljevlja, and amount of €5 mill., for arrangement between the EBRD and Montenegrin Solidarity Housing Fund for the project of apartments construction, the execution of which is postponed for the current year.

For the purpose of improved state guarantees management and reduction of risk in public finances, as emphasised in the previous program, Montenegro carries out strict control over the issue of state guarantees, with the condition that they will be issued only for infrastructure projects, and for loan facilities identified to contribute to economic development of the country.

As regards the above, the Budget Law 2015 envisages issue of guarantees in the total amount up to €101.6 million, as follows:

- for loan facility between the Montenegrin Transmission System (MTS) and European Bank for Reconstruction and Development, for Tivat – Pljevlja Cable Project, in the amount up to €40 mill.;
- for the project of Montenegro Solidarity Housing Fund “Solidarity Apartments”, in the amount up to €5 mill., for which the creditor will be determined in 2015;
- for the project of Montenegro Education Workers Housing Community “SOLIDARNO” - construction of housing units for education workers of Budva Municipality in the amount up to €6.6 mill., for which the creditor will be determined in 2015;
- for the project of Investment-Development Fund of Montenegro with Abu Dhabi Fund, Agriculture development through the support of Abu Dhabi Fund (ADMAS), in the amount up to €50.0 mill.

Table 15 Review of foreign guarantees

CREDITOR	LOAN	BORROWER	SIGNING DATE	AMOUNT (mill. EUR)	AMOUNT (USD)	DISBURSED BY 30 Sept. 2014 (EUR)	Debt stock as of 30 Sept. 2014
EIB	European roads project	Monteput	17.05.2004.	24,0		24,0	20,8
EIB	Energy system reconstruction	Elektroprivreda CG AD	15.08.2002.	11,0		8,0	5,7
EIB	Airport modernisation	JP Aerodromi Crne Gore	27.03.2004.	12,0		12,0	9,1
EIB	Small and medium-sized enterprises through commercial banks	Commercial banks	02.07.2009.	90,0		90,0	70,4
EIB	Railway infrastructure modernisation	ZICG	20.12.2010.	7,0		1,1	1,1
Total EIB				144,0		135,2	107,1
EBRD	Airport modernisation	JP Aerodromi Crne Gore	12.12.2003.	11,0		10,2	3,8
	Project of regional water supply system construction – southern branch, phase 1	JP Vodovod – first tranche	09.11.2007.	8,0		8,0	
EBRD	Project of regional water supply system construction – southern branch, phase 2	JP Vodovod – second tranche	16.05.2008.	7,0		7,0	12,4
	Project of regional water supply system construction – southern branch, phase 1 - Annex	JP Vodovod – second tranche expanding		3,0		3,0	
	Project of railway infrastructure reconstruction – phase 3	JP Željeznice CG – third tranche	8.11.2010.	4,0			
EBRD	Project of railway infrastructure reconstruction – phase 3 Annex	Željeznička Infrastruktura AD, Podgorica	12.10.2012.	10,0		3,6	3,2
EBRD	Project of urgent railway reconstruction 2	Željeznička Infrastruktura AD, Podgorica	11.12.2009.	15,0		12,8	11,7
EBRD	Project of procurement of electric-motor units and diagnostic equipment	Zeljeznicki Prevoz AD	8.11.2010	13,6		12,5	11,3
EBRD	Credit line for protection of deposits	Deposit Fund Protection	8.11.2010	30,0		0,0	0,0
EBRD	Pljevlja interconnecting cable	CGES	09.06.2014.	20,0		4,5	4,5
Total EBRD				121,6		61,6	46,9
KfW	EPCG-Perućica	EPCG	15.12.2003.	3,6		3,4	0,6
KfW	EPCG-Piva	EPCG	28.12.2007.	16,0		6,3	5,5
KfW	EPCG – substation Podgorica-Ribarevine	EPCG	20.07.2007.	5,4		4,8	3,1
KfW	EPCG – Replacement of filters in TPP Pljevlja and expanding of substation Podgorica-Ribarevine	EPCG	11.12.2008.	15,0		14,3	12,8

KfW	Erste Banka	Erste Banka	24.06.2009.	15,0	15,0	4,7
	NLB	NLB	26.10.2009.	16,0	16,0	7,3
KfW	Interconnecting cable	CG Elektroprenosni Sistem AD	08.05.2013.	25,0	6,8	6,8
Total KfW				96,0	66,6	40,8
EXIM China	Procurement and overhaul of vessels	Crnogorska Plovidba	21.01.2010.	47,4	37,7	37,7
EXIM China	Procurement and overhaul of vessels	Barska Plovidba	29.01.2013.	46,4	25,8	25,8
Total EXIM				74,5	63,5	63,5
WTE Wassertechnik	Waste water project	Opstina Budva	16.03.2010.	29,3	29,3	29,3
Total WTE				29,3	29,3	29,3
Abu Dhabi fund	Water supply project	JP Regionalni vodovod	07.04.2010.	10,6	8,4	7,4
Total Abu Dhabi				8,4	8,4	7,4
Czech Export Bank	Completion of railway	Podgorica- Niksic ZICG	12.12.2011.	5,0	5,0	4,0
Total Czech Export Bank				5,0	5,0	4,0
TOTAL				478,7	369,5	298,9

I.3.6 Sensitivity analysis and comparison with the previous program

The main risks in fulfilment of fiscal projections, whether political or economic, may have positive or adverse implications. The review of risks by fulfilment of the given projections is presented in the following table:

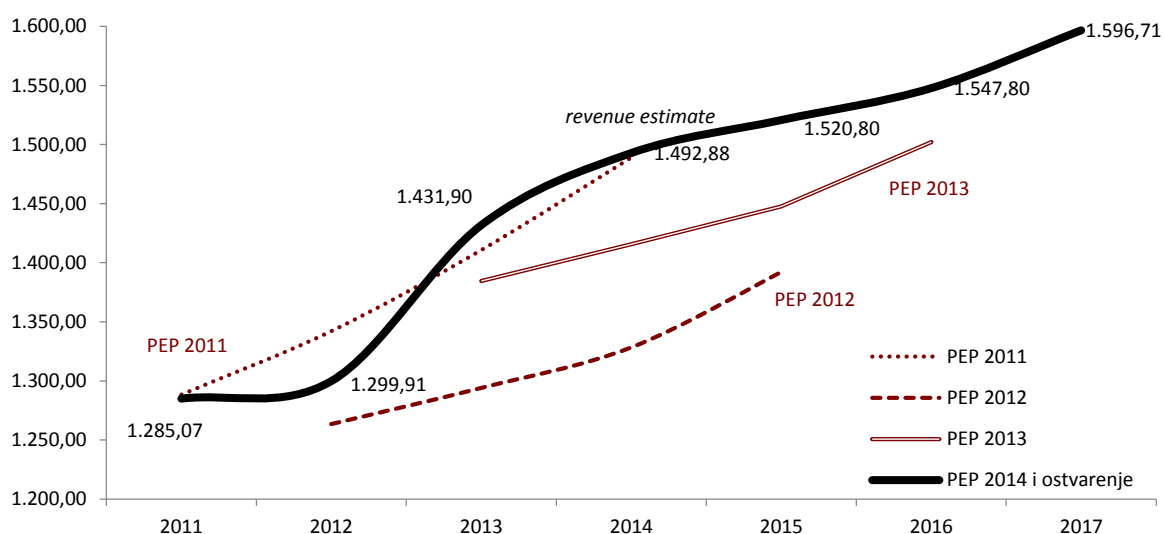
Table 16 Overview of Fiscal Risks in the Mid-term

	Positive	Adverse
Political	<ul style="list-style-type: none"> • Invitation to NATO membership in 2015 will increase confidence of western investors and tourists which will positively affect economy of Montenegro; • Progress on the way to the European Union accession will condition increase of confidence of investors, more stable business environment and access to EU funds; • Continuation of the political crisis in the Eastern Europe and Near East may represent a positive risk with regard to execution of the base scenario, due to the fact that the capital from that region is moved out and placed in other, safer destinations; 	<ul style="list-style-type: none"> • Continuation of the crisis in the Eastern Europe may induce an adverse impulse –reduction of interest of investors from that region to make investments in our country, which has not taken place yet;
Economic	<ul style="list-style-type: none"> • Measures and instruments of fiscal policy specified in the Analysis of specific aspects of tax system, depending on their character may have positive or adverse effect on fulfilment of projections; • Multiplicative effects of the commencement of the high-way construction and execution of announced investments represent a risk to positive adjustment of revenue projection; • Continuation of efforts to reduce grey economy and achieve results in that field, will increase tax base that will contribute to budgetary revenues to gain additional momentum; 	<ul style="list-style-type: none"> • Structural weaknesses of the economy; • Unsustainable pension system; • Social pressure; • Increase of the price of high-way construction potentially up to 10%; • Further postponing of the commencement and/or delays in execution of investment projects will threaten the presented macro-economic scenario, and therefore fiscal projections for the medium-term period; • The amount of government debt is an adverse economic pressure on fulfilment of projections, and increase of government debt has adverse effect on the borrowing conditions in international market;

In relation to the last year's Program and conservative revenue schedule from previous year, public revenues in 2014 significantly exceeded the plan, and thus were above the estimate given in the last year's document. The most significant deviations took place with regard to value added tax and contributions as well as personal income tax. Improved collection of indirect and direct tax forms imply that this deviation is the result of the fight against grey economy, which brought about increase in the number of legally employed persons, and thus increase in the collection of personal income tax and contributions. Also, the growth of collection is the result of the growth of economic activity in the country.

The following Figure clearly shows comparison to previous Programs, in nominal amounts. Conservative access in projecting public finance revenues and implementing fiscal measures (one-off settlement of tax debt and amendments to the regulatory framework) which encouraged collection of revenues caused the projections from 2012 and 2013 to be significantly exceeded.

Figure 10 Revenue analysis - execution and comparison to the previous Programs



Last year's program set fiscal policy goals that remained almost unchanged. In the previous period Montenegro actively worked on fulfilment of such goals, and the success can be noted already in the current year. Grey economy, identified as one of the key public finance problems has been successfully targeted, while efforts are continued to be made to suppress such anomalies. Based on the previously described revenue side of the budget the successfulness of implemented measures can be easily determined – value added tax growth suggests the reduction of grey economy in general consumption, whereas the growth of personal income tax and contributions indicate the reduction of grey economy in the labour market. After comprehensive activities and increase of coverage of tax audits, business entities have reported significantly higher debt towards the state than was the case previously, which affected increase of tax debt from around €320 mill., as published in the previous program, to around €520 mill. (15.3% GDP), which is its amount in the current year.

In accordance with the set goals, business environment has been improved, which was also noted by the World Bank *Doing Business* report, where Montenegro progressed by 6 places. Fiscal incentives aimed at balanced growth have been introduced through exemption of newly founded companies from tax, incentive interest rates by Investment Development Fund for businesses in under-developed municipalities and the like. Further implementation of these measures is anticipated in the following period too, through execution of the conclusions from the *Analysis of specific aspects of tax system*.

1.3.7 Sustainability of Public Finances

Montenegro is implementing reforms that need to ensure long-term sustainability of public finances. One of the most important reforms in Montenegro is the reform of the state pension system. Namely, longer life expectancy, low population growth rate and low rate of active labour force, caused the need for age limit for retirement to gradually move to 67. In addition, the pension adjustment formula has been changed. In the previous period, Montenegro has solved its burning social issues through amendments to legislation which allowed mass early retirement of persons employed with a part of public sector and with companies that are brought to the edge of survival through restructuring, bankruptcy, privatisation or unsuccessful business policy. In that way, the number of pensioners increased, which now, threatens sustainability of public finances with the effect of annual increase of pensions. In 2015 the pension freezing measure will cease. Given the high deficit of the Pension and

Disability Insurance Fund activities will be undertaken in the coming period to find a model that will ensure a higher level of pension system sustainability.

Large-scale reform is also taking place in the health sector, with the credit support by the World Bank. Efforts are directed to rationalisation of the health sector and improvement of efficiency of this system, as well as general health of citizens. To that end, health care institutions are consolidated in regional health care centres, the primary health care level reform is getting completed and efforts are made so illness prevention and early diagnosis become more focused on than hospital treatment of citizens in need of health care. In the coming period, special attention will be paid to monitoring of procurement of sophisticated medical equipment given that the procurement of new equipment frequently fails to give expected results, and therefore the relevant investment is not reasoned according to the cost/benefit analysis. In the next year, citizens will be enabled to procure prescription medicines in private pharmaceutical institutions at expense of the Health Care Fund. Positive fiscal effects of health care system reforms frequently are not visible in the medium term, but through the mentioned improvements savings will be achieved in the long run through lower number of citizens who are in need of hospital treatment or secondary and tertiary health care form.

For the purpose of further improvement of fiscal discipline and creation of a long-term sustainable wage system, amendments to the regulatory framework governing public sector salaries have been initiated. The new law would specify the way of establishing salaries for all public sector employees, which will be conditioned by deficit level trends or financial results of public enterprises and companies that are under majority ownership of the state, while a unified method of salaries calculation for performance of the same jobs would be ensured at the same time.

The execution of the social welfare records project will have a long-term impact on public finances, as specified in the previous PEP. Namely, in order to improve allocation of funds for social and child care, achieve greater fairness and efficiency, and reduce system administering costs, the Government has initiated the implementation of the project: »Social Welfare Records (also called “Social Card”) – Social Care Information System«. The system has been released into operation and currently is in the test phase. Its full implementation is expected from the next year.

All the fiscal consolidation measures that were introduced in the previous period and will be applied in the following period are aimed at establishing of long-term sustainability of the public finance system.

1.3.8 Institutional features

The main amendments regarding the budget system in Montenegro in 2014 are related to adoption and coming into force of the Law on Budget and Fiscal Responsibility. Adoption of this law enables further improvement of the public finance system through enhancement of fiscal responsibility, transparency and medium-term and long-term sustainability of public finances. Also, this law is aimed at enhancement of responsibility for legal use of budgetary funds through improvement of the control and oversight in view of ensuring fiscal discipline.

The Law on Budget and Fiscal Responsibility envisages adoption of fiscal strategy for the period of the Government term.¹³ Based on the fiscal strategy the Government adopts Fiscal Policy Guidelines which establish the main fiscal goals to be achieved in the medium term. Maximum level of budget expenditures that is obligatory for the state budget law for the first year and indicative for the second and third fiscal years is determined by the expenditures ceiling. Expenditure ceiling growth rate for the

¹³ This provision of the Law will be applied after the Parliamentary elections, after which new Government with full four-year term will be established

current budget and the budget of state funds must be lower than the planned GDP real growth rate, i.e. for capital budget and budget provisions it may not be higher than the GDP nominal growth rate.

In addition to the above, this law introduces fiscal responsibility criteria based on which meeting of conditions established by numerical fiscal rules is analysed. In case of deviation from the established debt and deficit levels, the Government needs to establish fiscal policy measures to ensure the set budgetary surplus/deficit level.

Provisions of the Law on Budget and Fiscal Responsibility have been harmonised with the European Commission Directive 85/11 – introduced have been numerical fiscal rules, medium-term fiscal framework, schedule of document and projection development has been harmonised to the European semester and methodological provisions of this Directive, as well as the dynamics and form of budget data publication. For full adjustment to the mentioned Directive lacking is consistent implementation of ESA 2010 methodology and adoption of definitions and coverage of public finances envisaged by such methodology.

In line with the provisions envisaged by the Law on Budget and Fiscal Responsibility the Montenegro Budget Law 2015 has been established, which meets the criteria based on which fiscal policy is planned and implemented, and are related to the provisions that:

- primary budget cash surplus should be generated;
- the level of current expenses and transfers should be lower than the current revenues and donations;
- borrowing policy should be responsible, with increased attention paid to the profession rules in view of ensuring fiscal sustainability.

The mentioned criteria have been met excluding the calculation of expenses related to the beginning of high-way project implementation. Investment in the high-way construction and other elements of public works will condition increase of deficit, while it is important to note that the planned capital investments have distinctive development feature, so, as such, they create assumptions for stronger economic growth and development and contribute to increase of GDP level, which, further, creates the base for reduction of deficit and public debt level as the two most significant fiscal parameters.

According to the Law on Budget and Fiscal Responsibility the State Audit Institution assesses the application of fiscal responsibility criteria within the annual report that is submitted to the Parliament. Based on the assessment by the State Audit Institution, the Ministry of Finance gives to the Government and the Government to the Parliament a proposal recovery plan for exceeding numerical limits, in accordance with this law.

Continuation of implementation of measures directed to the public revenue growth primarily through the reduction of grey economy level, reduction of tax receivables, tax discipline fostering and tax system enhancement remains one of the priorities in the years to come. Investment framework consisting of established working bodies of the Ministry of Finance, Administration for Inspection Affairs, Tax Administration, Customs Administration, Police Administration and other relevant institutions continues working in line with the adopted action plan for suppression of grey economy.

For the purpose of consolidating public expenditures related to local self-government, the Ministry of Finance undertakes activities directed to improvement of regulatory framework which will provide greater powers to local self-governments in collecting tax, and also sanctions for violation of the provisions of the law, while insisting on preserving their financial and management independence, according to the decentralisation principles, as it is specified in the relevant legal documents of the state.

At the meeting held on 4 December 2014 the Government of Montenegro adopted the Brief on the public finance stance and number of employees on the local level and, with regard to this, conclusions

relating to the rescheduling of tax debt of municipalities and possibility of converting the municipality debt through functional assets in view of reducing burden on public finance of local self-governments. In addition, in the coming period a loan reschedule model will be designed for municipalities having lower fiscal capacity, in sense of longer maturity and lower interest rates, through the mechanism of the Equalisation Fund.

The Government gave recommendations to local self-governments, public companies and institutions founded by municipalities, with evident redundancy, to urgently undertake measures to optimise the number of employees within the established standards in order to rationalise expenditures in that respect.

The mentioned conclusions assign the Ministry of Finance and the Ministry of Interior Affairs to do Local Self-government Sustainability Analysis with the assistance of the reference international organisation, particularly from the aspect of the number of employees and the current local infrastructure in view of obtaining relevant recommendations which would serve as the base for determination of the local self-government financing policy. Based on the given recommendations, the Ministry of Finance will prepare amendments to the Law on Local Self-Government Financing the adoption of which is envisaged in the Montenegro Government Work Program 2015 by the end of the second quarter.

At the end of December, the Government of Montenegro adopted the Proposal Law Amending the Law on Tax on Immovable Property. The objective of the mentioned law is to improve fiscal policy and ensure plentiful revenues to local self-government units and create assumptions for more rapid development in the areas of tourism, agriculture and construction, with special accent on the northern region.

Amendments to the Law on Local Self-Government Financing are envisaged in 2015.

The proposed solutions:

- provide conditions for establishing a comprehensive database through introduction of an obligation for notaries, courts and other state authorities to submit to the local self-government units where the immovable property is located the documents (contracts, decisions and the like) based on which title over an immovable property is acquired or changed, as well as the deadline for submission of the mentioned documents, for the purpose of timely, efficient, complete and qualitative taxation of immovable property,
- increase lower limit of the rate of immovable property tax from 0.10% to 0.25% of the immovable property market value, which will result in achieving a larger scope of immovable property tax revenues,
- provide possibility to local self-government units to introduce higher or lower tax rate in relation to the tax rate established for specific immovable property categories and specify in details the immovable property that is subject to taxation at higher or lower rate, all in view of eliminating business barriers in the area of tourism, i.e. encouraging elite tourism, developing agricultural activity and preventing illegal construction,
- reduce exemptions,
- introduce fines for non-filing and non-paying tax liabilities (for notaries, responsible person in the court or state authority, legal entities, entrepreneurs and natural persons).

For the purpose of enhancing public debt management, within the State Treasury the preparations for implementation of the software for debt tracking is on-going, which will enable easier debt tracking, its recording and reporting. Also, the preparation of the Strategy for transit of public sector to accrual accounting is on-going, which will be considered by the Government of Montenegro in the first quarter 2015, which is an integrated part of the process of introducing ESA 2010 methodology in public finances.

In 2014, IPA authorities undertook activities directed to further capacity strengthening, improvement of the current legislation and institutional framework and final preparation for conferring

responsibilities over pre-accession funds management. Taking into account the achieved progress, as well as the measures undertaken in view of implementing recommendations from audit reports, the European Commission in 2014 made a Decision on conferring responsibilities for pre-accession funds management in case of Operational Program Regional Development 2012-2013 within IPA component III and the Decision on conferring responsibilities for pre-accession funds management in case of Operational Program Human Resources Development 2012-2013 within IPA component IV. In accordance with the mentioned, the bodies involved in the implementation of operational programs for IPA components III and IV, have undertaken all the required activities related to the preparation for decentralised management, such as preparation of operational identification forms, financial plans, procurement plans and other.

I.4 Structural Reforms underpinning the Macro-Fiscal Strategy

Reforms in all areas of the economic system are a prerequisite for ensuring long-term sustainable economic growth and development of the country. In this Chapter are presented those reforms having significant impact on the budget, while directed at the same time at the growth of the economy's competitiveness. Whereby, we will briefly discuss reforms implemented in 2014 with a focus on reforms that Montenegro is to carry out in the forthcoming medium-term period. At the same time, a summarised and individual overview of budget effects is also presented, that the structural reforms are to generate in identified policy areas.

I.4.1 Obstacles to growth and the Macro-economic Structural Reform Agenda

At the present, there is no uniform methodology for a comprehensive analysis of obstacles to a faster economic growth. However, by using various methodologies, starting from macro-economic and fiscal analysis, through institutional and sectoral, up to the micro-economic analysis based on the behavioural analysis of some legal entities and households, in essence these obstacles may be divided into two core groups. One group is made of macro-economic obstacles, such as those in the field of public finances and financial systems, and horizontal obstacles such as for example obstacles in the labour market area and business environment area. Second group of obstacles are those more of sectoral or microeconomic nature. Both groups of obstacles are tightly intertwined, which is sometimes making difficult or even prohibiting their classification in one or another group. Key challenges Montenegro is facing at the macroeconomic level and also in other horizontal areas are pertaining to the fiscal stability and stability of the financial system, and specifically of the banking system within it. Moreover, certain improvements are also possible and desirable in areas pertaining to the labour market flexibility and business environment. Obstacles to development with an emphasis to specific sectors are discussed in the Chapter 4.2 of the second part of ERP.

Fiscal stability: Montenegro is an economy that, as a result of taking over euro as its own currency, has fiscal policy as only macroeconomic policy to respond to external shocks and impact the business environment. It is understandable that as a result of that, a policy of maintaining the long-term fiscal stability is of foremost importance for a long-term stable economic growth and development of the country. The fiscal responsibility is momentous for creating conditions for faster growth of the private sector and for better and higher quality accessibility to international sources of capital, both for the state and for its entities.

Deep economic crisis that has affected Montenegro in previous years had substantial negative impact on the public finances of the country. Under such conditions, energetic and politically unpopular economic policy measures were undertaken, which were aimed at increasing the public finances revenues and consolidation of expenditures.

The Government's strategy in this area is to bolster efforts for fiscal consolidation, along with creating conditions to establish a public debt reduction trend, excluding the segment that pertains to the construction of the highway. Even though the budget deficit will be relatively high in the forthcoming period, due to the construction of the priority section of the highway, it will be at the path to sustainability, as this is an investment that will be enhanced by raising the economic growth of the country over a long run. At the same time, its realisation will contribute to a more balanced development of the country, followed by a better connectivity of Montenegro with countries in the region.

Fiscal stability represents a challenge for Montenegro, not over a medium term but also over a long term. Therefore, it is necessary to commence the pension system reform, whereby the key objective should be to reduce the pressure at the State Budget posed by payment of pension benefits. More space would be opened in the budget, in this manner, for investments, which have a key role in increasing the economic growth of the country over a long term. The pension system reform is also necessary in terms of the long-term sustainability of public finances, considering the ageing of population of Montenegro.

Stability of the financial system, and of the banking system within it: The most recent crisis, which is not yet over, has clearly pointed that a macro-fiscal position of the country and the stability of its banking system are intertwined. Exceptional fast credit growth, which was the basis for a fast economic growth of Montenegro in years preceding the crisis, was abruptly interrupted in 2009. Volume of the banking loans was decreased in the following years, both due to reduced demand by the real sector, as well as because of considerably unfavourable terms under which the banks were willing to approve new or the refinance old loans. In addition, due to reduced readiness of parent banks to finance their banks in Montenegro, those were forced to adjust their credit activity to reduced volume of available lending funds. Withdrawal of deposits from some banks in the country represented an additional problem as well at the time immediately after the outburst of the crisis.

In 2014, the banking sector in Montenegro was stabilised and is recording again a mild growth in lending activity. Nevertheless, a high share of non-performing loans in banks' balance sheets continues to be present, which is a consequence of numerous reasons, including also slow handling of insolvency proceedings, as well shortcomings of the legal framework that drives the debt restructuring processes. Under such circumstances, banks are increasingly oriented towards lending to households, while sizeable segments of the entrepreneurial sector either do not have access to bank loans or have rather restrictive lending terms. Accessibility of financing and its price are one of the key horizontal obstacles for a faster economic development of Montenegro in the forthcoming period. This is especially important obstacle for development of a large number of small and medium-sized enterprises.

Economic policy measures that will be used for further stabilisation of the banking system and its efficient intermediation between net savers/depositors and net investors in the national economy are very different, and there is also a difference in their time horizons. Over a short term, a priority is certainly the strengthening of the capital base and liquidity position of banks, which is one of the conditions for efficient resolution of the high non-performing loans problem. The second condition is efficient solutions concerning the realisation of collateral and faster court proceedings. Other than that, the Central Bank will continue to strengthen the supervision of the banking system, and with improvements in the field of the macro-financial stability.

Labour market flexibility: Qualified and flexible labour force is a key element that features the business environment prone to development of national and foreign business entities. Large disproportion between outputs of the educational system, i.e. supply at the labour market and profile in demand on that market represents a considerable challenge for Montenegro. Results of such disproportion continue to remain high unemployment rate, which is to a large extent structural in nature and particularly high among youth. Demand for labour force was further reduced due to negative effects of the crises on the economic growth in recent years.

Even though Montenegro is generally ranked rather favourable in terms of the labour market flexibility if compared to other countries in the region, thus it does not represent a noteworthy obstacle for faster economic growth, there are several areas with room for considerable improvements. The following have been identified as obstacles to doing business in this area, precisely areas where improvements are possible: rigidity of collective bargaining agreements, or wage bargaining; and rigidity in the area of open-ending term employment. Apart from regulations directly affecting the labour force flexibility there are regulations in some other areas that have an important influence on individual initiative to take part in the labour market, as well as to the initiative of companies to employee. Those are primarily regulations in the area of pensions and various types of social transfers.

Improvements in the business environment: As far as the business environmental quality is concerned, Montenegro has evidenced important results, which have continuously improved over the previous years. According to the Doing Business 2015, in the overall rank Montenegro has advanced by 6 positions (from 42nd to 36th, out of 189 ranked countries). At the same time, Montenegro is the best-ranked country in the region, after FYR Macedonia. Its performances are above average within the regions in many fields, such as for example, getting electricity. On the other hand, there are areas where Montenegro has still a lot of room for improvement of the business environment. Even though there is an improvement of 27 positions if compared to the previous Report, the slow pace in getting construction permits is identified as particularly important obstacle (having score of 63 out of possible 100, Montenegro is ranked 138th out of 189 countries). Moreover, a room for improvement is identified as well with the indicator *enforcing contracts* (score of 50 out of possible 100; ranked 136th). Rather complex legislation in some areas and their frequent changes are not contributing to the business environment quality.

I.4.2 Key areas of Macro-economic Structural Reforms

In order to create conditions for a long-term sustainable growth and development, as mentioned in the Chapter 4.1, structural reforms need be carried out with the objective to ensure fiscal stability and financial system stability, and especially of the banking sector within it. Furthermore, reforms having as the objective to increase the labour market flexibility and improve the business environment are also required.

I.4.2.1 Product Market and Business Environment

I.4.2.1.1 Privatisation and Restructuring of State-owned Enterprises

In 2014, activities in the field of privatisation were carried out in line with the Decision on the Privatisation Plan for 2014, dated 30 January 2014. Tenders were carried out for sale of share capital of the Institute “dr Simo Milošević” and of the *Jadransko brodogradilište* (Adriatic Shipyard) from Bijela. After the fourth failed tender for sale of the Adriatic Shipyard capital and lack of interest for such privatisation model, it was decided that an investor is to be sought via a restructuring through a bankruptcy (programmed bankruptcy), who will in a transitional period keep the core activity of the Shipyard, with a reduced number of employees, while will at the same time invest in the activity of overhaul of yachts and mega yachts. As far as the Institute “dr Simo Milošević” is concerned, the negotiations to conclude a contract are underway, as well as for the “Montenegro Defence Industry” LLC Podgorica. The following privatisation tenders are active, for: “Novi duvanski kombinat” (*New tobacco factory*) AD Podgorica, Hotel “Park” Bijela, and Poliex AD, Berane. Activities concerning the full utilisation of tourism sites and realisation of capital projects fall under the competence of the Council for Privatisation and Capital Projects, and the following tenders are active in this segment: Mediteran Žabljak, Donja Arza, Ecolodge Vranjina, Kolašin 1600 and the Mamula Island. A Contract on Financing and Design of the priority section of the Bar-Boljare Highway was concluded (priority section Smokovac-Mateševo), and activities to create prerequisites for the construction of the 2nd block of the Thermo-Power Plant Pljevlja are at their final stage.

The Council for Privatisation and Capital Projects will propose the Privatisation Plan for 2015, which will be submitted at the beginning of 2015 to the Government for adoption. Bearing in mind the experience from previous years, it is expected that failed tenders will be carried forward from the present into the new privatisation plan, which will be oriented towards projects where planning documents are completed and property-legal relations settled.

As far as the future ownership structure of state-owned companies is concerned, the Government opted for a position that the State should remain the majority owner in the Crnogorski elektroprenosni sistem (*Montenegro Electricity Transmission System*), Aerodromi Crne Gore (*Airports of Montenegro*), 13. Jul -

Plantaže AD (*Vineyards and fruit plantations company*), Crnogorska plovidba (*Montenegro maritime shipping company*), and Barska plovidba AD Bar (*Bar maritime shipping company*). Even though the Government has signed a Contract on Recapitalisation and Partial Privations of the Elektroprivreda Crne Gore AD Nikšić (*Electricity Power Company*) in 2009, with a possibility of transferring the majority package of shares to the Italian partner, in the meantime a Memorandum of Understanding was signed whereby it is stated that A2A waives the right to acquire the majority ownership. Negotiations are currently underway on continued cooperation through a shareholders contract and new management contract. The Privatisation Plan will seek a new majority private owner for all other companies.

The Law on Public-Private Partnership – a proposal of the Law to be adopted by the Government in Q1 2015 – will provide prerequisites to create a regulatory and institutional framework for identification of PPP projects, award of PPP contracts, and oversight of their implementation. A choice of a PPP project will be conditioned by its fiscal sustainability. Establishment of the Agency for Investments is envisaged, which will issue consent to proposal of projects for PPP, among other. The Law will cover all forms of public-private partnerships and will be aligned with the new EU Directive on concessions as one form of PPPs.

It is not possible to estimate budgetary effects of privatisation in 2015. If commenced/planned privatisation processes are finalised it is obvious that those would have a positive effect on budgetary revenues.

1.4.2.1.2 Improving the Business Environment

Reforms in the area of improving the business environment are constantly being implemented. During 2014, reform activities were directed towards, among others, reducing the costs of obtaining a construction permit, realisation of activities in overcoming the problems of lack of liquidity in the economy (Proposal of the Law on Voluntary Financial Restructuring of Debts with Financial Institutions is in the parliamentary procedure – more details in the Chapter 4.2.2), application of the RIA (Regulatory Impact Assessment) to laws and secondary legislation, preparation of the Ministry of Finance's opinions concerning the validity of the RIA analysis, as well as its impact on the business environment.

The World Bank has also recognised the efforts in implementation of reforms, which was evidenced in the Doing Business 2015 report, whereby Montenegro has advanced by 6 positions in the global rank, from the 42nd to 36th, out of 189 ranked countries. Even though a significant effort was made under the indicator "Dealing with Construction Permits" (from 164th to 138th position), where the reforms implemented in the field of reducing fees for delivery of municipal utility services were recognised, as well as abolition of fees to municipalities for obtaining urban-development and technical conditions, there is considerable room for improvement.

The implementation of reforms and continued advancement in commenced administrative procedures will be a priority for the period 2015-2017. In this respect, the following activities are planned to be carried out:

- Reform of the public sector;
- Improvement of state in the area of issuing construction permits, through implementation of one-stop shop for issuing construction permits at the local self-government units;
- Realisation of the third phase of the "Podgorica Approach", by implementing voluntary restructuring loans, issued to retail and corporate sectors;
- Introduction of full electronic registration of enterprises;
- Improvement of the situation in the area of registration of enterprises and enabling registration in all branch offices of the Tax Administration;
- Simplification of procedures in the area of enforcing contracts, by improving efficiency, reducing costs and duration of proceedings;

- Simplification of procedures in the area of paying taxes, by creating options for electronic payment of majority of taxes;
- Monitoring implementation of activities envisaged under the Public Administration Reform Strategy, especially in the segment pertaining to the area of the state administration;
- Continued implementation of recommendations set forth in the Legislative Guillotine; and
- Continuation of activities concerning the RIA implementation; and
- Fiscal incentives concerning the relief from an obligation to pay public revenues during a construction phase in the sectors of tourism, agriculture, and energy (more details in the Chapter 4.2.4.1, page 52).

Fiscal effects of the measures could not be quantified.

1.4.2.1.3 State aid

During 2014, intensive activities to improve the legal framework governing the state aid policy were implemented. To that end, and based on the European Commission recommendations set in the Screening Report, the Decree on Detailed Criteria, Conditions and the Manner of Awarding the State Aid was supplemented to define that the rules set forth by the European Union regulations are to apply on the state aid. In line with the said Decree, the Ministry of Finance has adopted the Rulebook on the List of the State Aid Rules, which has published 7 EU legislation in this area, and a Rulebook Supplementing the Rulebook on the List of the State Aid Rules is in preparation, which will publish additional 6 EU legislation. While additional supplements are planned during 2015, by publishing another set of EU legislation.

Total awarded state aid in Montenegro in 2013 was 100.3 million euro (3.03% of GDP) and it represents the highest ever allocation of the state aid since it is monitored in Montenegro. A reason for that is the calling upon guarantees issued to KAP in 2009, which were paid out in 2013, of 102.7 million euro. However, if paid guarantees are excluded, the state aid in 2013 was 17.5 million euro, which represents only 0.53% of GDP and is approximately at the same level as allocations in EU 27+1.

Having in mind that the Commission for the State Aid Control issued ten (10) decisions on compliance of the state aid with the Law on the State Aid Control and one decision whereby the reported state aid is not considered the state aid within the meaning of the Law, in the period from January to mid December 2014, which mainly addressed the award of regional aid in a form of fiscal incentives and interest rate subsidies, it is expected that the state aid in Montenegro for 2014 will be considerably lower relative to the comparative period. However, the final position could not be established until the Annual Report on the amount of awarded state aid is completed, which will be available in June 2015.

It is not possible at this moment to quantify the fiscal effects of measures.

1.4.2.1.4 Public procurement

Activities to strengthen the public procurement system have also continued in 2014. Implementation of activities falling within the competence of the Public Procurement Administration, pertaining to the preparation and monitoring of implementation of the public procurement legislation, monitoring, analysing and achieving the public procurement system, was provided for in terms compliance with the European Union *acquis*.

In order to improve the legislative and institutional framework, administrative capacity, increased oversight, more efficient and effective control, corruption reduction and ultimately in order to protect more successfully funds of taxpayers and citizens, the Law Amending and Supplementing the Law on Public Procurements was adopted, which includes key EU Directives (Directive 2004/17/EC, 2014/18/EC, and Directive 81/2009/EC). In line with the updated Montenegro Accession Programme

and supporting action plan, a new law on public procurements will be adopted during 2016/17, whereby the Directives 24/EC/2014 and 25/EC/2014 will be transposed into our legislation.

By signing the agreement on 29 October 2014, Montenegro became a member of the Agreement on Government Procurement (GPA) in the World Trade Organisation.

The public procurement policy will be aimed, in the forthcoming period, at increasing transparency, effectiveness and cost-effectiveness of public funds spending. To that end, the Project of introducing a comprehensive electronic system will be implemented, which will be financed from the IPA funds. At the same time, in line with financial possibilities, activities aimed at strengthening the administrative capacities of authorities in charge of public procurement activities will be also carried out.

It is rather difficult to quantify precisely budgetary effects of implementation of the public procurement policy, even though sizeable savings on the budget expenditure side are estimated.

1.4.2.1.5 Highway Bar-Boljare (priority section Smokovac-Mateševo)

Construction of the priority section of the Bar-Boljare Highway will start in the first half of 2015 and will last for four years, thus the realisation of this project will have important impact on the growth of economy and on budget expenditures in the period covered by the ERP (2015-2017). Contracted value for the design and construction of the priority section Smokovac-Uvač-Mateševo of the Bar-Boljare Highway is 809.6 million euro, of which 689.0 million euro (85% of funds) will be secured from the EXIM bank loan (repayment period 20 years, including a grace period of six years, with annual interest rate of 2%), while the State will provide the rest of 120.6 million euro (15% of funds).

A very data that investments of 100.0 million euro per annum, in the period 2015-2018, will result in GDP in 2018 that will be 10% higher than the one in 2014, is sufficient description of the effect of this investment on the GDP growth in Montenegro.

Budget effects of implementation of this project are presented in part in the Table 17. Namely, total costs for realisation of this project are distributed in equal amounts in all years of implementation, as it is not possible to have more precise planning of time schedule for its realisation. On the other hand, it is not possible to quantify revenues that would be generated by the realisation of this project. The Budget revenues will be primarily increased on the account of involvement of the national construction industry, which consequently affect an increase of employment in this sector. However, indirect benefits are much higher, which are observed in the form of a large-scale investment spending generation, with multiplier effects on the overall economy.

1.4.2.2 Financial stability

Financial system in Montenegro is pronouncedly bank-centric, as out of all sectors (banking sector, insurance sector and capital markets), the banking sector has a key role, if observed in terms of value of assets and overall impact on the economy.

The Financial Stability Council, which performs a macro-prudential oversight of the financial system functioning, has assessed that the financial system is in a stable state, and that the level of system risk is moderate. Potential risks to financial stability, in the forthcoming period, could origin from spill-over of negative shocks and geopolitical tensions from the international environment and slowed-down economic activity in the EU and EMU countries, with which Montenegro has a dynamic economic cooperation; fiscal sustainability and public debt management; high current account deficit of the balance of payments; growing illiquidity of the real sector with negative implications on the state of the banking sector, as well as high level of non-performing loans and interest rates in the banking sector.

1.4.2.2.1 Banking sector

Satisfying level of the stability is characteristic the banking sector status, but it is burdened with the “ballast” of non-performing loans, due to the fact that is largely driven by the illiquidity of the real sector. In October 2014, 13,819 judgment debtors were blocked with debt amounting to 482.6 million euro, which represents an enormous burden even for much stronger economies than the Montenegrin one. The real sector illiquidity spiral has naturally also caught the banking sector, manifesting itself in constantly high share of non-performing loans in total loans and receivables (at the end of October was 16.5%). In order to resolve this problem, in the period 2009-2014 the banks have removed and/or sold non-performing assets to parent banks and factoring companies in the amount of around 670.0 million euro, of which as high as 50% was sold in 2011, but the problem reappeared with not lesser degree of intensity. Therefore, activities to strengthen the regulatory and supervisory framework for system-level resolution of both non-performing loan and thus accumulated financial debt in the broader sense were intensified during 2013/2014.

The key system-level instrument for resolving these problems is the implementation of the “Podgorica Approach” project, which will be implemented in line with the new Law on Voluntary Financial Restructuring of Debts with Financial Institutions. The financial restructuring of debts could be carried out only for loans of debtor classified by banks into the classification groups B and C, or for loans in arrears of up to 270 days with MFIs or leasing companies, except for loans classified in these groups that were sold and redeemed. The Law sets certain tax incentives both for debtors and for creditors that could be exercised only for the first financial restructuring of a debt. Everyone else, national and foreign creditors, including also foreign banks can as well take part in the financial restructuring, in addition to the financial institutions. Implementation of adopted solutions will contribute to: incentivising recovery of debtors or users of mortgage loans in financial difficulties; preserving the stability of the financial system and enabling access to new sources of financing to provide stimulus for economic recovery and growth. The Law will be applied for two years from the day of its entry into force.

In November 2013, under the same project and in line with amendments and supplements to the Decision on Minimum Standards for Credit Risk Management in Banks, banks were obliged to: adopt special strategies for dealing with non-performing loans over a three year period; set annual operational objective to execute those strategies; and report on quarterly basis to the Central Bank on their implementation. From submitted strategies of banks for dealing with non-performing loans, one could draw a conclusion that at the end of 2016 the growth of non-performing loans will be stopped and they will be reduced on aggregate level.

In 2014, supervision of banks and MFIs was strengthened and it was implemented through 12 on-site targeted controls of banks. Upon the demand of the Administration for Prevention of Money Laundering and Terrorism Financing, two extraordinary targeted controls of banks were carried out. In order to continue with a successful cross-border cooperation with supervisors of parent banks having their subsidiaries operating in Montenegro (five from EU member states and one from country outside of EU), the supervisors of the Central Bank have participated in six supervisory colleges. In 2014, there was a high interest for establishment of new banks in Montenegro. A licence for operation of one new bank was issued in May, while three additional requests are in the decision making process for licensing of new banks.

Regulatory activities in 2014 were directed towards the further harmonisation of the regulatory framework with the EU *acquis*. The Central Bank Council has adopted 12 new enabling regulations in November in the field of payment operations that will be applied from 9 January 2015, with commencement of application of the new Law on Payment Operations. The Law on Voluntary Financial Restructuring of Debts with Financial Institutions is in the parliamentary procedure and the new Law on Banks and new Decision on Capital Adequacy are in preparation. In October 2014, the Central Bank Council has adopted a Decision on Medals and Tokens Similar to Euro Coins, which harmonises the legislation with the European Union regulations in the area of ensuring the protection of euro against

counterfeiting and stipulates penalty measures in form of fines and fine-like sanctions against entities in breach of this Decisions (Directive 2182/2004 supplemented with the Regulation (EC) No 46/2009).

In line with the timing set forth under the Negotiation Position for Chapter 9 – Financial Services¹⁴ and new regulatory framework of the EU, which entered into force in July 2013 (Basel III), activities concerning the further harmonisation of laws and enabling legislation with relevant EU regulations will continue. The priority activity pertains to the drafting of the new Law on Banks and supporting enabling regulations. Moreover, as part of the Vienna Initiative, Montenegro, together with non-EU member states having financial systems largely dependent on financial groups with head offices in EU, is successfully finalising activities to formalise cooperation with ECB and EBA¹⁵. Reason for this being as the decisions of competent European authorities concerning supervision, management, recovery and liquidation of banks could affect their financial stability. By signing the Memorandum of Understanding, a platform will be created to improve cooperation among supervisors, exchange information, and find solutions for potential problems, as well as a format for adequate representation of all countries in the procession of decision-making under the Single Supervisory Mechanism (SSM), especially in the work of supervisory colleges.

It is not possible to measure direct budgetary effects of the banking sector reforms, while the indirect effect of the banking sector stability or its instability are rather versified, and in addition to that have also a quantitative relevance due to a high share of the banking system in the overall financial sector. A stable banking system, as a prerequisite for economic growth, along with the creditworthiness of the country, has a direct influence on the quality of accessibility to international financial markets.

1.4.2.2.2 Capital markets

In 2014, the first initial public offering (IPO) of corporate bonds was successfully completed, and for the first time there was a trade with the State bonds. An increase was recorded in secondary trade (245%), stock exchange indexes (15.68%), and market capitalisation (5.40%). An amount of 205.0 million euro of capital was raised on the market. A limiting circumstance relates to the issue and trade of Treasury Bills outside of the capital market system.

The Securities Commission has prepared a draft Law on Capital Markets and draft amendments to the Law on Takeovers, which will be sent to the Government procedure at the beginning of the next year. Enabling legislation necessary for implementation of the Law on Investment Funds was adopted. The Securities Commission has implemented and established an automatic exchange of data with the Commission for Prevention of Conflict of Interest.

Alignment of legislation with the EU regulations will continue in 2015. The Law on Capital Markets will be implemented and relevant enabling legislation will be adopted to that end.

Medium term horizon is based on the obligation from the Negotiation Chapter 9 – Financial Services, primarily concerning the drafting of the Law on Alternative Funds. The Commission will continue to strengthen institutional and administrative capacities, with strong reliance on ICT and to achieve high degree of automation of business processes.

It is not possible to estimate budgetary effects of planned programmes and measures.

1.4.2.2.3 Insurance

Continuous stability is the characteristic of the Montenegrin insurance market, along with an established growth trend. However, in terms of the structure and level of generated premium, it is still

¹⁴On 24 September 2014, DG MARKET has made positive assessment of the final draft of the Negotiating Position for Chapter 9 – Financial Services, adopted at the session of the Government of 9 October 2014 and currently in the EU Council's internal procedure.

¹⁵European Banking Authority.

markedly lagging behind the European average. The slowdown of the Montenegrin economy growth has also reflected, to a certain degree, on results in the insurance sector in the form of more moderate growth in value of the written premium at the market in 2013. Gross insurance premium has recorded a growth in 2013, with a declining trend concerning the market concentration, and generating positive financial result at the level of the overall insurance market. Gross written premium at the insurance market of Montenegro was 72.8 million euro in 2013 and recorded a growth of 8.7%, if compared to the previous year. Gross written premium per capita in Montenegro was 117.4 euro in 2013, which continues to be considerably below the EU member state average in 2011 (according to estimates 1,942 euro). According to the preliminary data, the gross written insurance premium at the end of Q3 2014 remained at approximately same level as the one in the comparative period, with an increase of share of life insurances.

As part of the regulatory activities during 2014, activities were directed predominantly towards further alignment of regulations with the EU directive. To that end, and with the objective of alignment with the Directive 2001/17/EEC, the draft Law on Bankruptcy and Liquidation of insurance Companies was prepared, which is currently in procedure of obtaining an opinion from the European Commission. Its adoption is planned in 2015. A set of enabling regulations was adopted in order to ensure full implementation of legal instruments. That has improved the regulatory framework of the insurance sector and has provided for additional alignment with standards from EU directives.

Activities of the Insurance Supervision Agency will be directed towards further alignment with the EU standards in the forthcoming period. The Agency has commenced with drafting of amendments and supplements to the Law on Insurance, which will provide alignment with missing provisions from the Solvency I, required for harmonising operations of insurance companies at the national level until Montenegro joins EU. Furthermore, preparatory activities to draft the new Law on Insurance will also commence in 2015, which will transpose the Solvency II into the Montenegrin legislation. A team would be established as well, which will deal with issues of implementing the Solvency II into the Montenegrin legislation.

In addition to the abovementioned and as far as the legislative segment is concerning, the Agency will make changes to the Rulebook on Proceedings upon Complaints of Insured and the Guidelines for Analysis of Risks from Money Laundering and Terrorism Financing, and will also prepare a Rulebook on the Content of Annual Report on Operations. Activities commenced in 2014 with respect to alignment with the Directive 91/674/EEC, which governs the obligation of annual reporting and introduces new balance sheets for insurance companies, will be continued as well.

It is not possible to estimate budgetary effects of planned programmes and measures.

1.4.2.3 Labour Market

A trend of mild recovery of the labour market, which commenced during 2013, has continued in 2014. However, challenges continue to be present, which primarily pertain to: long-term unemployment, high unemployment rate of youth (especially university graduates), regional differences in employment and unemployment levels, insufficient employment of labour force in seasonal jobs, and unregistered work¹⁶. Problems in the labour market are a consequence of structural nature of unemployment, conditioned by change in structure of economy (from production based to services based) and cyclical character of unemployment, caused by impacts of the global economic crisis.

Observing the labour market supply and demand ratio over a nine-month period of 2014, as well as number of hired non-residents, one could not claim with confidence that there is high degree of mismatch between supply and demand at the level of educational cohorts. According to data of the Employment Office, during this period predominant demand was for non-qualified and semi-qualified

¹⁶Draft Program for Reform of Employment Policy and Social Policy 2014-2020.

labour force to carry out seasonal jobs in tourism and construction industry, and it was considerably higher than the supply; while the demand for professions with secondary, lower tertiary and higher education was lower and sizeably lower than the supply. However, these findings need to be observed carefully, having in mind the procedure for employment of foreigners, whereby for professions with higher qualification level a degree validation needs to be obtained. Likewise, the fact that employers continue to prefer labour force from the neighbouring countries is indicative and leads to a conclusion that there are mechanisms for the work of foreigners to be made cheaper than the work of local labour force. However, in spite of that, structural mismatch of supply and demand remains as a long-term challenge of the Montenegrin labour market. Results of measure in the domain of education reforms, both implemented and planned, should be to reduce the skills gap, which is increasingly becoming a natural consequence of introduction of new technologies and new organisational structures, and what is rather important, a consequence of adjustment to a higher completion level.

Realisation of the professional development programmes for persons with higher education level in its second cycle for 2013/2014 provided job-skills training for 3,945 university graduates with employers in the private and public sector, with an exception of the state administration authorities. The programme envisages a third cycle for 2014/2015 as well, for which the 2015 Budget allocated around 8.5 million euro.

The Decree on Subsidies for Employment of Specific Categories of Persons will be in application in 2015 as well. During the previous two-year period of implementation, an average of around 5.5 thousand persons was hired for a certain number of months during a year, whereby the incentives amounted to 5.6 million euro and 2.8 million euro respectively annually.

The General Collective Bargaining Agreement was signed at the end of March 2014, which enabled easier firing of employees by introducing provisions concerning the termination of labour contracts.

Generally, the labour legislative is improved extensively, both in terms of harmonisation with the EU standards, as well as in order to reach higher labour market flexibility. Further alignment process will be in line with the negotiation dynamics for the Chapter 19 and the Action Plan for this Chapter, which is expected to be adopted in the forthcoming period.

Key challenge of further development and improvement of the labour market outcomes is insufficiently developed private sector, apart from the flexibility, which points to a need to carry out additional activities to advance the environment for investments and doing business.

Objectives for the future labour market reform are set based on the labour market analyses, which pertain to¹⁷:

1. Aligning the education system with the labour market requirements, in order to overcome the knowledge and skills supply and demand gap;
2. Strengthening of active labour market policies; and
3. Increasing the labour market flexibility.

In order to achieve the set objectives, the measures that pertain to the following will be carried out continuously:

- Develop qualifications matching the labour market needs, and which are aligned with the principles of the National Qualifications Framework;
- Increase labour force participation in the life-long learning programmes and education of adults;
- Improve professional development of youth;

¹⁷Objectives are compatible with recommendations of the Ministerial Meeting of May 2015 and Montenegro Progress Report of October 2014.

- Improve the design and implementation of active measures by strengthening the monitoring and evaluation model for existing active labour market policy measures;
- Increase funds for financing active employment policies; and
- Improve legislative framework on the labour market in order to increase further the labour market flexibility and mobility.

The budgetary effects of proposed measures are presented in the Table 17.

I.4.2.4 Public Finance Reform

I.4.2.4.1 Tax System Reform

Realisation of the fiscal consolidation measures, set in order to cure the public finances, has resulted in better collection of budgetary revenues and evident improvement in tax discipline in 2014 as well. Since the implementation of these measures over a longer term bears a risk that could slowdown future growth and development, via negative effects on the competitiveness of the economy, the incentive-type measures were also implemented in parallel.

The reforms activities carried out during 2013 and 2014 have resulted in an increase of revenues in excess of 90.0 million euro, which has contributed, alongside the spending rationalisation, to the recovery of public finances and creation of conditions for improvement of standards for all citizens.

A series of fiscal incentives was introduced in 2014, in addition to the consolidation measures implementation, and so as follows:

- For new enterprises and new employment in the northern municipalities of Montenegro, tax holiday for personal income tax and corporate profit tax payment for a period of 8 years and for payment of tax on personal earnings of newly employed persons for a period of 4 years;
- Approval of a discount to taxpayers who make a one-off payment of liability for corporate profit tax;
- Write-off of interest for one-off repayment of the tax debt;
- Higher level recognition of standard costs (from 30% to 70%) for those leasing private accommodation in the tourism sector;
- Right to refund the full excise duty value for mineral oils used for agricultural and forestry machines, snowplow machines, as well as part of the paid excise duty for fuel used for heating and commercial or industrial purposes.

In order to overcome illiquidity of business operations, a special form of incentive was provide during 2013 and 2014 providing a possibility to net out tax liabilities against the taxpayers assets/property, which was used to collect tax debt in arrears of approximately 10.0 million euro.

In the forthcoming period, the Government will continue to create and implement tax policies based on the principles of competitiveness, predictability and consistency, which will ultimately promote Montenegro as an attractive investment destination. To that end, a medium-term strategy for fiscal policy implementation was defined, and has established at the same time core objectives of the tax system reform:

- Ensure the public finances sustainability and limit the public debt growth;
- Reduce tax burden; and
- Improve investment environment and competitiveness of the Montenegrin economy.

Ensuring the public finances sustainability, while limiting the public debt growth, will be provided by stipulating new earmarked sources during 2015 for repayment of the debt for construction of the Highway, and so as follows:

- Increase excise duties on alcohol, carbonated drinks, tobacco and tobacco products;
- Introduce tax on coffee and gains from games of chance;
- Stipulate earmarked fees for retail price of fuel 0.05 euro per litre to finance part of costs for construction of the Highway;
- Narrow down the grey economy zone – introduce criminal liability for payment of wages without paying taxes and contributions; realization of the “Project of Recording Tourist Stay”, which will be financed revenues generated by its implementation under a public-private partnership approach.

In order to achieve a balanced budget, for 2015 the tax policy reform envisages:

- Reduction of the higher personal income tax rate by 2 pp (from 15% to 13%);
- Increase of the health insurance contribution rate by 0.5 pp.

In order to improve the investment environment and competitiveness of the Montenegrin economy, fiscal preferences are envisaged for investments in the following sectors:

- High-end tourism – hotels with 5 or more stars;
- Production of food products, except for the primary agricultural production;
- Capital investment in the energy sector.

Investments in these sectors would provide investors with an entitlement to a holiday from payment of the VAT, customs duty, municipal utility fees, charges and fees, in order for the resources to be utilised in the best, most efficient and fastest manner. This would release a potential for growth, which would along with supporting reforms in other areas, undoubtedly contribute to a more efficient capitalisation on resources, and to a faster achievement of the Montenegro economic policy objective – strengthening the competitiveness of the economy, achieving higher economic growth rates and increasing the standard of living of population.

The budgetary effects of proposed measures are presented in the Table 17.

1.4.2.4.2 Pension System Reform

Key reforms of the pension system, which were carried out in the previous period, were directed towards ensuring the sustainability of the first pillar of the pension system.

Even though aware of the fact that the pension system of Montenegro is not sustainable, and having in mind adverse demographic trends, conditions at the labour market, as well as general state of the national economy and neighbouring economies, and even broader, which to a great extent affect the economy of Montenegro, it is estimated that the reforms in this area should be implemented in the forthcoming period. In this respect, the efforts of the Government will be directed towards finding a new pension system model, which would be more relying on individual responsibility for old age, respecting the social security standards arising from ratified international conventions, along with abolishing provisions that pertained to “retirement under more favourable conditions”.

During 2013 and 2014, as a result of the fiscal consolidation, the pension benefits were not adjusted according to the applicable formulae for adjustment, which has proved to be the best solution for adjusting pensions after detailed analysis.

Considering that the measure of “freezing pension benefits” was of temporary nature, regular adjustment of pensions will be applied from January 2015. Bearing in mind trend of parameters for pension benefits adjustments, i.e. decline of the consumer prices index and reduction of the average wage in 2014, if a current formulae for adjustment is to be applied, the pensions benefits should be reduced. However, in order to preserve standard of the oldest population, the Government has proposed that a protection mechanism is to be introduced through amendments to the Law on Pension

and Disability Insurance, resulting in no adjustment in case of negative parameters for pension benefits adjustment.

The budgetary effects of measures concerning the “freezing of pensions benefits” in 2014, as well as effects caused by postponing the regular pension benefits adjustment in 2015 are presented in the Table 17.

1.4.2.4.3 Healthcare System Reform

Healthcare policy is determined by a necessity to secure sustainable and stable development of the healthcare system, while being aligned with trends in developed countries. To that end, the reform of the healthcare system is directed towards the connection and integration into a functional unit covering primary, secondary and tertiary health care levels, whereby it will provide accessible, quality and efficient healthcare system and consequently higher quality of the health of population. Bearing in mind that the costs of healthcare are continuously going up and that healthcare systems are hardly self-sustainable, it is necessary to carry out activities creating conditions for a higher sustainability of the healthcare system, which includes that priorities and their implication on the system of public finance of Montenegro are set based on the information about health. In that respect, activities in the forthcoming period will aimed at:

1. Introducing a transparent system for patient’s classification, as a basis for changing the system of financing, i.e. charging for service based on the diseases’ complexity: Introduction of this payment model for acute hospital treatment will create a higher transparency in financing, which will be aligned with actual results of hospital’s work; better allocation of funds among healthcare service providers, as well as better quality of the healthcare services within the available funds. To that end, the Health Insurance Fund has developed a grouper, as part of the ICT support in introduction of system for payment of acute conditions under the DRG – Diagnosis-related Groups and continues with activities on its implementation.

2. Strengthening the speciality-ambulatory-care activity, acute and non-acute hospital treatment and treatment of patients in same-day hospitals: All hospitals have ambulatory-care facilities in specialised fields, as well as in sub-speciality fields developed in the general hospital, in addition to hospital treatment, which enables better accessibility, efficiency and cheaper medical treatment. By increasing the number of patients treated in ambulatory-care facilities a number of those referred to hospital is reduced and consequently number of hospital treatment days and in relation to that a possibility of intra-hospital infections is also reduced, which leads to the reduction of hospital costs.

The Clinical Centre of Montenegro has introduced treatment of patients through one-day hospitals in several clinics, and in cooperation with the community health centre, has opened a specialised ambulatory care facilities in Danilovgrad, which has resulted in reduction of travel expenses for patients.

3. Implementing the development programme for a palliative care at the national level: Preserving, preventing and improving the health of citizens include also development of an appropriate model for organisation of the palliative care. In that respect, the Ministry of Health has established cooperation with the National Society for Oncology and Palliative Care of Croatia and collected data that represent a good basis for drafting of a development programme for this area. However, activities have slowed down since the model for organisation of palliative care in Montenegro is not yet developed; precisely prerequisites to pilot a model in one environment are not yet created.

4. Implementing national and international clinical guidelines and establishing clinical directions, standards, protocols and professional rules based on scientific evidence: Adopted set of national guidelines has a slow implementation, thus the Ministry of Health will undertake adequate activities and in that respect monitor their implementation dynamics. The clinical guidelines (good practice guidelines) assist medical doctors and patients in making decisions about an appropriate health care in a specific clinical situation, which will enable rational planning, or control of treatment costs.

5. *Reform of the primary healthcare for the entire territory of Montenegro:*As part of the primary healthcare reform, which in principle is completed, segments that affect the implementation of the caption with a selected medical doctor will be strengthened.Funds will be provided from the new World Bank loan that will be approved for continuation of the healthcare system reform.

Activities to implement the cancer screening (colorectal, cervical, and breast) are carried out continuously.In 2015, a screening for early detection of harmful use of alcohol and cancer in children is planned to be introduced.

6. *Rationalisation of the Healthcare institutions Network as an optimal spatial distribution of capacities of public healthcare institutions and concessionaires:*In accordance with the Law on Health Care, which is in the parliamentary procedure and its adoption is expected at the beginning of 2015, activities concerning the rationalisation of the Healthcare network will commence, and one of the activities will be also to establish eight healthcare centres.

7. *Development of quality standards and indicators:*One of the conditions for a good quality and efficient work of healthcare institutions is permanent improvement of the clinical practice of healthcare practitioners by methods of constant improvement in quality of services.This continuous process includes collection, observation and comparison of performances (results of work) against the performance indicators aligned with the international standards.Areas for improvements are recognised, problems indentified and causes leading to them analysed and possible solutions defined, including an implementation plan, based on the obtained data.A reliable precondition and efficient mechanism for assessing the clinical practice success is provided through collection and comparison of quality indicators.

8. *Development of the accreditation program – Accreditation Authority – Monitoring the accreditation efficiency:*Accreditation represents a voluntary procedure carried out upon a request an entity engaged in health care line of business in line with the accreditation standards according to legal provisions of a given country or international recommendations (WHO), to professional associations (ISQHua, ESQH).An evaluation for the General Hospital Nikšić was completed in order to commence the accreditation process and the Action and Financial Plan for 2015-2017 was also prepared.

9. *Assessment of healthcare technologies – Coordination in application of healthcare technologies:*New technologies are generator of cost increase in the health sector, thus introducing them represents a risk to financial sustainability of the healthcare system.To that end, the Ministry of Health will establish a working group to assess justifiability for introduction of new technologies in diagnosis and treatment, upon adoption of the Law on Health Care.

10. *Regional development centre for chronic non-communicable diseases:* The Regional development centre for chronic non-communicable diseases, that operates as part of the Public Health Institute and is part of the South Eastern Europe Health Network, has prepared a plan of activities for next two years and is at the same time the Centre for Control of Chronic Non-Communicable Diseases at the national level.

11. *Accessibility of prescription medicines:* In 2015, conditions will be created for citizens to be able to take prescription medicines in private pharmacies as well.This will improve the healthcare accessibility, and will enable control of funds allocated for medicines.

1.4.2.4.4 Public Sector Wages Policy

The Reforms of the wage system in the public sector will be carried out since the level of wages needs to be aligned in all segments of this sector, while respecting the same principles for officials, administration employees at the state and local level, enterprises with majority state ownership and local self-governments, as well as the regulatory agencies and other institutions and bodies carrying out public services.The objective of such policy is to define, in a uniform manner, setting and exercising

rights to wage, wage compensation and other earnings of the public sector employees, securing funds, as well as other matters relevant for exercising these rights. The reform of this segment includes also a need to consolidate the regulatory framework (laws, decisions, decrees, collective bargaining agreements, statutes and other regulations) governing the area of wages, remunerations and other earnings of the public sector employees. In addition to the key objective aimed at introducing a new uniform concept for calculating wages for all segments of the public sector, a separate focus is placed on: the segment concerning the control of the public sector wages policy; correcting inequalities in wages, depending on the branch of government, and aligning the wage level with the level of responsibility; increasing transparency of the wage system as well as increasing the level of fiscal responsibility. Core principles the employees' wage setting is based on in the future system are: balanced wages in the public sector for work at same or similar tasks and job positions requiring the same level or sub-level of qualifications; wage transparency; and their fiscal sustainability.

Principal solutions of the public sector wage policy reform pertain to:

- Introducing mechanisms for realistic planning of wages during the planning stage of the Law on Budget and based on fiscal and macro-economic parameters;
- Simplifying the system for increasing or decreasing the public sector wages;
- Establishing the equality principle for calculation of wages for all public sector employees, in line with the education level, degree of responsibility and job complexity;
- Making equal wages for key persons by the branches of government (legislative, executive and judiciary);
- Making equal level of wages for ministers with the level of wages of members of the Parliament and key positions in the judiciary;
- Revising the policy for payment of remunerations for working groups and working bodies of the Government, abolishing supplements and others wage increases;
- Reducing costs and lowering misuse of the wage system by unifying data on wages and introducing provisions that supplements include all increases (overtime work, shift work, and work on days of public holidays);
- Improving the financial situation in the state-owned enterprises and local self-government units.

It is not possible to quantify fiscal effects of the wage policy reform at present, since the negotiations among all interested parties are underway. It is expected that it will be neutral, since the focus of the reform is quality, increased transparency and realistic planning of wages.

1.4.2.4.5 Division of Competences and Resources among Various Levels of Administration

The local self-government units carry out activities within their competences, which are stipulated by the Law on Local Self-Government. Those are the tasks having direct or common interest for the local population, as well as tasks conferred by a law or assigned by a regulation of the Government. As opposed to countries in the region, municipalities in Montenegro do not have competences in the health and education sector.

The Law on Local Self-Government, Law on Financing Local Self-Government and special laws introducing specific tax forms (taxes, fees, charges, and other) that either entirely or in part are allocated to the budget of municipalities, govern the local self-government financing system.

The fiscal decentralisation degree in Montenegro is determined based on two indicators, share of revenues of the local self-government in GDP and share of public spending at the local level in the consolidate public spending, which have mainly increased in the previous period continuously, but not to an extent that would translate into a high decentralisation degree.

One of the objectives of the public sector reform, defined by the Public Sector Reform Strategy 2011-2016, in the area of the local self-government reform, is the higher level of functional and fiscal decentralisation, along with adjustments of financial and material resources of local self-governments with tasks they are performing.

To that end, the decentralisation process should continue, primarily in the fields of education, primary healthcare, social and child welfare, employment, as well as in other areas of interest for the local population. In that respect, a detailed analysis of possibility to introduce a polytypic model for organising local self-governments, which includes transfer of additional competences and resources to local self-government units, which meet clearly defined conditions, while the local self-government units having lower development potential and capacities will keep or reduce the scope of existing competences.

1.4.2.4.6 Administrative Reform

Reorganisation of the Public Sector: In the period covering Q3 of 2013 and Q1 and Q2 of 2014, when 201 activities should have been implemented, in accordance with the Action Plan for Implementation of the Plan for Internal Reorganisation of the Public Sector, 75 activities were completed, 46 partially completed, while 80 activities were not completed. As far as the entire public sector is concerned, there was a reduction in the number of employees by 36, which is sizeable departure from the planned number (1,387). In order to optimise the number of public sector employees, reduce labour costs and to provide for better allocation of human resource, financial and technical resources, activities in line with solutions set forth in the Plan of Internal Reorganisation of the Public Sector will be carried out in the forthcoming period. Activities envisaged by this document will be intensified in order to avoid usual delays against set deadlines.

First findings in the area of the civil service system indicate that the Law on Civil Servants and State Employees and supporting enabling regulations is implemented in the practice, however there are certain problems that primarily refer to the lack of data completeness of the Central Human Resources Records and system of human resources planning. In order to create prerequisites for the public administration authorities to deliver quality services to citizens, entrepreneurs and other entities (simplification of administrative procedures, higher degree of protection of parties, introduction of e-government), the Law on Administrative Procedure will be adopted (the Law is in the process of being adopted by the Parliament of Montenegro). The analysis of conditions in organisations exercising public authorities (public agencies, public services and other) is currently underway, with the objective to determine possible problems as well as to issue recommendations for improvement of the conditions. First findings show a high diversity in status and functioning of organisations with public authorisations, as well as that there is no satisfying degree of control over legality and appropriateness of their work.

Activities concerning the amendments and supplements to the Law on Local Self-Government are in progress, objective being to improve the legal framework for successful functioning of local self-government (public nature of work of local self-government, financial sustainability, human resources management, etc), precisely to regulate in more complete and precise manner legislative assumptions for rights of citizens to be exercised at the local self-government level. In line with the Law on Regional Development, majority of municipalities have adopted strategic development plans. Local self-government units that are late with the obligation to adopt strategic development plans, which are one of the assumptions for creating conditions for their faster development and for use of funds from the IPA funds, will adopt their development plans in 2015.

Bearing in mind the share of wages in total Budget expenditures, as well as sizeable difference in the level of wages of the public sector employees, in accordance with the Reorganisation Plan, activities concerning the adoption of a comprehensive legal framework for calculation of wages of public sector employees are underway (draft Law is being aligned with the trade unions).

Financial management and control: 89 users of the budgetary funds have appointed persons to establish and develop financial management and control (75 at the central and 14 at the local level), 30 users of the budgetary funds have developed action plans for implementation of activities concerning the establishment, implementation and development of financial management and control, adopted by managers of entities (28 at the central and 2 at the local level), 60 budget users have adopted internal rules and procedures in the form of books of procedures (51 at the central and 9 at the local level). **Internal audit:** All public sector entities at the central level that were obliged to do so have established an internal audit unit. They have assigned 37 internal auditors. Some 32 users of the Montenegro Budget funds have conferred the internal audit tasks to the internal audit unit of another entity based on an agreement. In such manner, entities of the public sector have established the internal audit function that covers more than 95% of the Montenegro Budget funds. An office for internal audit was established in 13 municipalities (which have 23 internal auditors), out of 15 municipalities where such obligation exists. 70 internal auditors in the public sector were certified so far, of which 45 have acquired CIPFA certificates and 25 national certificates. Activities in the internal financial control area will be focused on strengthening the management responsibility, improving the financial management and further human resources strengthening of internal audit units, in terms of number of auditors and their professional development, in the forthcoming period.

It is not possible to quantify budgetary effects of proposed measures.

I.4.3 Budgetary Implications of Major Macroeconomic Structural Reforms

The Table 17 provides an overview of quantified fiscal effects of those structural reforms or structural policy measures that have been presented in details in previous sub-chapter. In terms of the methodology, the table is composed based on inputs obtained for specific segments of structural reforms, and which could be quantified. Quantified reforms/measures essentially demonstrate what would be the change in budget revenues or expenditures due to introduction of specific structural reform/measures if compared to the situation where such reform would not be put in place, thus if compared to the “no-reform scenario”.

Structural reforms/measures have impact both on the Budget expenditures and on its revenue side. As far as the budgetary expenditures are concerned, the very implementation of specific structural reforms is monitored by certain increase in expenditures, due to preparation and implementation of individual reforms. Increase of budgetary expenditures caused by structural reforms/measures in the table is marked with sign plus (+), and if the reform causes a decline in expenditures then it is marked with sign minus (-).

As it could be noted in the Table, it is estimated that in the summary effect in 2015 of envisaged structural reforms/measures will cause an increase in budgetary expenditures of 227.1 million euro. Over the next two years this increase if compared to the “no-reform scenario” will be somewhat lower and will amount 226.8 million euro in 2016 and 226.7 million euro in 2017. The most notable increase of budgetary expenditures in the field of structural reforms will be the costs for the construction of the Highway section Smokovac–Mateševac and increase in expenditures for implementation of new economic policy measures in the labour market area is another relatively large item.

Structural reforms/measures may have impact on the revenue side of the Budget as well, and most often in the form of increase in revenues, such as in the case of introduction of new forms of taxation or increase of tax rates, and there are also cases where a structural reform may cause reduction of budgetary revenues, as is the case of reduction or abolition of some tax rates. Increase in budget revenues caused by a structural reform/measure in the table is marked with sign plus (+), and if the reform causes a decline in revenues then it is marked with sign minus (-). In 2015, it is envisaged that

due to introduction of structural reforms/measures, principally due to the tax reform, the total volume of the Budget revenues will be by 31.0 million euro higher than under the “no-reform scenario”. Positive budgetary effect on the revenue side will also continue in the next two years, whereby the envisaged volume for 2016 is 31.1 million euro and 31.2 million euro for 2017.

Considering that the increasing of the budgetary expenditures is going to exceed the increase of revenues, it is reasonable that Montenegro will record a net negative effect of structural reforms as far as the national budget is concerned. Such negative net effect is estimated to be 196.1 million euro in 2015, 195.7 million euro in 2016, and 195.5 million euro 2017, which are primarily a consequence of high expenditures for financing of the highway and inability to quantify positive budgetary effects for majority of the planned reforms. Finally, it should be emphasized that only direct fiscal effects are taken into account, while the indirect effects are not covered here i.e. those expressed through impact in increase/decrease of the economic activity for specific fiscal categories.

Table 17 Budgetary effects of planned reforms

Highway BAR-BOLJARE				
	2014	2015	2016	2017
Construction of the Highway section Smokovac-Mateševó				
Net Budgetary impact		-206,000,000	-206,000,000	-206,000,000
Direct impact on Budgetary revenues				
Direct impact on Budgetary expenditures		206,000,000	206,000,000	206,000,000
Labour Market				
	2014	2015	2016	2017
Active employment policy				
Net Budgetary impact	-2,200,000	-3,200,000	-4,600,000	-4,900,000
Direct impact on Budgetary revenues	1,000,000	1,400,000	2,000,000	2,100,000
Direct impact on Budgetary expenditures	3,200,000	4,600,000	6,600,000	7,000,000
Ensuring social safety of unemployed persons				
Net Budgetary impact	-8,800,000	-9,600,000	-9,600,000	-9,600,000
Direct impact on Budgetary revenues	2,200,000	2,400,000	2,400,000	2,400,000
Direct impact on Budgetary expenditures	11,000,000	12,000,000	12,000,000	12,000,000
Legislation – Labour Law				
Net Budgetary impact		800,000	300,000	300,000
Direct impact on Budgetary revenues		800,000	300,000	300,000
Direct impact on Budgetary expenditures				
TOTAL BUDGETARY IMPACT OF THE REFORM IN THE LABOUR MARKET AREA	-11,000,000	-12,000,000	-13,900,000	-13,900,000
TAX REFORM¹⁸				
Excises				
Net Budgetary impact		9,000,000	9,000,000	9,000,000
Direct impact on Budgetary revenues		9,000,000	9,000,000	9,000,000
Direct impact on Budgetary expenditures				
Personal Income Tax				
Net Budgetary impact		-4,000,000	-4,000,000	4,000,000
Direct impact on Budgetary revenues		-4,000,000	-4,000,000	4,000,000
Direct impact on Budgetary expenditures				
Contributions for Health Insurance				
Net Budgetary impact		2,700,000	2,700,000	2,700,000
Direct impact on Budgetary revenues		4,200,000	4,200,000	4,200,000
Direct impact on Budgetary expenditures		1,500,000	1,500,000	1,500,000
Fee for the highway				
Net Budgetary impact		9,000,000	9,000,000	9,000,000
Direct impact on Budgetary revenues		9,000,000	9,000,000	9,000,000
Direct impact on Budgetary expenditures				
Tax on coffee and gains for the games of chance				

¹⁸ These are envisaged fiscal effects of the fiscal reform proposed in the document the “Analysis of Certain Aspects of the Tax Policy – Reform Perspectives”, adopted by the Government in December 2014, which is not entirely translated into legislative proposals, which should be adopted by the Parliament of Montenegro.

Net Budgetary impact		3,200,000	3,200,000	3,200,000
Direct impact on Budgetary revenues		3,200,000	3,200,000	3,200,000
Direct impact on Budgetary expenditures				
Suppressing the grey economy				
Net Budgetary impact	5,000,000	5,000,000	5,000,000	5,000,000
Direct impact on Budgetary revenues	5,000,000	5,000,000	5,000,000	5,000,000
Direct impact on Budgetary expenditures	-	-	-	-
TOTAL BUDGETARY IMPACT OF THE TAX REFORM	5,000,000	24,900,000	24,900,000	24,900,000
REFORMS IN THE AREA OF THE HEALTHCARE SYSTEM				
NET BUDGETARY IMPACT REFORMS IN THE AREA OF THE HEALTHCARE SYSTEM	-1,200,000	-1,000,000	-700,000	-200,000
Direct impact on Budgetary revenues				
Direct impact on Budgetary expenditures	1,200,000	1,000,000	700,000	200,000
PENSION SYSTEM				
Pension adjustments				
Net Budgetary impact	11,000,000	-2,000,000		
Direct impact on Budgetary revenues				
Direct impact on Budgetary expenditures	-11,000,000	2,000,000		
TOTAL NET IMPACT OF PROGRAMMES AND MEASURES	3,800,000	-196,100,000	-195,700,000	-195,500,000
Direct impact on Budgetary revenues	8,200,000	31,000,000	31,100,000	31,200,000
Direct impact on Budgetary expenditures	4,400,000	227,100,000	226,800,000	226,700,000

I.5 Implementation of the Economic Policy Guidance

This chapter describes the response of Montenegro to the economic policy guidance adopted at the regular annual Joint Ministerial dialogue of 6 May 2014, attended by ministers of economy and finance of the EU member states and candidate countries, representative of the European Commission, the European Central Bank, as well as representatives of central banks of candidate countries.

I.5.1 Public Debt; Impact on the Public Debt of the Construction of the Highway Priority Section Smokovac-Mateševo; Improving the Public Finance Transparency

The public debt reduction is the strategic objective of Montenegro in the area of public finance, precisely reduction of its share in GDP, which could be achieved with different combinations of two macro-economic categories. One of them, which is assessed as being realistic having in mind the conditions in Montenegro, is based on an accelerated economic growth, which is not possible without sizeable investments. The fact is that such investments may have an adverse effect on fiscal indicators over a medium term, such as public finance deficit and public debt, while over a long-term they can, by virtue of increasing the economic growth rate, consequently increase public revenues, create conditions for stabilisation of public finances', including also start of the reduction of the public debt share in GDP.

The Law on Budget and Fiscal Responsibility (entered into force in May 2014) stipulates the fiscal rules concerning the deficit and public debt level, which are aligned with the Maastricht criteria. The Law defines, amongst other, the budget planning and execution in such manner that the public debt will not exceed 60% of GDP. Even though the logic behind the Law is for budgetary expenditures to be covered by revenues, it does however enable certain exceptions. Thus, it is possible, in accordance with Article 21 of the Law, to breach the limit in events when funds are used for financing projects of national interest and approved by the Parliament (the Law on Highway was adopted on 8 December 2014). The assessment was that the Bar-Boljare Highway construction project, precisely construction of its priority section Smokovac-Mateševo, meets these requirements. Namely, the project will represent a strong impetus to the growth and development of economy, over a short and medium term, by increasing the public financed investments, while in the long term faster development of the Northern region, better utilisation of natural and economic potentials and better connectivity of the Port of Bar with regional markets using this facility for export and import of goods.

The cost for the design and construction of the Highway priority section is 809.6 million euro, of which 689.0 million euro (85% of funds) will be provided from the Exim bank loan (repayment period of 20 years, including a grace period of six years, with annual interest rate of 2%), while the State will provide the remaining funds of 120.6 million euro (15% of funds). Works will commence at the beginning of 2015, after the Chinese partner develops a main design. The contractor, Chinese company CCCC-CRBC has the obligation to complete the design and construction of the Highway priority section within 48 months, as well as to engage domestic construction industry and other related lines of business for realisation of 30% of the total investment.

The fact is that in the next four years, due to model of financing the Highway construction, the public finance deficit will increase temporarily (to around 5% per annum). Namely, the public finance would be in case of "no project" scenario record a surplus as early as in 2016, which demonstrates a responsible fiscal policy management in Montenegro. The debt will rise solely as a consequence of the project, from the present close to 60% to almost 70% of GDP in 2018, and after that it takes a downward trend. In case of "no project" scenario, the debt of the country would not exceed the Maastricht limit of 60% of

GDP, but even with the loan for the highway construction, it remains below the average public debt level in the Euro area and the EU.

The Government of Montenegro has already acted against increased risks linked with the realisation of the Highway project and has done so with measures both at the revenue side and expenditure side of the Budget. As far as the revenue side of the budget is concerned, the Government has adopted *the Analysis of Certain Tax Policy Aspects – Reforms Prospects* in December 2014, which contains conceptual solutions for planned tax reform. In line with this document, a set of laws will be amended with aim to (a) increase the degree of public finance sustainability and limit the public debt growth, (b) reallocate tax burden in such manner to purport growth more extensively, and (c) improve the investment environment and competitiveness of the Montenegrin economy. Proposals contained in the *Analysis* are also quantified and results are presented in the Table in sub-chapter 4.3. It should be emphasized that those proposals are not included in the fiscal projections for this year's ERP.

Measures at the revenue side of the Budget will be accompanied with a preparation of system-level measures aimed at the expenditure side of the Budget, in the forthcoming period. A principal objective of these measures will be to govern the public sector wage system and to establish a pension system that would be sustainable not only over a short run but also over a medium and long term. Within the EU accession context, the Government will continue to place a special attention to costs directly arising from the alignment with the EU *acquis*. Even though the construction of the Highway in the period 2015-2017 will not affect the reduction of the annual capital budget volume for other investments in comparison to 2014, a special consideration will however be on the ranking of their priority.

1.5.2 Revision of the Old-Age Pension Benefits Indexation System; Public Sector Reorganisation Plan; and Reform of the Public Sector Wages System (more details in section 4.2.4 *Public Finance Reform*)

Defined model for pension benefits adjustments will be kept in the forthcoming period, since the analysis has shown that the existing formulae is a good solution over a long term. During 2015, after the duration of fiscal consolidation measures has lapsed, which referred to "freezing of pensions" in 2013 and 2014, pension benefits would have been reduced due to negative parameters making the formulae (consumer prices index and average wage in 2014). However, in order to preserve standard of the oldest population the Law on Pension and Disability Insurance will be amended (the Law is in the parliamentary procedure) in such manner that the pension benefits will not be adjusted in case of negative parameters.

Even though aware of the fact that the pension system of Montenegro is not sustainable, and having in mind adverse demographic trends, conditions at the labour market, as well as general state of the national economy and neighbouring economies, and even broader, which to a great extent affect the economy of Montenegro, it is estimated that the reforms in this area should be implemented in the forthcoming period. In this respect, the efforts of the Government will be directed towards finding a new pension system model, which would be more relying on individual responsibility for old age, while respecting the social security standards arising from ratified international conventions. At the same time, benefits that pertained to "retirement under more favourable conditions" will be abolished.

In order to optimise the number of public sector employees, reduce labour costs and to provide for better allocation of human resource, financial and technical resources, activities in line with solutions set forth in the Plan of Internal Reorganisation of the Public Sector are carried out. Tasks were not implemented in line with the planned time schedule so far, thus it is necessary to intensify activities concerning the implementation of the said Plan.

Bearing in mind the share of wages in total Budget expenditures, as well as sizeable difference in the level of wages of the public sector employees, in accordance with the Reorganisation Plan, activities

concerning the adoption of a comprehensive legal framework for calculation of wages of public sector employees are underway (draft Law is being aligned with the trade unions).

I.5.3 Improving the Business Environment – “Legislative Guillotine”; Reducing/Abolishing Fee for Equipping Buildable Land and Finding Solution for Sustainability of Public Finances at the Local Level

According to data of the latest World Bank Report, the Doing Business 2015, in the overall rank Montenegro has advanced by 6 positions, from 42nd to 36th, out of 189 ranked countries. Even though a significant effort was made under the indicator “Dealing with Construction Permits” (from 164th to 138th position), where the reforms implemented in the field of reducing fees for delivery of municipal utility services were recognised, as well as abolition of fees to municipalities for obtaining urban-development and technical conditions, there is considerable room for improvement. To that end, activities to simplify procedures will be intensified, as well as to create and implement the one-stop shop for issuing construction permits at the local self-government units.

Bearing in mind the need to ensure the fiscal sustainability of municipalities, while retaining the need to improve the investment environment, the fee for equipping buildable land, as one of the key levies, will be gradually abolished in the period from 2016 to 2020. Criteria and limits for the amount of the fee will be set until such time the fee is abolished. This will leave room to municipalities for consolidation and replacement of revenues. Tax on immovable property will be increased, as a tax that has lowest negative effect on the economic growth, in order to improve finances at the local level.

Since the Action Plan for Implementation of the Legislation “Guillotine”¹⁹ was adopted (17 May 2012, reviewed on 12 September 2013) and as of Q2 of 2014, 987 recommendations out of 1,446 accepted recommendations were realised (realisation degree is 68.3%). Realisation of 172 recommendations is envisaged for 2015, while the remaining recommendations will be realised during 2016 and 2017.

I.5.4 Aligning Education²⁰ and Skills with Labour Market needs; Establishing better Cooperation among Between Educational Institutions and Economy; Introducing Higher Labour Market Flexibility through Distinct Collective Bargaining Agreement for the Public and Private Sectors

Structural mismatch of supply and demand remains as a long-term challenge of the Montenegrin labour market. One of the labour market reform objectives is to align the education system with the labour market needs, in order to overcome gap between the supply and demand and knowledge and skills. The following measures will be continuously realised with the aim to achieve the abovementioned objective:

- a) *Development of the National Qualifications Framework (NQF)*: One of the strategic objectives in the education policy is development of vocational education and carrier orientation, in order to develop professional competences for easier labour market entry and successful carrier

¹⁹ Legislative “Guillotine” is an ex-post analysis of effects of provisions of the existing legislation – amendments to or abolishing legislation with objective to shorten deadlines, minimise administrative costs and streamline procedures.

²⁰ The Education System reform and its alignment with the labour market needs is addressed in series of strategic development documents: Study on Labour Market Needs from the Higher Education (adopted in December 2013); Strategy of Vocational Education Development in Montenegro 2015-2020 (adopted in December 2014); Plan of Education of Adults 2015-2019 adopted in December 2014). The Life-long Entrepreneurial Learning Strategy 2015-2019, along with the Action Plan is also adopted, which is a contribution to the development of human resources and increase of the human capital, and consequently to the development of competences aligned with the labour market needs.

development, which is carried out, among other, through development of standard occupations, standard qualifications and modular education programmes (for elementary, secondary and higher vocational education) and special programmes, which are taking into account the labour market needs. A need for missing skills and qualifications will be established through cooperation of all partners based on relevant research, data and forecasts for development of specific sectors, and consequently the labour market needs. Sector-level commissions will establish a need for all types of qualifications, which will be composed of representatives of employers and their associations, trade unions, institutions engaged in development of education, competent ministries, universities.

- b) *Life-long learning and education of adults*: The concept of life-long learning is exercised through formal education, informal and formal learning. Life-long learning is not a stand-alone system operating in parallel with the formal education; rather the formal education is part of the life-long learning. Valuing knowledge, skills and competences of individuals who have acquired them in various contexts (on-the-job, informal and formal learning) will improve the structure of the available labour force and thus reduce the structural unemployment.
- c) *Advancing the job-skills training of youth*: The Program of job-skills training of university graduates is carried out in accordance with the Law on Job-Skills Training of Persons with University Degree. The Program enables persons with university degree without job experience at certain education level to acquire knowledge, skills and competences to carry out independently activities and tasks, that will enable them faster participation in the labour market. In order to advance knowledge, skills and competences for independent carrying out of activities and tasks for persons having acquired second and third level vocational education under NQF, the activities concerning the preparation of the Program for Job-skills training of the Secondary School Graduates are underway. Likewise, programmes relating to the employment of youth during the season are implemented as part of the active employment policy measures, the objective being to resolve temporarily problems of their unemployment, for them to acquire job experience (more detail in Part II of the document, item 2- Human Capital – Education and Structural Unemployment).

Social partners and the social dialogue participants are involved in the process of defining the development strategies and objectives for changes in the education from the very beginning of the education system reform. In that respect, they are also involved in the decision-making process through sectoral commissions, council for qualifications, the National Education Council, school boards and other professional bodies. Representatives of employers and employees are participating in working groups for development of new standard occupations and are members of the body that adopts them. Representatives of the Chamber of Economy of Montenegro, the Union of Employer of Montenegro, the Trade Union of Education Sector and the Trade Union Confederation of Montenegro are participating in accreditation of educational programmes and training programmes through representatives in competent councils.

Improvement of the on-the-job education with employers, which will include both students and teaching staff, will represent a particular challenge in the forthcoming period.

The new General Collective Bargaining Agreement was signed in March 2014, which covers both the public and private sector and which has opened space for increasing the labour market flexibility. Introduction of provisions concerning the employment contract termination enabled easier firing of employees. There are 19 sector-level collective bargaining agreements, in addition to the General Collective Bargaining Agreement in practice in Montenegro.

1.5.5 Implementing the Voluntary Restructuring Programme (so called Podgorica Approach) in order to Resolve Problems of Non-performing Loans in Banks' Balance Sheets

The Central Bank of Montenegro and the Ministry of Finance, in cooperation with the World Bank, have prepared the Proposal of the Law on Voluntary Financial Restructuring of Debts with Financial Institutions (the Law is in the parliamentary procedure) as part of the Project for resolution of non-performing loans, so-called "Podgorica Approach". Instruments from the said Law create a purporting legal framework that supports and incentivises real restructuring in off-the-court proceedings of economically viable economic entities, which will eliminate reasons for their bankruptcy, which as a rule puts both creditors and debtors in much harder position. The financial restructuring, within the meaning of this Law, means that debtor-creditor relations between a debtor-legal person (business entity and entrepreneur) or natural person (user of a mortgage loan), which are suitable for financial restructuring, and creditors, are to be regulated again, while having entitlement to certain incentives.

The implementation of so-called "Podgorica Approach" will be possible only upon the adoption of the Law, which is expected at the beginning of 2015. However, the very implementation of the Project is based on the voluntary principle, as well as that any other creditor of the debtor could participate in the financial restructuring process, in addition to banks and other financial institutions (MFIs and leasing companies), thus it is not possible to give a precise estimate on the share of non-performing loans (classification group C) which could be restructured in accordance with this Law.

In the meantime, under the same project and in line with amendments and supplements to the Decision on Minimum Standards for Credit Risk Management in Banks from November 2013, the Central Bank has obliged banks to: adopt special strategies for dealing with non-performing loans over a three year period; set annual operational objectives to execute those strategies; and report on quarterly basis to the Central Bank on their implementation. From submitted strategies of banks for dealing with non-performing loans one could draw a conclusion that at the end of 2016 the growth of non-performing loans (NPLs) will be stopped and they will be reduced on aggregate level.

In line with the abovementioned, it is estimated that the voluntary restructuring that would be carried out in line with the said Law and an increased activity of banks, taking place in accordance with requirements from the Central Bank's regulations, will contribute to mitigation of negative NPL trends and ultimately result in their reduction over the coming period, which is the objective and interests of potentially interested parties the Law is targeting.

1.5.6 Finding a Sustainable Solution for the Kombinat aluminijuma Podgorica (KAP)

After adoption of the Decision of the Commercial Court in Podgorica in declaring bankruptcy of the debtor Kombinat aluminijuma Podgorica (*Aluminium Plant Podgorica*), the bankruptcy administrator has published two announcements for sale of assets, in accordance with the Law on Bankruptcy.

Four offers were received at the first announcement for collection of offers in writing for purchase of assets of KAP - in bankruptcy (public opening of offers in writing under this public announcement was done on 10 January 2014), and the following companies have submitted offers: Uniprom DOO Nikšić, Politropus Alternative DOO Tivat, Getsales Ltd London, and Alemani Trade DOO Beograd. The bankruptcy administrator has made a decision to accept only the offer of Politropus Alternative DOO Tivat for purchase of part of assets of KAP, and to issue the second public announcement on sale for the remaining assets.

One offer was received at the second Announcement for collection of offers in writing for purchase of assets of KAP - in bankruptcy (public opening of offers in writing under this public announcement was

done on 20 February 2014), which was submitted by the company Uniprom DOO Nikšić. This company has offered total purchase price of 28.0 million euro (opening price at the second announcement), under the terms described in more details in the offer, and plans to invest 76.0 million euro and employ 300 employees. The bankruptcy administrator has made a decision to accept the offer of Uniprom DOO Nikšić, and has signed a purchase and sale contract with owner of the company Uniprom on 10 June 2014.

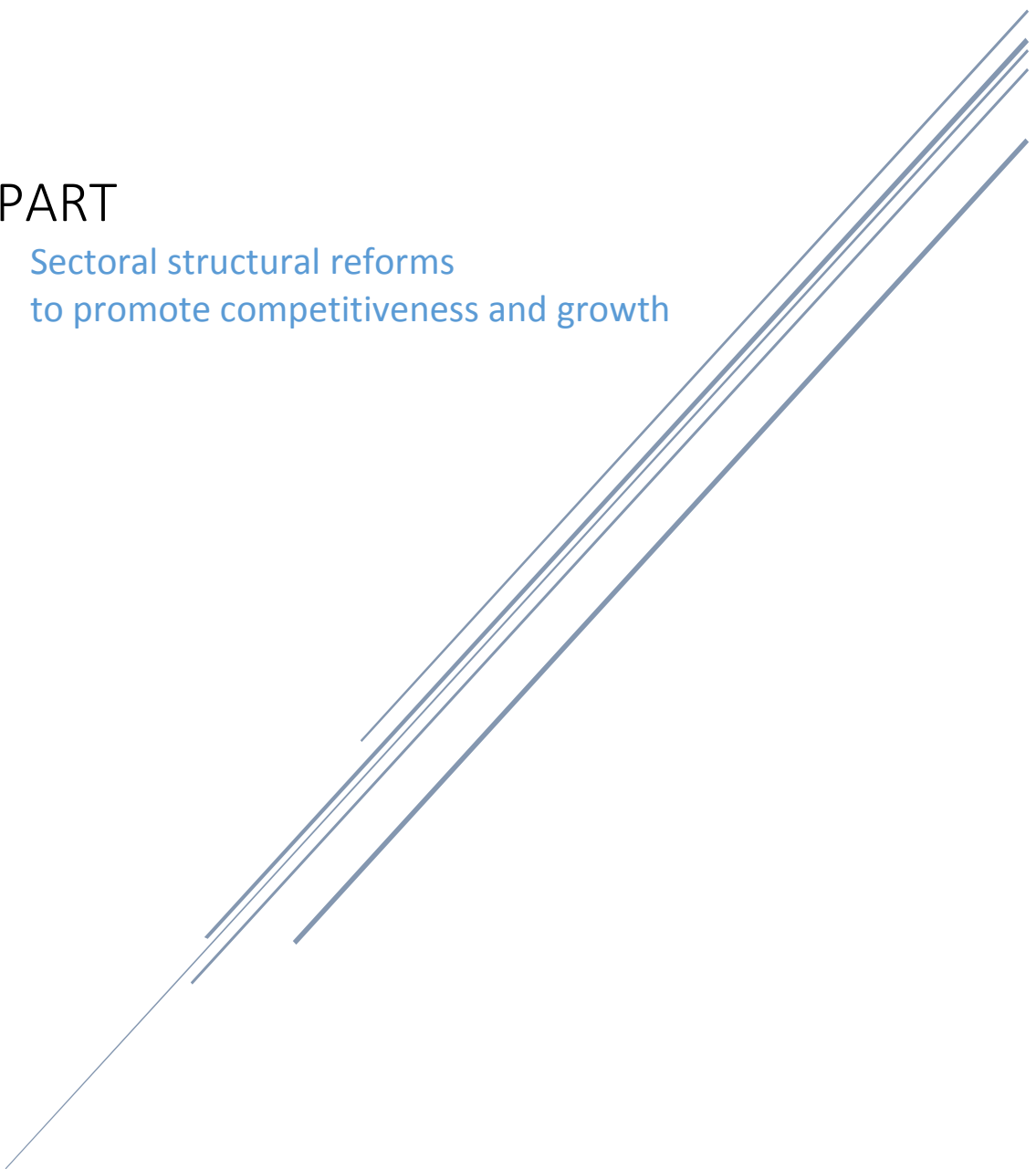
After the purchase and sale contract was concluded, the former owner of KAP, the Central European Aluminium Company (CEAC) has initiated the court proceedings. The company Uniprom has paid in 4.0 million euro and the bankruptcy administrator has extended the deadline for payment of the remaining 24.0 million euro for six months (until mid March 2015), until the court proceedings in Nicosia and before the Commercial Court in Podgorica are finalised. It is expected that the sale will be completed within that deadline.

Regardless of the assets sale process, in order to sustain the production process, precisely to prevent reduction of the bankruptcy estate and consequently to protect interest of creditors and other persons having interests linked with KAP (employees, shareholders), the bankruptcy administrator has signed a Contract on Business and Technical Cooperation with Uniprom in July 2014.

After taking over the management based on the Contract on Business and Technical Cooperation, Uniprom has commenced with certain reconstructions, while it is expected that the investments will continue even after the sale procedure is completed. At present, 533 persons are employed and the monthly production is 3,440 tons.

II PART

Sectoral structural reforms
to promote competitiveness and growth



II.1 Introduction

II.1.1 Sectoral Obstacles to Economic Growth of Montenegro

Development model of Montenegro in years following immediately upon its independence was based on the strong domestic consumption, which was enabled by high inflow of foreign accumulation, both in form of foreign direct investments as well as in the form of banking loans. The outburst of the crisis led to a national economic growth downturn. Even though an economic growth was generated in recent years, new reality in the international environment has clearly showed that the development model that existed before the economic crisis could not produce any longer the economic growth rates Montenegro recorded in the period before the start of economic crisis and which is striving to approach in the forthcoming period as well.

The crisis Montenegro has gone through in recent years has not only reflected on the reduction of its economic growth outturn, but also on reduction of its long-term potential growth. Key challenge for the country, like is the case in all other neighbouring countries as well, is the issue on how to regain higher economic growth rates, or how to remove again those key obstacles hampering the country's more prominent development of potentials for faster economic growth.

The Chapter 4.1 of Part I of the Montenegro Economic Reform Programme for 2015-2017 (ERP) provides a detailed overview of those constraints to the economic growth of Montenegro having horizontal nature. These primarily refer to obstacles in the area of public finance and financial sector. Moreover, the economy is facing also a series of constraints which could be classified as sectoral obstacles. Those are chiefly obstacles arising from relatively narrow economic structure of Montenegro, as well from the existing characteristics of the human capital and physical infrastructure.

A systemic expansion of the production and export base of the economy needs to take place in order for Montenegro to take a long-term stable economic growth path in the forthcoming period. Export of goods, especially if metals are excluded, has rather low share in the national GDP and is considerably lower if compared to many more developed small countries. Thus there is pronounced need in Montenegro for production diversification of the economy. The World Bank analysis (Country Economic Memorandum, 2013) confirms that the potentials for growth of the Montenegrin export of metals and consequently of revenues generated from this segment, are rather limited. It further indicates that even though there is room for diversification of production in some areas – clear example being the agro industry and its connection with the tourism sector – their potential in terms of revenue increase is relatively limited.

The human potential quality is the key element to enunciate competitive advantages of Montenegro in the forthcoming period. The existing education system is still to a certain degree steered towards employment in the public sector. In order for the country to continue on the path of diversification of economy and export expansion, further changes will be needed, both in the very education system but also among the students' or pupils' preferences. Montenegro requires in the next period added strengthening of the human resources potential, not only at the level of human resources with university education, but also at the level of various vocational-crafts profiles.

In order to reduce differences in development among specific regions of the country and in order to improve its connectivity with neighbouring countries and the EU, Montenegro should considerably improve its physical infrastructure as well, chiefly in the transport and energy sectors. Construction of the new transport infrastructure, especially the highway connecting the Coastal Region of Montenegro with the North is of the key relevance to invigorate cohesion of the country. Good quality transport connectivity with the North of the country is a prerequisite for faster development of this region,

particularly in the areas of tourism and agriculture, and thus the increase of economic growth of the entire country.

Montenegro has notable, but insufficiently utilised, potentials in the energy sector. New investments, both in electricity generation facilities and in good quality facilities for electricity transmission to the Western Europe and regional electricity market, will contribute to its full utilisation.

Active use of information and communication technologies is of utmost importance for a small country like Montenegro. ICT could bring a substantial contribution in cementing the competitive capacities of the country, improving the investment climate and bolstering the innovation potentials of the country. The World Bank analysis mentioned above, points out that the investments in infrastructure of information and communication technologies and related human resources profiles have large potential in terms of invigorating the economic growth and creating high quality jobs.

II.1.2 Montenegro Sectoral Structural Reforms Priorities based on its Strategic Documents and dialogue with the EU

Montenegro has defined its strategic objectives in the area of economic development for the next medium-term period in two core documents. First – **Development Directions of Montenegro for the Period 2013-2016 (MDD)** – is the Government's document having the objective to enable consolidation of the medium-term investment and development plan, which will propel the realisation of development priority which would encourage economic growth in the country. The PRCG has identified tourism, energy, industry, agriculture and rural development as priority sectors of Montenegro development. Primary objective of the second strategic document – **South East Europe Development Strategy by 2020 and action plan for its realisation** – is to reach high and sustainable economic growth, and by doing so to purport higher economic growth in the region, increase prosperity and create new jobs, all by heightening regional cooperation and link with the EU. The Strategy is clearly oriented towards improvement of the South East Europe competitiveness and defines a holistic development pattern for the region, while striving to stimulate key long-term growth factors: innovation, skills and higher trade in goods in the region. Apart from these two strategic documents, there is also a series of sectoral strategies linked to these two umbrella documents.

Save for sectoral priorities of Montenegro contained in its strategic documents, EU documents are key inputs for defining the priorities in this segment of the National Economic Reform Programme (ERP). Out of them, the especially important are the **Conclusions of the Joint Ministerial dialogue of May 2014, the European Commission's Montenegro Progress Report for 2014, and the IPA: Indicative Strategy Paper for Montenegro 2014-2020**. These three documents provide a set of assessment on the present state of the Montenegro's economy. In terms of those documents, a special focus should be placed on the assessments of the European partners about obstacles to development Montenegro is facing and recommendations for their removal, precisely on how to create conditions for increasing international competitiveness and by doing so for a faster economic growth.

II.2 Macroeconomic context and scenario

II.2.1 Main Characteristics of the Macroeconomic Scenario for the Period 2015 – 2017

This chapter provides an overview of macroeconomic projections for the period 2015-2017, which is presented in details in the sub-chapter II.2.2 of the ERP, but also includes the effects of structural reforms, both those in the macroeconomic sphere (see chapter I.4 of Part I of the ERP) and those of sectoral nature (see Chapter III of this Part of ERP). The latter one refers principally to envisaged loans to small and medium-sized enterprises (SMEs), growth of investments and increase of export of goods and services (which will be supported by envisaged measures in the area of energy, tourism, encouraging investments, SMEs development, etc).

The following table provides a selection of several core data on the macroeconomic projections of Montenegro for the period 2015-2017, while the complete table is contained in the sub-chapter I.2.2 of the Part I of ERP. As presented in the said table, even though a notable national economic growth is envisaged due to investments in the years to come, it will be accompanied with much slower growth of employment, thus the issue of further unemployment reduction will continue to remain one of the key economic issues of the country that should be under a special lens.

Table 18 Macroeconomic projections 2015 - 2017

Montenegro: Macroeconomic projections, 2015-17					
	2013	2014	2015	2016	2017
Nominal GDP in million €	3.327	3.393	3.547	3.737	3.964
Nominal growth	5,7	2,0	4,5	5,4	6,1
Real growth	3,3	2,0	3,5	3,8	4,0
Inflation (at year-end)	2,2	-0,5	1,0	1,5	2,0
			(u % BDP-a)		
Core items:					
Current account deficit	-14,6	-14,2	-13,3	-13,8	-14,6
Export	41,8	41,1	41,3	41,2	40,8
Import	62,1	60,4	59,5	59,7	59,9
Other	5,7	5,1	4,9	4,7	4,4
Household consumption	80,6	80,3	78,8	77,9	77,0
Gross investments	18,1	19,2	20,1	21,7	23,6
Governments spending	21,6	19,7	19,3	18,9	18,5
GDP deflator	2,2	0,0	1,0	1,5	2,0
			(realne stope rasta %)		
Real GDP growth	3,3	2,0	3,5	3,8	4,0
Domestic demand	2,9	1,1	2,6	4,0	4,5
Household consumption	0,8	0,5	1,6	2,6	2,7
Gross investments	0,3	3,5	8,0	12,1	13,3
Governments spending	-4,9	1,5	1,3	1,5	1,8
Export	-2,1	0,4	4,0	3,5	3,1
Import	-6,8	-0,7	2,0	4,0	4,4
			100,0 godišnji rast u % ako nije drugačije naznačeno)		
Core assumptions:					
Employment growth	3,0	0,8	1,5	1,2	0,8
Unemployment (LFS)	19,5	19,4	18,2	17,6	17,2

FDI % GDP	9,7	10,7	11,6	14,7	13,9
Domestic loans (corporate)	5,0	1,7	3,9	4,6	5,2
Export growth	0,1	0,4	5,0	5,0	5,2
Import growth	-4,7	-0,8	3,0	5,6	6,5

Source: Ministry of Finance of Montenegro

II.2.2 Connectivity and Interdependency of Structural Reforms at Macro and Sectoral Level

Presently there is no uniform methodology that would comprehensively analyse obstacles to economic growth of the country. However, by using various methodologies, ranging from macro-economic and fiscal analysis, through institutional and sectoral analysis, up to the micro-economic analysis based on the behavioural analysis of some legal entities and households, these obstacles may be divided into two core groups. One group is made of macro-economic obstacles, such as those in the field of public finances and financial systems, and other horizontal obstacles as for example obstacles in the labour market area and business environment area. Second group of obstacles are more of sectoral or microeconomic nature. Both groups of obstacles are tightly intertwined, which sometimes makes it difficult or even preventing their classification in one or another group. Furthermore, in terms of the methodology it is not quite clear, in the first place, how to decide what is an obstacle to development, and second how to quantify the “strength” of such obstacle. Every country has numerous disruptive factors to faster economic growth, but only some of them are a serious obstacle to economic growth. Their reduction or even elimination would have a strong positive effect on the economic activity of the country. Moreover, reduction/elimination of obstacles to growth has also a time dimension. While the reduction/elimination of certain type of obstacles is essential to faster achieving higher economic growth rates, reduction/elimination of some other may have positive effect on the economic growth only over a medium-term or even a long-term.

Sub-chapters I.4.1 and I.4.2 of the Part I of ERP present structural reforms having a macro-fiscal effect and define key obstacles to growth and increase of competitiveness at the macro-fiscal level, while this part of ERP discusses sectoral reform measures more of a micro-economic or sectoral character, which also have as an objective to remove obstacles to economic growth. As already noted, sometimes it is not possible to make a precise distinction between them. In such context, the case of the highway construction is a typical example. Even though this is undoubtedly a sectoral project, it also has rather important macro-economic implications. Similar situation is with some reform measures in the area of improving the business environment.

II.3 Sector Reform Measures Implemented and Planned in view of Achieving Economic Policy Objectives 2014-2017

This section consists of seven sub-sections, where the first two are of methodological nature and they provide information regarding the selection process of priority measures through which, in the coming period, the Government of Montenegro will pursue reduction or elimination of the most significant obstacles to strengthening its international competitiveness and thus create conditions for higher economic growth. The structure of the remaining five sub-sections is integrated and they are essential sub-sections relating to the main economic policy sector measures in the areas of physical capital, human capital, better industrial structures, business environment and trade integration.

II.3.1 Selection of priority sector reforms/measures

Phase 1: Articulation of priority sectors i.e. topical units for the National Economic Reform Program 2015-2017

Based on national strategic documents (section II.1.1.) and taking into account positions, conclusions and recommendations included in EU documents (section II.1.2), at the meeting held on 20 November 2014, the Government of Montenegro established the proposal of the following eight sectors i.e. topical units with priority status in the preparation of the second part of ERP 2015: 1. **Transport Policy**, 2. **SME Growth and Development (access to financing, clusters, regional connectivity)**, 3. **Employment and Structural Unemployment**, 4. **Business Environment (“regulatory guillotine”)**, 5. **Strengthening External Position of the Country (strengthening export capacities, FDI promotion, trade integration)**, 6. **Spatial Planning and Protection Policy**, 7. **Rural Infrastructure Development**, and 8. **Electronic Service Development (radio-broadcasting digitalisation)**.

Phase 2: Selection of sector priority measures

The basic goal of this phase is to determine how to select economic policy measures through the application of which Montenegro would efficiently respond to sector issues that are in national and EU documents identified as the key for improvement of international competitiveness of the country. It is about how to: (i) *solve the problem of structural disbalance in the labour market (high unemployment of the youth and long-term unemployment)*, (ii) *improve research and innovation for the purpose of development as to strengthen competitiveness of domestic companies*, (iii) *make business environment simple and predictable through further efforts in fighting corruption*, (iv) *strengthen external position of the country through fostering export capacities and integration of Montenegrin business into the joint market*, (v) *build infrastructure to support expansion of economic growth*.

Given that the ERP preparation guidelines require the document to focus on narrow selection of sector measures²¹ for encouraging economic growth, the ERP top priority measures have been determined based on it. The following criteria have been used for selection of priority measures: (i) priority measure is a response to one or several significant obstacles to faster economic growth of Montenegro identified either within the ERP preparation, relevant EU documents or documents by some other organisations,

²¹ Although the European Commission Guidelines do not specify clearly what is implied by the term »measure«, from the document it can still be understood that it implies a specific economic policy measure (investment, administrative measure, legal measure, program including a combination of several measures i.e. package of measures) – which has a committed way of implementation and the time horizon. So, the measure may not be a sector strategy/action plan as a whole, but some of the specific measures significant for implementation of such strategy/action plan.

for example the World Bank, (ii) priority measure should have direct impact on improvement of international competitiveness of Montenegro, (iii) priority measures should be selected in a way that from each of the five segments identified in the European Commission (EC) Guidelines at least one measure is selected, and (iv) priority measures should be selected in a way that from each of the eight sectors i.e. topical units set by the Government as priority for ERP at least one measure is selected.

The following Table on one side shows how the priority measures selected by the Government in the context of ERP preparation are included in the structure envisaged in the European Commission Guidelines for preparation of the subject document, and on the other side how such priority measures correspond, i.e. respond to assessments or recommendations given in the EU documents.

Table 19 Link between priority measures selected for ERP preparation and relevant European documents

Segments according to the EC ERP Preparation Guidelines	Priority measures selected in the context of ERP preparation	EU relevant assessment or recommendation
Physical capital	Priority measure no. 1: Construction of the high-way Bar-Boljare - priority section Smokovac-Matešev	- <i>Build infrastructure to support extensive economy growth</i> - Progress report p. 35, Chapter 14 (“Montenegro must ensure better investments in all transport areas and further harmonisation with the EU safety standards and inter-operability”.)
	Priority measure no. 2: Preparation of spatial-planning documents for the Adriatic-Ionic High-Way.	Progress Report p.24 (“Economy is going under the transformation process, service and energy sectors are strengthened, while older activities such as metallurgy and transport are under restructuring”).
	Priority measure no. 3: Railway network modernisation.	- Progress Report p. 37, Chapter 15 (“Preparations for adjustment to the third energy package should be accelerated. Legislation regarding mandatory oil reserves and Action Plan on renewable energy sources has not been adopted yet”.)
	Priority measure no. 4: Execution of the project of undersea cable connecting energy systems of Montenegro and Italy	- Progress Report, p. 69, Chapter 27 (“Strategic planning, significant investments and substance-related further efforts are required in order to ensure the harmonisation with the EU Acquis and the implementation of the Acquis in the area of the environment and climate change.”)
	Priority measure no. 5: Utility infrastructure enhancement	- Progress Report p.33, Chapter 11 (“Development Strategy for development of agriculture and rural areas should be adopted and capacities should be additionally strengthened to ensure future implementation of IPARD program and develop overall capacities for implementation of a joint agriculture policy.”)
	Priority measure no. 6: Construction and reconstruction of infrastructure in rural areas (water supply systems and road infrastructure).	
Human capital	Priority measure no. 7: Enrolment policy reform at university education institutions	Progress Report for 2014, p 22 Human and physical capital availability (“it is necessary to make additional efforts in the area of research, development and innovations in order to foster competitiveness of domestic business organisations, as well as efforts to build the required infrastructure to support sustainable expanding of economy. Implementation of education reform in order to decrease skills gap, strengthening of active labour market policies, as well as introduction of higher flexibility in the labour market through special collective agreements for public and private sectors are essential for reduction of unemployment.”) and Chapter 19 area of employment policies p. 41
	Priority measure no. 8: Program of Professional Training of Persons with Acquired Higher Education	
	Priority measure no. 9: Construction of Innovation – Entrepreneur Centre Tehnopolis in Nikšić	
Better industrial structures	Priority measure no. 10: Financial support to the SME sector	- P. 23 – Public sector support schemes to small and medium-sized enterprises are still limited
	Priority measure no.11 Enhancement of institutional and administrative capacities for SME support	P. 33- Administrative capacities and support measures should be strengthened to efficiently use programs of financial and non-financial support to SME.
	Priority measure no. 12: Enhancement of tourist offer in the north of Montenegro through construction of required infrastructure in ski resorts	- Progress Report p. 42- Limited progress has been achieved in the area of entrepreneurship and industrial policy.
Good business environment	Priority measure no. 13: Strengthening institutional framework for execution of contracts	Progress Report p. 21 (“Simpler and more predictable regulation of business and further efforts to suppress corruption are required for improvement of business environment”).

Priority measure no. 14: Improving the process of issuing building permits through upgrade of the existing ICT solutions

Priority measure no. 15: Online availability of public services and implementation of information system for exchange of data from registries of state authorities'

Trade integration	<p>Priority measure no. 16: Increase of competitiveness of business organisations through harmonisation with the requirements of international standards and quality improvement</p> <p>Priority measure no. 17: Promotion of agricultural-food products: project EXPO 2015</p> <p>Priority measure no. 18: Improvement of institutional framework for the promotion and encouraging investments with the emphasis on manufacturing industry.</p>	Progress Report p. 24 (Strengthening of external position of the country through export capacities strengthening and integration of Montenegrin business into a joint market)
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Source: Ministry of Economy

II.3.2 Uniform structure of texts in the following sections

In line with the EC Guidelines, this Section will be organised into 5 segments – Physical Capital, Human Capital, Better Industrial Structures, Better Business Environment and Trade Integration – where each of these segments will be the subject of one of the following 5 sub-sections. Each of the mentioned sub-sections will have the following basic structure:

- Core problems – economic growth obstacles
- Core objectives
- Economic policy measures aimed at achieving the set objectives
- »Priority measures« (presented in a uniform methodological manner).

II.3.2.1 Physical capital

»Physical Capital« Basic Problems / Economic Growth Obstacles

Good physical infrastructure is a precondition for fast economic growth and country development. Not only that it facilitates physical connectivity between its citizens living in different areas but also is a precondition for various forms of international cooperation. In addition, high-quality physical infrastructure strengthens country attractiveness as a tourist destination, a location of interest for foreign investors and a location for ICT business implementation. Understandably, weaknesses in physical infrastructure simultaneously imply obstacles on the way to faster economic growth.

Transport: Montenegro is facing objective problems on the road to qualitative transport infrastructure. Its topography by itself is a major financial challenge not only for new investments, but also for infrastructure maintenance, primarily in the areas of road and railway transport. Insufficiently developed transport infrastructure results in inadequate quality of transport services, relatively high maintenance costs, inadequate level of traffic safety, which consequently has adverse impact on economic growth. In addition, inadequate transport infrastructure is one of the key factors causing regional differences in Montenegro, as well as difficulties to active inclusion of the country in the

economic flows of the region. Air connectivity is limited, particularly out of season, and that has significant impact on competitiveness of Montenegrin tourism.

Energy: Insufficient connectivity of energy system of Montenegro with energy systems of the countries from the region and the EU have adverse effects on security of supplying buyers in Montenegro, possibility of export of available surplus electricity and participation in the regional and EU market. It is one of the reasons why hydro potential, the main energy resource in Montenegro, may not be sufficiently exploited in commercial terms or contribute more to economic development of the country. In this segment of physical infrastructure the country also encounters some other challenges such as insufficient investing in the current energy capacities, big electricity transmission and distribution losses and high power intensity. All the mentioned points out the necessity for higher investments in the energy sector of Montenegro.

Utility infrastructure: Due to standing inadequate utility infrastructure management and insufficient investments in its construction and reconstruction (particularly in the areas of water supply and waste and waste water management) for a longer period of time, the equipment and installations have become dilapidated and obsolete in technological terms. Such relation towards the utility equipment and infrastructure has resulted in lower quality of services and higher costs of performance of the activities. In the last several years, the activities of the Government of Montenegro related to providing technical and financial support from international financial institutions to municipalities, have facilitated the condition in these areas to start changing for the better.

The following segment of physical infrastructure where Montenegro, similarly to other neighbouring countries, is facing significant problems is rural infrastructure. Question is about the utility infrastructure, i.e. local roads, water and electricity supply, sewage and water purification and waste management. Although these problems are present in all parts of the country, they are still the most distinct in rural areas.

»Physical Capital« Basic Objectives

Transport: Development of an efficient transport system is one of the key conditions for achievement of better competitiveness and social-economic development. The basic objective of transport development according to the Montenegro Development Directions 2013-2016 (MDD) is "high quality and efficient transport, increased efficiency and mobility of transport, qualitative development of transport infrastructure, improvement of environmental protection, enhancement of transport safety of goods and people". This objective is fully compliant to the objective set in the Montenegro Transport Development Strategy, as well as the objectives of the SEE 2020 Development Strategy. According to the MDD 2013-2016, together with some other activities, transport is a precondition for growth and development, so it is a sector that will require significant investments financed from both public and private sources.

Energy: According to the Montenegro Development Directions 2013-2016, in addition to tourism, industry and agriculture, energy is one of the basic driving forces of future economic growth and development. As the main objectives in the energy area this document envisages: ensuring security in electricity supply, development of competitive energy market and sustainable energy development, grounded on accelerated but rational exploitation of own energy resources with observance of environmental protection principles, increased energy efficiency and use of renewable energy sources to a greater extent. Energy development is of special significance for increase of competitiveness and export capability of Montenegrin economy.

Utility infrastructure: The level of utility infrastructure equipment capabilities of cities and settlements, particularly in the areas of water supply and waste and waste water management, is one of the prerequisites for comprehensive implementation of relevant laws and regulations that have been harmonised with the corresponding EU Acquis pieces which gives contribution required for efficient

integration process of Montenegro in the community of European countries. According to the MDD 2013-2016, the construction of the waste water purification plants, the reconstruction of the current water supply systems, construction of sanitary landfills and other infrastructure for managing both communal and hazardous waste, as well as adequate functioning and maintaining these capacities, contribute to increased quality of utility service provision, and therefore competitiveness of different areas of the country. According to the MDD 2013-2016, the construction of waste water purification plants, reconstruction of the existing water supply plants, construction of sanitary landfills and other infrastructure for management of communal and hazard waste, as well as adequate functioning and maintaining of such capacities, contribute to increased competitiveness of different areas of the country.

In regards to the utility infrastructure in rural areas, through a well-designed rural development policy the rural area may provide good quality of life and work, where young people will see their opportunities to carry out agricultural and related activities or even activities from other sectors. This would enable the reduction in the village depopulation trend to a great extent. In that sense, the construction of water supply and other infrastructure in rural areas has big significance.

Economic policy measures aimed at achieving objectives set in the segment “Physical Capital”

Transport: The achievement of the transport sector objectives set in the Montenegro Development Directions 2013 – 2016 and other strategic documents is planned through application of different sets of economic policy measures. The most important one is the **construction of road infrastructure with accent on highways connecting Montenegro to neighbouring countries**. The first among them is the Bar – Boljare highway that is to connect Montenegro with Serbia and further to the European corridor no. X. The construction of the first section of this high-way Smokovac – Uvač - Mateševo should commence in 2015 and it is one of the priority measures of this ERP, through which the country strives to increase its international competitiveness and economic growth (**priority measure no. 1: Construction of the Bar – Boljare High-Way, section Smokovac – Mateševo**, detailed below). The second priority infrastructure project in the road sector infrastructure is the construction of the Montenegrin section Adriatic – Ionic high-way, but its implementation has not been specified yet in terms of timing. The preparation of spatial-planning documents for this high-way is of special significance for further activities on the construction commencement of this exceptionally important infrastructure project (**priority measure 2: Preparation of spatial-planning documents for Adriatic-Ionic High-Way**, detailed below).

Another set of measures in the area of road infrastructure construction is included in the **Bottleneck Resolution Program**, which envisages that in 2015 activities are to continue on implementation of the project of constructing by-passes around cities as follows: Golubovci phase 2 - Podgorica, Boulevard Bečići-Budva and Rožaje phase 2 and projects that are in the stage of preparation for the development of technical documentation for by-passes: Herceg Novi, Budva, Bar.

An important measure in execution of the strategy in the road area is also the *Arterial and Regional Roads Reconstruction Program*. It envisages reconstruction at nine locations on arterial and regional roads in Montenegro, as well as six locations related to the new arterial roads reconstruction and rehabilitation program for the purpose of better connecting of specific under-developed areas to the main arterial roads and tourist centres and access roads leading towards the border crossings to Kosovo, Albania and Bosnia and Herzegovina. The reconstruction financing is envisaged from the budgetary funds, as well as the loan from the European Bank for Reconstruction and Development (EBRD) and the European Investment Bank (EIB) specifically for projects that are already in the procedure with these banks. The new program envisages reconstruction and rehabilitation of arterial roads in the length of around 100 km at 16 locations that will be executed in the period 2015 – 2017. In 2015, after the project documents have been completed the works are planned to commence at 6 locations.

Moreover, further construction/reconstruction of road infrastructure will be executed through the *Program of reconstruction of several intersections on regional and arterial roads* in Montenegro as a

measure aimed at eliminating bottlenecks. In 2015, the intersection in Sutomore and intersection on the road Bar – Ulcinj at the turning point towards Bar hospital will be reconstructed.

The fifth set of measures included in the *Program of Investment coating of regional and arterial roads* envisages that every year 40 to 50km of regional and arterial roads should be coated. The budget 2015 envisages 2,500,000.00 euro for this purpose.

In addition to the very construction and modernisation of the road infrastructure, Montenegro also plans specific measures directed at **improvement of traffic safety and environmental protection**. The key implementation elements of these measures include adoption and implementation of two rulebooks. The first one is the Rulebook on detailed conditions and method of taking exam to verify knowledge acquired during training and additional training, amount of costs of taking the exam to verify knowledge regarding regulations from the area of road traffic, training and additional training, the form and contents of the professional driver license and certificate of passed verification knowledge exam. By the middle of 2015 the procedure of announcing public invitation for selection of a legal entity to provide training for professional drivers will be completed, and professional driver licenses are planned to be issued starting from 1 January 2016. The other rulebook is the *Rulebook on technical requirements for imported vehicles or vehicles for the first time placed on the market in Montenegro*. The adoption of the rulebook is envisaged for the first quarter of 2015, and its implementation by the end of the same year. Budgetary funds that are required for implementation of these rulebooks cannot be fully estimated at this stage. The effects of the rulebook introduction will be measurable after the legal entities in respect of both rulebooks have been selected, which will create conditions for implementation of the mentioned set of measures. In the medium term the effect will reflect on the fact that the country will have significant revenues in respect of training of drivers and issuance of professional drivers' licenses, as well as issuance of vehicle type certificates and confirmations for homologation of individual vehicles.

In the area of railway transport, the key measure is the continuation of the process of railway infrastructure modernisation (**priority measure no. 3: Railway network modernisation** is detailed below). Investing in network modernisation would make the railway transport become an increasingly attractive alternative to road transport, not only from the aspect of economic efficiency but also from the aspect of safety and achieving environmental area objectives. In this context, it is necessary to improve railway transport capacities through multi-modal maritime-railway transportation.

Measures in the area of **air transport infrastructure construction and reconstruction** should contribute to greater efficiency and safety in air transport and improvement of flow of passengers and quality of their servicing. All this directly serves to increase competitiveness particularly in the area of tourism. According to the Montenegro Airports Development Master Plan, these measures will be implemented in the period by the end of 2017 through: (i) expanding and reconstructing operating areas at the airports Podgorica and Tivat, then (ii) constructing new terminal building at the airport Tivat with supporting infrastructure. In the last 12 months, the implementation of the measure related to examination of the condition of operating areas and platforms at both airports. The obtained findings make the baseline for development of technical documents for this project. The funds for implementation of these projects in the total amount of around € 40 million have not been provided so far, but negotiations with EBRD are in the process in view of determining loan approving conditions.

In the area of maritime transport, as a significant set of measures identified, is the **Regulation on navigation safety, human life protection and environmental protection at sea**. These measures will be implemented through two key elements during the period 2015 – 2017. The first one is the adoption of laws and enabling regulations from the area of maritime transport in view of harmonising with the EU Acquis and international maritime organisation standards and recommendations, and the other one is investing in the seawall in Port of Bar. Based on the Concession Contract, AD "Kontejnerski Terminal and Generalni Tereti Bar" are obliged to invest around € 2 million in the seawall in Port of Bar during the period 2014-2017.

Energy: Montenegro Energy Development Strategy until 2030 has been developed for the purpose of long-term planning of energy development. Implementation of this Strategy for the period 2015 – 2020 includes measures that can be classified into four sets:

The first set of measures includes **establishing a legal-regulatory framework harmonised with the relevant EU directives, through adoption of laws and enabling regulations**. Within this set of measures the Draft Energy Law has been prepared, which will transpose the EU third energy package directives, Directive 2009/28/EC on renewable energy sources, Directive 2005/89/EC on security of electricity supply and a part of Directive 2012/27/EU on energy efficiency in power generation, transmission and distribution. Adoption of the Energy Law is planned by the end 2015. Draft Action Plan for securing mandatory oil derivatives reserves has been prepared, and its adoption is expected in the first quarter 2015. The Law on mandatory oil and/or oil derivatives reserves and the Law on transmission systems for cross border exchange of electricity and natural gas are envisaged to be adopted by the end 2015. National Action Plan for exploitation of energy from renewable sources until 2020 and Action Plan for energy efficiency for the period 2013-2016 have been adopted, and their implementation is in process now.

The second set of measures includes **institutional framework enhancement through establishment of a central authority to manage mandatory oil derivatives reserves and strengthen capacities of the current institutions**. Establishing of the Central Authority for mandatory oil derivatives reserves is the basic precondition for resolution of this issue. This Authority will be initially established within the Ministry of Economy, as a separate department within the Energy Directorate, while subsequently it is planned to be strengthened and potentially become a separate institution. The first task of the Central Authority will be to prepare the Law on mandatory oil reserves, and amend the current legislation on the needs of providing the reserves. Thereafter, the Authority will work on the preparation of all procedures that include data gathering, reserve planning, tender procedures etc. and their implementation.

The core of the third set of measures includes **adoption and implementation of action plans**. Adoption of the Action Plan implementing Five-Year Energy Development Strategy is envisaged by the end 2015. The adoption of the National Action Plan for development and use of remote heating and/or cooling and high-efficient cogeneration is envisaged by the end 2017. The Action Plan for providing mandatory oil derivatives reserves has been submitted to the EC for opinion and its adoption is expected in the first quarter 2015. National Action Plans for energy efficiency are adopted for the period of three years and the next one will be adopted in the second quarter 2016 for the period 2016-2018.

Finally, the fourth set of measures includes investments in rehabilitation and construction of new facilities for power generation, transmission and distribution, as well as investing into programs and projects of increased energy efficiency. While some energy investment projects are already in process, like the projects of construction of small hydro power plants and windmills and projects of increased energy efficiency, other large and for Montenegrin economy very significant projects in the area of power generation and transmission are in various stages of preparation. These projects include the construction of the Unit 2 of the Thermal Power Plant Pljevlja, the Ionic-Adriatic Gas Pipeline and Undersea cable to connect energy systems of Montenegro and Italy.

Execution of the projects of construction of small hydro power plants, windmills and Unit 2 of the TPP Pljevlja is planned in view of better exploiting available energy potentials, increased electricity generation and security of supply, as well as increased competitiveness and export capability of Montenegrin economy. The significance of these projects is substantially affected in positive way by the project of construction of the undersea cable to connect energy systems of Montenegro and Italy. Accordingly, as priority measure aimed at elimination of obstacles to increased competitiveness of Montenegrin economy specified is the investment in the construction of undersea cable between Montenegro and Italy (**priority measure no. 4: Execution of the project of connecting energy systems of Montenegro and Italy by an undersea cable**, detailed below).

Utility infrastructure : For the purpose of long-term planning of utility infrastructure development and creating conditions for implementation of EU Directives in the area of waste and waste water management, which have become known as “heavy directives” because of their demanding financial requirements, strategic planning documents have been produced that specify investment activities in all the municipalities in Montenegro until 2029. A large number of infrastructure projects has been and is implemented in accordance with these planning documents.

Utility infrastructure construction is mostly financed from the loans from international financial institutions such as KfW Bank, European Investment Bank, European Bank for Reconstruction and Development, the World Bank and other, with which several loan facilities have been arranged in the previous period. A large portion of funds has been provided from the EU funds and the State and local self-government budgets.

In cooperation with the KfW Bank, since 2004 the project “Enhancement of water supply and waste water drainage on the Adriatic Coast” has been implemented on the Montenegrin Coast, for which this Bank has provided €99 million loan facility and a grant in the amount exceeding 20 million within five phases. The project “Waters and Sewage in Montenegro” is implemented in the Central and Northern region with the support of the European Investment Bank, for which this Bank has provided €57 million, as well as the project “Solid Waste in Montenegro” for which the loan in the amount of €27 million has been provided.

One of the key activities within the project “Enhancement of water supply and waste water drainage on the Adriatic Coast”, phase 3, is the project “Construction of water supply and sewage network and waste water purification plants in Herceg Novi Municipality”, and within the project “Waters and Sewage in Montenegro” the project “Construction of waste water purification plant in Nikšić” as projects whose completion should contribute to utility infrastructure enhancement in Montenegro in 2015 as support to increased competitiveness (**priority measure no. 5: Utility Infrastructure Enhancement**).

Inadequate or non-existent infrastructure is an important feature of rural areas in Montenegro, particularly in distant mountain areas. In order to prevent depopulation, exploit available natural resources in view of general improvement of conditions of living for rural population and increasing their competitiveness, Montenegro strives to implement the program of improved road, water supply and electricity infrastructure in rural areas of the country. Reconstruction and construction of rural infrastructure is primarily financed from the budget under the program “Rural rehabilitation and development and infrastructure construction”. Specific projects are implemented in cooperation with local self-governments and inhabitants of the areas to which investments are related. Municipalities submit priority lists to the Ministry of Agriculture and Rural Development (MARD), which are based on criteria (project value, number of agriculture households with number of agriculture population, number of heads of cattle, planted areas, number of katuns (summer mountain pastures) and number of farmers coming to the katuns, ranked with an additional requirement that they submit reports on the MARD funded investments executed in the previous year, if any, and thus allocating the support. Investments are executed with the assistance of the funds from the MARD, local self-government and participation of applying local communities. The program of supplying electricity to katuns is implemented through Public Invitations announced by the MARD and funded by the Ministry of Economy.

The Program “Rural rehabilitation and development and infrastructure construction” has been implemented for many years and will continue to be implemented in the coming period according to the established procedure. One of the key projects to be executed in the coming period is presented in the continuation of this section (**priority measure no. 6: Construction and reconstruction of infrastructure in rural areas (water supply systems and road infrastructure)**). The possibility of using the International Fund for Agriculture Development (IFAD), which is a part of the UN system to be expected in 2015, will partly condition the change of implementation methodology but with the same result, i.e. rural infrastructure improvement.

Physical Capital Priority Measures

The segment “Physical capital”, in the selection process represented in sub-section 3.1 of this section identifies 6 “priority measures”, those being : 1) Construction of the High-Way Bar-Boljare - priority section Smokovac-Mateševo; 2) Preparation of the spatial planning documentation for the Adriatic-Ionian Highway; 3) Railway network modernisation; 4) Execution of the project of connecting energy systems of Montenegro and Italy by an undersea cable; 5) Enhancing the utility infrastructure; 6) Construction and reconstruction of infrastructure in rural areas (water supply systems and road infrastructure).

Priority measure no. 1: Construction of the High-Way Bar-Boljare priority section Smokovac-Mateševo

Measure description and its classification: This is an investment measure, i.e. investment in the construction of the High-Way Bar – Boljare priority section Smokovac – Uvač - Mateševo.

Contribution of the measure to the removal of obstacles to economic growth and increased competitiveness of the country: High-way Bar - Boljare (SEETO²² road direction 4) should connect Montenegro from the Adriatic Coast via the capital Podgorica with the Serbian border, and via Požega-Belgrade road to TEN-T corridor X with Romania and Central Europe. At the same time, High-way Bar – Boljare will connect the major regional centres Sarajevo (Bosnia and Herzegovina), Tirana (Albania) and Skopje (FYR Macedonia). It is the reason why this project has important strategic role for the whole Region. The high-way will also connect the Adriatic ports with the Danube ports (Corridor 7 and Corridor 10) and further with the entire network of Pan-European corridors. At the same time it will be the shortest connection between Hungary and Romania via Serbia and Montenegro with the southern Italy and Albania. The high-way Belgrade – Southern Adriatic has a wide catchment area with around 4.7 million citizens.

The High-way Bar – Boljare project is the most important priority of the Government of Montenegro and one of the elements of our integration strategy towards the European Union, which will facilitate increased and safer mobility of people, goods and services. This transport communication will fully connect the Port of Bar with the rest of European corridors, which will then be able to better meet the needs of Kosovo and Serbia, and thus contribute to the economic and political stability of the Western Balkans. The High-way Bar-Boljare project is also specified as a project, which once executed, will enable more balanced regional development of the country, exploitation of natural resources, tourism development, better transport connectivity and the overall economic development.

Measure preparation/implementation current stance supported by relevant indicators: Construction of the high-way Bar-Boljare – priority section Smokovac-Uvač-Mateševo (41km long), will be executed on the basis of inter-state agreement (“Agreement between the Government of Montenegro and the Government of the People’s Republic of China on enhancement of cooperation in infrastructure construction”). Taking into account that the subject Agreement enabled execution of large infrastructure projects only on the concession basis, it had to be amended as to enable the execution of the specific High-way Bar-Boljare project and it is exactly the highway construction project that is the subject of the Amendments to the mentioned inter-state agreement. On 26 February 2014, the Government of Montenegro, i.e. line Ministry of Transport and Maritime Affairs and China Communications Construction Company Ltd. (CCCC) and China Road and Bridge Corporation (CRBC) signed the Design and Build Contract of Bar-Boljare High-way Priority Section Smokovac-Uvač-Mateševo, and on 30 October 2014 the Government of Montenegro, i.e. line Ministry of Finance and Chinese EXIM Bank signed the Preferential Buyer Credit Loan Agreement, related to funding of execution of the subject project. The mentioned agreements have been provided to the Parliament of

²² South East Europe Transport Observatory/ <http://www.seetoint.org/>

Montenegro for informative purposes together with the Proposal Law on Bar-Boljare High-way, which has been submitted for adoption. Proposal Law on Bar-Boljare High-way regulates the following in a special way: expropriation procedure, method of development and review of technical documents, conditions for building permit issuance, conditions for performance of preparatory works, tax and customs exemptions, all for the purpose of efficient work on the construction of the mentioned high-way section. On 8 December 2014, the Parliament of Montenegro adopted the Law on Bar-Boljare High-Way which is the fulfilment of the basic precondition for commencement of the implementation of the above mentioned agreements, and the following have been published in the Official Gazette of Montenegro: the Law on Bar-Boljare High-Way, Design and Construction Agreement with CCCC/CRBC, the Preferential Buyer Credit Loan Agreement with the Chinese EXIM Bank.

Envisaged timetable for measure implementation: Design and construction of the Bar-Boljare High-way – priority section Smokovac-Uvač-Mateševo will take 48 months.

Contribution of the measure to achievement of the targets set in the South East Europe (SEE) Development Strategy 2020: Contribution of this measure to implementation of the National Action Plan for the SEE 2020 Strategy is reflected through the dimension I “Transport” within the pillar “Sustainable Growth”.

Potential/specific risks to the implementation of the measure: Risks may relate to potential amendments to the schedule and quality of performance of works, which might affect completion date and costs.

Direct and possible indirect impacts of the measure on the budget/other financing sources (IPA, loans, own funds, etc): The total value of design and construction of the Bar-Boljare High-way – priority section Smokovac-Uvač-Mateševo is €809,577,356.14 out of which €206,000,000 is projected for the year 2015. The financing structure envisages that 85% of the total project value should be funded by the loan from the Chinese Exim Bank, with whom the loan arrangement was ushered into in October 2014. The remaining 15% of the total project value will be provided through the Budget. Given that the construction of the Bar-Boljare High-way will be one of the key links in encouraging economic growth of Montenegro in the years to come, the project will have positive indirect impact on budgetary revenues.

Description of envisaged impacts and expected timing: The construction of the most difficult High-way Bar – Boljare section is the most relevant Montenegro economic policy measure for the coming medium term period. The execution of this project will create possibility for significantly easier communication between the relatively under-developed North and more developed Central and Coastal Region of Montenegro. In addition to increased internal connectivity within the country implying creation of assumptions for reduction of regional gaps, the project will also be a significant step towards better connectivity with Serbia and qualitative connectivity with the European transport corridors. All this will gain its full relevance when the Bar – Boljare High-way gets fully constructed.

Similar to all large infrastructure projects, the time horizon of the project effects is extremely long, so its economic cost-benefit analysis should be considered in that context.

Priority Measure 2: Preparation of spatial planning documents for Adriatic-Ionian Highway

Measure description and its classification: This measure is primarily related to **the adoption of the detailed spatial plan for the Adriatic-Ionian High-Way** and it is a precondition for implementation of the investment, i.e. investments in the construction of the Adriatic-Ionian High-Way section through Montenegro.

Contribution of the measure to the removal of obstacles to economic growth and increased competitiveness of the country: Adriatic-Ionian High-Way should connect Montenegro with Bosnia and Herzegovina and Croatia, and on the other side with Albania and Greece and contribute to substantially

greater integration of the Montenegrin space into and then its connectivity with regional and European road network. Therefore, this project has important strategic role for the entire region. The high-way will connect Western and Eastern Europe, and at the same time it will be the shortest land connection between the Western Europe countries and Greece and Albania. This road direction should make accessible more than has been the case so far, tourist destinations on the coast, both for the European users and local needs.

The Adriatic-Ionian High-Way is around 94.40km long on the territory of Montenegro.

The Adriatic-Ionian High-Way Project is an important priority of the Government of Montenegro and one of the elements of our European Union integration strategy, which will facilitate greater and safer mobility of people, goods and services. The Adriatic-Ionian High-Way Project is also identified as a project whose implementation will facilitate more balanced regional development of the country, exploitation of natural resources, tourism development, better transport connectivity and overall economic development.

Measure preparation/implementation current stance supported by relevant indicators:Detailed Spatial Plan for Adriatic-Ionian High-Way is currently under development in phase 1, and it is in the form of a proposal.

Envisaged timetable for measure implementation:Adoption of the Detailed Spatial Plan for Adriatic-Ionian High-Way is planned for March 2015.

Contribution of the measure to achievement of the targets set in the South East Europe (SEE) Development Strategy 2020:Contribution of this measure to the execution of the National Action Plan implementing SEE 2020 Strategy is reflected through the dimension I Transport within the pillar Sustainable Growth.

Potential/specific risks to the implementation of the measure:Risks may be related to potential amendments to the timetable for completion of the plan development, which potentially would impact the deadlines for commencement of project documents development and construction development.

Direct and possible indirect impacts of the measure on the budget/other financing sources (IPA, loans, own funds, etc):In 2015, the funds intended for completion of this measure are projected in the budget of the Ministry of Sustainable Development and Tourism and will amount to approximately EUR 14,000 in 2015, while for implementation of this measure of detailed spatial plan development the budget for 2014 paid out EUR 261,000 out of the total EUR 275,000.

Description of envisaged impacts and expected timing:Through implementation of this measure, the Ministry of Sustainable Development and Tourism intends to create preconditions for the commencement of execution of this important infrastructure project for Montenegro.

Like for any large infrastructure project, the time horizon of effects of this project is extremely long, so in this context it is necessary to consider its economic cost-benefit analysis.

Priority measure no. 3: Railway network modernisation

Measure description and classification: The mentioned priority measure is of investment nature.

Contribution of the measure to the removal of obstacles to economic development and strengthening competitive capacity of the country:In the previous years intensive activities have been undertaken on execution of the track overhaul projects, financed from the loan facilities with the EBRD, EIB, pre-accession funds, and, of course, the Budget of Montenegro. Around 40% of Vrbnica-Bar track has been overhauled so far, and it has contributed trains operating at designed speed from Vrbnica to Kolašin, and reduction of travel time and delays, and also the reconstruction of a part of signal-safety system

has been covered, as well as telecommunication equipment and replacement of a part of contact network. Within the track overhaul, two platforms in the border station Bijelo Polje have been electrified, which contributed to increased capacity of this station. In the coming period, intensive activities will be undertaken on implementation of other projects for which the funds have been provided and are related to the overhaul of track sections from Kolašin towards Podgorica, then development of designs and performance of works on rehabilitation of 16 steel bridges, rehabilitation of 5 tunnels, rehabilitation of 12 slopes, performance of works on disassembling and setting up new EVP Trebješica. At the same time, activities are undertaken on finding finances for overhaul of a part of the track for which the funds have not been provided yet. In addition, after several years, operation of traffic has been established on the completely overhauled track Podgorica-Nikšić. In addition to raising safety levels in railway traffic, the basic objective of this measure is to increase speed of operating trains, eliminating slow travels, reducing delays of trains, increasing capacity of intersecting stations, all for the purpose of increased competitiveness of railway transport and increased quality of passengers and goods carriage services. The overhaul of the track Vrbnica-Bar will significantly impact the business operations of the Port of Bar, given that this port is located at the very entrance to the Adriatic Sea and is directly connected to the railway network of Montenegro.

Measure preparation/implementation current stance supported by relevant indicators: This measure will be executed through continuation of the track overhaul from Kolašin towards Bar, rehabilitation of slides, tunnels, slopes, railway stations.

Envisaged timetable for implementation of the measure: The measure will be implemented in 2015, including continuation of specific activities in the years to follow.

Contribution of the measure to the SSE 2020 Development Strategy targets: Contribution of this measure to implementation of the SEE Strategy objectives is related to the pillar "Sustainable Growth", dimension I "Transport".

Direct and possible indirect impacts of the measure on the budget/other financing sources (IPA, loans, own funds, etc): The planned funds for implementation of programs and projects under this measure amount to EUR 12,060,000 in 2015.

Potential/specific risks to measure implementation: Potential risks are related to the possibility that not all the funds required for implementation of programs and projects will be ensured after 2015.

Description of envisaged impacts of the measure and expected timing: Effects of this measure will be measurable after the implementation of the program, implying very reconstruction or construction of railway infrastructure. In general, they will be related to increase of speed of railway traffic, and also higher flow of passengers and goods, which has multiple effects on economic business too.

Priority measure no. 4: Execution of the project of undersea cable connecting energy systems of Montenegro and Italy

Measure description and classification: The mentioned priority measure is an investment for execution of the project of undersea cable connecting energy systems of Montenegro and Italy.

Contribution of the measure to the removal of obstacles to economic development and strengthening competitive capacity of the country: Execution of the project of undersea direct current cable connecting energy systems of Montenegro and Italy is envisaged to contribute to: 1) the construction of substantially better and stronger transmission network in Montenegro; 2) the establishment of direct connection of Montenegro to the EU electricity market; 3) the positioning of Montenegro as an important energy hub in the region; 4) encouraging of investments in new electricity sources, particularly renewable energy sources. In view of integrated approach this project will contribute to increased competitiveness and will be an incentive for investments in the energy sector not only of

Montenegro but the entire region. Also, this is an extremely important infrastructure project in Montenegro, given that its execution will ensure substantially more reliable and stronger transmission network, a 400 kV network ring will be formed which is significant from the aspect of system stability, Montenegro will receive 20% of transmission capacity and cable congestion revenues, more reliable supply of electricity to the Montenegrin Coast will be ensured and the risk that transmission network may be a bottleneck for development of that part of Montenegro will be neutralised.

Measure preparation/implementation current stance supported by relevant indicators: The project of undersea direct current cable connecting energy systems of Montenegro and Italy envisages: 1) construction of an undersea direct current cable with capacity 1.000 MW between Italy and Montenegro with pertaining converting facilities (investment value exceeds €758 million and is the obligation of Terna); 2) construction of the substation 400/110/35 kV Lastva, 400 kV power line Lastva-Pljevlja and introduction of the existing 400 kV power line Podgorica-Trebinje in SS Lastva (investment value exceeds €105 million and is the obligation of the Montenegrin transmission system operator (CGES), while in some of the subsequent phases the construction of 400 kV power line towards Serbia and/or Bosnia and Herzegovina is envisaged. Taking into account that the project i.e. construction of envisaged infrastructure is implemented by CGES on the Montenegrin side, credit funds from EBRD and KfW have been provided for the project execution. International tenders have been implemented according to the EBRD rules, and with the approval of these banks, contracts have been signed with contractors for all three parts of the project, as follows: 1) SS 400/110/35 kV Lastva; 2) 400 kV power line Lastva - Pljevlja, section Lastva – Čevo; 3) 400 kV power line Lastva - Pljevlja, section Čevo - Pljevlja. Activities that are currently undertaken are: providing land required for project execution, preparation of project documents by the contractor, terrain preparation in segments where conditions have been etc. .

Envisaged timetable for implementation of the measure: Intensive activities on the project are planned in 2015 and beyond.

Contribution of the measure to the SEE 2020 Development Strategy targets: The envisaged measure is fully compliant to the key strategic objectives from the National Action Plan implementing SEE 2020 Strategy within the pillar »Sustainable Growth«, Dimension H – “Energy”.

Potential/specific risks to measure implementation: Given that an extremely complex investment project is in question, it is understandable that the project execution is conditioned by different risks. Among other things, it is a project that envisages construction of 400 kV power line with the length of around 150 km on very demanding terrain, then it envisages construction of a substation, and laying of undersea cable which is by itself an extremely complex part of the project and depending on the problems that the contractors encounter during the execution, there is a risk of delay and effects on the project implementation schedule.

Direct and possible indirect impacts of the measure on the budget/other financing sources (IPA, loans, own funds, etc): The value of the part of the project implemented by CGES is approximately €105 million, while the part of the project implemented by Terna (including infrastructure facilities in Italy, undersea cable and facilities in Montenegro) is around €800 million. For implementation of its part of the project the CGES has provided credit funds from KfW (€25 million) and EBRD (€60 million), and part of the funds comes from subscription of shares by Terna from new issue in the process of capital increase, whereby Terna became the owner of 22.0889% share capital of CGES, while the state of Montenegro remains the owner of 55% of share capital. According to the plans, the funds envisaged for implementation of the project in 2015 amount to around €20 million, and subsequently they will depend on the project implementation pace. Investments in 2015 and in the coming period are related to performance of works on all three parts of the project as follows: SS 400/110/35 kV Lastva; 400 kV power line Lastva - Pljevlja, section Lastva – Čevo; 400 kV power line Lastva –Pljevlja, section Čevo-Pljevlja.

Description of envisaged impacts of the measure and expected timing: The project of undersea direct current cable connecting energy systems of Montenegro and Italy will ensure fostering of energy system in Montenegro, establishing of direct connection with the EU electricity market and positioning of Montenegro as an important energy hub in the region. Also, this project will have long-term effects on encouraging investments in the construction of generation capacities in Montenegro and creating better conditions for electricity generation, which will contribute to increased competitiveness and export capabilities of Montenegrin economy.

Priority Measure no. 5: Utility Infrastructure Enhancement

Measure description and classification: The mentioned priority measure is an investment measure, and in the focus of the measure in 2015 is the enhancement of a part of utility infrastructure, i.e. completion of the construction of water supply infrastructure (Herceg Novi) and waste water management (Herceg Novi and Nikšić).

Contribution of the measure to the removal of obstacles to economic growth and increased competitiveness of the country: Through implementation of the projects of the construction of water supply and sewage infrastructure in Herceg Novi Municipality and the waste water purification plants will contribute to systemic improvement of the system of water supply and drainage of waste waters, and thus increased quality of utility services, as well as better preservation of the environment. Increased level of utility services contributes to increased competitiveness of these areas and interest of investors to invest.

Measure preparation/implementation current stance supported by relevant indicators:(1) The Project in Herceg Novi comprises the construction of 35.3 km of water supply and sewage network, 13 pumping stations, 1 undersea discharge outlet and construction of the waste water purification plant with the capacity of 65,300 population equivalent (PE), and the project in Nikšić includes the construction of the waste water purification plant with the capacity of 103,000 PE and reconstruction and construction of the main incoming collector in the length of 1665 m. Based on the developed project documents, a contractor has been selected in the tender procedure. The works on construction of the water supply and sewage network are contracted according to the FIDIC red book, and the works on the construction of the plant according to the FIDIC yellow book. The completion of the construction works is expected by the beginning of the summer tourist season, and release of the system into operation by the end 2015.(2) The construction of the waste water purification plant in Nikšić is financed from the European Investment Bank loan as follows: €12.65 million for works, and €1.51 million for consulting services. So far, around 90% works have been completed and complete equipment has been delivered and most of which has been installed. A part of the waste water purification plant provides mechanical purification of waste waters, and it was released into operation on 18 September 2014. The waste water purification plant is planned to be fully completed by the middle of 2015.

Envisaged timetable for measure implementation: The measure is planned to be implemented by the end 2015.

Contribution of the measure to achievement of the targets set in the South East Europe (SEE) 2020 Development Strategy: Ensuring qualitative infrastructure enables achievement of the objectives specified in the SEE 2020 Strategy, and the mentioned measure is directly related to the Pillar - Sustainable Growth (Infrastructure-environment and competitiveness).

Potential/specific risks to the implementation of the measure: In the period of project implementation, the problems that might represent potential risk for its execution have been resolved. Smaller delays by the contractor are possible.

Direct and possible indirect impacts of the measure on the budget/other financing sources (IPA, loans, own funds, etc):(1) The funds required for implementation of the project in Herceg Novi amount to €29.74 million as follows: €2.38 million for consulting services (KfW Bank donation) and €27.36 million for the construction of the plants and segments of water supply and sewage network – plant construction €8.84 million and the construction of the sewage network, pumping stations, undersea outlet and water supply network in the amount of €18.52 million. Within the KfW Bank loan the funds are provided in the amount of €19.36 million. The Government of Montenegro provided €4.26 million. The funds in the amount of €3.58 million will be provided from the Municipality budget. KfW Bank donated €155,750 for the construction of the sewage and water supply network. The funds for the implementation of the measure for the project in Herceg Novi are provided from the loan and donation (for consulting services) by KfW Bank, Municipality budget and Budget of Montenegro. There remains €7.81 million loan and €3.58 million from Municipality budget to be spent in 2015. (2) funds for implementation of the project in Nikšić have been provided from the European Investment Bank loan and there remains around €1.3 million to be disbursed in 2015.

Description of envisaged impacts and expected timing:The result of this measure is the construction of two waste water purification plants and 35.3 km of water supply and sewage network. The execution of the mentioned project will affect better environmental protection in Herceg Novi and Nikšić, increased level of utility services, and in the long run increased competitiveness and encouragement of investments in the construction of new capacities.

Priority measure no. 6: Construction and reconstruction of infrastructure in rural areas (water supply systems and road infrastructure).

Measure description and classification:The mentioned measure is primarily of investment nature. The basic precondition for further rural development, prevention of depopulation and exploitation of available natural resources is the presence of qualitative infrastructure. However, poor or non-existent infrastructure is the feature of rural areas in Montenegro, particularly in distant mountain areas. Taking into account the activities directed at fostering competitiveness of agricultural producers in Montenegro it is necessary to work further on rural infrastructure improvement. Rural infrastructure support measures that are funded from the budget of the Ministry of Agriculture and Rural Development, through development and investment programs facilitate achieving of the objective, through reconstruction of the existing infrastructure and construction of the new infrastructure where necessary (local roads, water supply systems, supply of electricity using solar panels, etc.).

Contribution of the measure to the removal of obstacles to economic development and strengthening competitive capacity of the country:Providing of qualitative infrastructure in rural areas ensures achievement of the basic objective of agriculture development as specified in the Agriculture Development Strategy 2014-2020 and Montenegro Development Directions 2013-2016, which is related to ensuring adequate standard of living for rural population and increased competitiveness. Better infrastructure in rural areas would significantly improve the quality of life of citizens, and thus mitigate the depopulation trend, and increase competitiveness of rural areas. Exploitation of natural resources of these areas *will lead to an increase in GDP*, better road infrastructure will facilitate the flow of goods in the direction production-market, which will affect trade deficit, decrease the gap between urban and rural areas and increase the possibility for creation of new jobs.

Measure preparation/implementation current stance supported by relevant indicators:The Ministry of Agriculture and Rural Development (MARD) within its activities carries out the measures “Renewal and development of villages and infrastructure construction” (filling and building roads, electrification, etc.) and Water Management Projects Incentive Program (water supply infrastructure). Measures are implemented in cooperation with local self-governments, local communities, villages and population from the area to which investment is related. Upon the request by the MARD, municipalities submit

priority lists in the rural infrastructure area. Investment is implemented in partnership relationship of the ministry, municipality and citizens. The program of supplying electricity to mountain pastures (katun) is carried out through Public Call announced by the MARD and financed in cooperation with the Ministry of Economy.

Envisaged timetable for implementation of the measure:The measures will be implemented in 2015 with the possibility of continuation in 2016-2017. The Action Plan implementing Agriculture and Rural Areas Development Strategy 2015 – 2020 envisages implementation of this measure through IPARD II program from 2018.

Contribution of the measure to the SSE 2020 Development Strategy targets:Providing of qualitative infrastructure in rural areas facilitates achievement of objectives set in the SEE 2020 Strategy, and the mentioned measure is directly related to the Pillar “Sustainable Growth” (Infrastructure-environment and competitiveness”).

Potential/specific risks to measure implementation:Potential risk to implementation of the measure is lack of finances by other partners, unresolved property-legal relations, etc.

Direct and possible indirect impacts of the measure on the budget/other financing sources (IPA, loans, own funds, etc):In 2015, the funds intended for the purpose of implementing this measure are projected in the budget of the Ministry of Agriculture and Rural Development, and are in the amount of approximately €800,000.

In regards to providing additional funds for development of rural infrastructure, Montenegro has commenced the membership procedure with the International Fund for Agriculture Development (IFAD). After accessing IFAD, the possibilities of financing local infrastructure through the resources of this Fund will be considered.

Description of envisaged impacts and expected timing: Through implementation of this measure, the Ministry of Agriculture and Rural Development strives to complete the commenced projects, commence and execute new ones regarding construction and reconstruction of rural infrastructure, in order to improve quality of life in rural areas. Anticipated results of this measure in 2015 are works on around 20 local water supply systems of which the completion of works on construction or reconstruction is expected for 10 water supply systems. Around 600 households are expected to be supplied by water in 2015. In regards to financing of building, filling and clearing roads in 2015, around 30 projects are expected to be supported in almost all municipalities of Montenegro.

II.3.2.2 Human capital

Core problems/obstacles to economic growth in the segment »Human Capital«

Human capital quality is one of the key drivers for increasing of international competitive capability of Montenegro and is one of the most significant preconditions for Montenegro to become an export-oriented economy.

Education and reduction of structural unemployment: Under the conditions of economic recovery in 2014, the labour market is still characterized by problems attributable for markets in the region and wider, and the most distinct ones are long-term unemployment, which causes structural unemployment and high unemployment rate of the youth, regional gaps in employment and unemployment levels, insufficient employment of labour force on seasonal jobs and illegal employment²³. The problems in the labour market result from the structural nature of unemployment, conditioned by the change in

²³ Draft Program of Employment Policy and Social Policy Reform 2014-2020.

economy structure (from production towards services), and cyclical nature of unemployment, caused by the global economic crisis effects.

Structural mismatch of supply and demand remains a long-term challenge of Montenegrin labour market. The result of measures in the education reform domain, implemented and planned, should be the reduction of skills gaps, which is an increasing natural effect of the introduction of new technologies and new organisational structure and, which is particularly important, adjustment to the higher competition level, so the measures of professional training of persons with acquired higher education are of major importance in that sense.

Research and development: According to the World Bank Report, Montenegro directs around 0.4% of its GDP to the sector of research and development, which is higher than the average of 0.33% in the countries of the Western Balkans, but less than the EU average of 2.03%. Although, this percentage is low, it has increased in comparison to the previous years (from 0.13% in 2010 to 0.41% in 2011). In addition to the size of funds directed for this area, questionable is also their structure where budgetary funds dominate, and private sector funds for research and development are very low. In order to effectively use the knowledge fund in the state and release innovative potential, Montenegro should continue the commenced trend of increasing investments in the science and research on national level. In the following period further work is needed on the development of the system for statistical tracking of resources oriented for research and development, as well as setting up a system for innovation statistics. It includes progress in respect of institutional and political reforms and primarily undertaking further strategic steps in achieving the three key objectives set in the reviewed Scientific-Research Activity Strategy 2012-2016, as follows: (i) Development of scientific-research community in Montenegro in view of increased efficiency and development of knowledge-based community, (ii) Fostering bilateral and multilateral cooperation (including cooperation with science diaspora) and (iii) Cooperation between academic and economic sectors.

Core objectives in the segment »Human Capital«

Education and reduction of structural unemployment: According to the Montenegro Development Directions (MDD) 2013-2016, the basic objective in this area is increased quality of education and increased employment of economically active population, particularly young persons. This objective is fully compliant with the goal specified in the country sector strategy, as well as with the objectives of the SEE 2020 Development Strategy.

Research and development: The basic objective in the science area set in the MDD 2013-2016 is increased quality of scientific-research work and better connectivity of scientific-research work with economy. This objective too is also compliant to the objective specified in the sector Scientific-Research Activity Strategy, as well as the objectives set in the SEE 2020 Development Strategy.

Economic policy measures aimed at achieving objectives set in the segment “Human Capital”

Education and reduction of structural unemployment: Montenegro plans to achieve the set objectives in the sector of education and structural unemployment specified in the MDD 2013 – 2016 and other strategic documents applying different sets of economic policy measures. The most important among them certainly is the **Enrolment Policy Reform in Tertiary Education Institutions** and **Program of professional training of persons with acquired higher education**, i.e. those are the two ‘priority measures’ of this ERP through which the country strives to increase its international competitiveness and economic growth (**Priority measure no 7: Enrolment Policy Reform in Tertiary Education Institutions** and **‘priority measure’ no. 8: Program of professional training of persons with acquired higher education** – detailed below).

Another set of measures in the area of education and reduction of structural unemployment refers to the **development of qualifications adequate to the labour market needs in accordance with the National Qualification Framework (NQF)**. These measures will contribute to the development of a competitive

society through education and increased employment of economically active population. It will be achieved through the cooperation of all partners, in the way that the needs for lacking skills and qualifications will be identified based on relevant research, data and projections of specific sectors and, accordingly, the labour market needs. The needs for all types of qualifications will be identified by sector committees, composed of the representatives of employers and their associations, unions, institutions engaged in education development, competent ministries and universities. The Law on national qualifications framework, with which the other education regulations are harmonised, envisages clear mechanisms for ensuring quality in development and acquiring of qualifications, which will ensure their relevance for the labour market. These measures will be implemented by the end 2018. Envisaged effects of this set of measures are: improved education offer in all regions of Montenegro, improved availability of acquiring various types of qualifications, which, by contents and scope, enable an individual better possibility employment and mobility in the labour market, as well as improvement of competences of the teaching staff.

In further enhancement of education process and reduction of structural unemployment, significant are also the measures of **increased participation of labour force in the life-long learning and adult education programs**. The concept of life-long learning is implemented through formal education, non-formal and informal learning. Life-long learning is not an isolated system running in parallel with the formal education, but formal education is a part of long-life learning. This measure will contribute to the development of a competitive society through education and higher employment of economically active population in the way that each individual will understand better the importance of permanent professional training for better professional and personal development and better employability and competitiveness. Also, these measures will increase social inclusion of adult citizens, employed and unemployed, through the life-long learning activities. Evaluation of knowledge, skills and competences of individuals, acquired in different contexts (on work, non-formal and informal learning) will improve the structure of available labour force and thus the structural unemployment will be decreased. Envisaged effects of these measures are improved education structure of labour force, improvement of their mobility. The measures will apply in the period 2015-2020.

Research and development:In this area the key is economic policy intervention directed at **encouragement of scientific excellence and increase of the quality of scientific-research organisations**. The key measure within this set of measures is related to establishment of an excellence centre relevant for development of scientific-research activity and financing large research grants.. The funds for implementation of this measure are envisaged in the total amount of € 5.84 million for the period 2014-2017. The envisaged effect of this measure is improved research environment directed to scientific excellence including international and inter-sector mobility.

Another set of measures includes **closer connectivity between science and economy**. In this context particularly significant is the construction of an innovation-entrepreneur centre “Tehnopolis” which is important for further connectivity between science and economy (**priority measure 9: construction of the innovation-entrepreneur centre “Tehnopolis” Nikšić**). This measure is in line with the Strategic Plan introducing Science and Technology Park (STP) in Montenegro, which envisages that a science and technology park should be designed as a networking structure that will be seated in Podgorica and have three decentralised units – Impulse centres, as follows: in Nikšić, Bar and Pljevlja. The measure will lead to the improvement of the existing and creation of new high-technology goods and services and thus contribute to increased competitiveness and the overall economic development of the country. At the same time, the measure will in general enable increase of research and innovation capacities and therefore increase the number of successful projects in large European programs (H2020) in the period from 2014 to 2020.

Priority measures in the segment “Human Capital”

The segment Human Capital presents through the selection process in sub-section II.3.1. three identified priority measures, being: “Enrolment policy reform at tertiary education institutions”, “Program of

professional training of persons with acquired higher education” and “Construction of Innovation-Entrepreneur Centre Tehnopolis in Nikšić”.

Priority measure no. 7: Enrolment policy reform at tertiary education Institutions

Description and classification of the measure:This measure is a measure combining the administrative and in certain segments the investment measure. Design and implementation of an adequate enrolment policy in line with the development objectives of the State and strategic development sectors is of essential importance over a long term for positioning, organisation and operation of the entire system. The highest responsibility in designing the enrolment policy lays with the tertiary education institutions. The enrolment policy should be aligned with the mission of the actual tertiary education institution, precisely to be focused on what is the best for students at given time and to ensure conditions for achieving the best and required knowledge, skills and competences, in other words the learning outcomes or to be aligned with actual labour market needs. This measure also includes a better quality connection of the secondary and tertiary education in such manner to take into account, in addition to the general score of a candidate at the matura exam (*secondary education exit exam*) and technical exam, whether a candidate has taken tests at the matura exam or the technical exam from subject-matters relevant for appreciating the selected study program at the time of valuating the enrolment at the faculty.

Contribution of the measure to the strengthening of competitive capacity of the country:This measure will contribute to further redesign of the existing study programmes, creating new and possible termination of study programs or qualification with lower interest, all aimed at aligning them with the labour market needs. The measure will contribute to raise the awareness on the need to produce human resources that will be easier employed, in other words, which will have knowledge and skills upon completion of a specific study program that will be needed at the modern market. This will create competitive human resources, at not only the regional level, but also even border, facilitate improved labour market flexibility in countries in the region and EU, and thus building an image for the tertiary education system of the country.

Measure preparation/implementation current stance supported by relevant indicators:In line with the information from the Employment Officer concerning the supply and demand for specific qualification, a number of students enrolled at the study programmes whereby once completed would acquire skills where there is a long term mismatch between the supply and demand was reduced. Such a trend will continue **in the forthcoming period as well, and a good indicator for planning the enrolment policy will be from data obtained as part of** the Programme for job-skills training of persons with university education, which is a direct input to tertiary education institutions and to all relevant stakeholders responsible for designing the tertiary education policy. This Programme is a good indicator not only in terms of quality study programmes and for graduated students, but also for their preferences for employment regionally.

Envisaged timetable for implementation of the measure:This measure should be implemented continuously, in close cooperation of the tertiary education institutions, relevant ministries, the Employment Office, the Chamber of Economy, and the Union of Employers. Preparation of regulations concerning better quality in connecting the secondary and tertiary education is planned for 2015 and 2016, while the enrolment under the new regulations for 2017.

Contribution of the measure to the SSE 2020 Development Strategy targets:Implementation of this measure will contribute to meeting the National Action Plan for SEE 2020 Strategy, pillar – Samarth Growth, precisely the implementation of activities under the Dimension L – Employment.

Potential/specific risks to measure implementation: Potential risks to implementation of the measure are concerning the inconsistency in implementation of the enrolment policy against the labour market needs.

Direct and possible indirect impacts of the measure on the budget/other financing sources (IPA, loans, own funds, etc): Funds are allocated from the Budget of Montenegro, IPA IV funds, as well as from the ongoing Project “Higher education Research for Innovation and Competitiveness” financed from the World Bank loan for implementation of the enrolment policy.

Description of envisaged impacts and expected timing: Envisage effect of this measure is the human capital development through acquiring knowledge, skills and competence aligned with the labour market needs, rational enrolment aligned with the long-term strategic objectives of Montenegro, reduction of the number of unemployed persons having tertiary education, establishment regional and broader fluctuation of the labour force with university education.

Priority measure 8: Program of professional training of persons with acquired higher education

Measure description and classification: The subject measure is of combined nature, i.e. administrative, and investment from a specific aspect. Employment of young persons is a constant challenge to inclusive development of the society and basic generator of competitiveness and growth. The Program of **professional training of persons with acquired higher education** is implemented in accordance with the Law on professional training of persons with acquired higher education. The Program provides the possibility for persons with acquired higher education with no work experience at a specific education level, to acquire knowledge, skills and competences for independent performance of work and tasks, which will enable them sooner involvement in the labour world. Activities on preparation of the Program of professional training of high school students are undertaken for the purpose of improving knowledge, skills and competences for independent performance of work and tasks for persons with **acquired vocational education of the second and third NQF level**. Also, within the measures of active employment policy there are programs implemented with regard to **employment of young people during the season** for the purpose of temporary resolving of problems of their unemployment, acquiring work experience and practice.

Contribution of the measure to the removal of obstacles to economic development and strengthening competitive capacity of the country: This measure will contribute to the achievement of the development objective, i.e. development of a competitive society through education and higher employment of workable population, in the way that persons with acquired university education should acquire through practical training that takes place through this program and active employment policy programs specific knowledge and skills that will facilitate their easier subsequent inclusion in the labour world.

Measure preparation/implementation current stance supported by relevant indicators: The current implementation stance of the measure includes undertaking of activities of the third cycle of the job-skills training of persons with acquired university education. Also, the Draft Law on Job-Skills Training of Persons with Acquired Vocational Education has been prepared and after the approval by the EC has been obtained further procedure for its adoption will commence.

Envisaged timetable for implementation of the measure: Implementation period of the measure is 2015 with the planned continuation beyond.

Contribution of the measure to the SSE 2020 Development Strategy targets: The implementation of the measure will contribute to execution of the National Action Plan implementing the SEE 2020 Strategy, pillar “Smart Growth”, i.e. completion of activities within the Dimension D.

Potential/specific risks to measure implementation: The potential risks for the measure implementation are related to the provision of required and sufficient funds for completion in the medium-term period,

while on the other side the risk may reflect on potential absence of future labour force demand and creation of new jobs that will absorb the potential human capital.

Direct and possible indirect impacts of the measure on the budget/other financing sources (IPA, loans, own funds, etc):For programs aimed at improvement of professional capabilities of the youth, the funds are allocated from the Budget of Montenegro. For the Program of professional training of persons with acquired higher education EUR8.5 million has been allocated for 2015.

Description of envisaged impacts of the measure and expected timing: Envisaged effects of this measure include human capital development, through acquiring of knowledge, skills and competences which will contribute the unemployed persons to become more competitive in the labour market, which finally contributes to the reduction of the unemployment rate of the youth and these effects can be expected in the medium-term period, i.e. 3-5 after the implementation of the measure.

Priority measure no. 9: Construction of Innovation-Entrepreneur Centre “Tehnopolis”

Measure description and classification: It is an investment measure for construction of an innovation-entrepreneur centre “Tehnopolis”. In 2012, the Government of Montenegro adopted the Strategic Plan introducing the Science and Technology Park (STP) in Montenegro, which is designed as a networking structure that will be seated in Podgorica and have three decentralised units – Impulse centres, as follows: in Nikšić, Bar and Pljevlja.

“Tehnopolis” will enable generating and commercialisation of innovative ideas into a specific product or service, which will thereafter be placed in the market, and this will be an ideal opportunity for everyone with good ideas and entrepreneurial spirit. Also, conditions will be created for strengthening of the cooperation between academic and scientific-research institutions from one side and private sector on the other, in view of strengthening innovative activities.

Contribution of the measure to the removal of obstacles to economic development and strengthening competitive capacity of the country: “Tehnopolis” may have multiple positive effects on economy and innovative, scientific and business environment in Montenegro, given that it will support creating and attracting new SME and consolidation of the existing ones and because of that it will have impact on opening of new jobs, and the overall economic development of the city of Nikšić.

According to the detailed design, the “Tehnopolis” activity will be carried out in the business premises of the reconstructed building of the Military Cultural Centre in Nikšić, with the total area of approximately 2,000 m². In this building there will be office premises for up to 20 micro and small-sized enterprises, a large meeting hall and 3 laboratories, as follows: 1) Biochemical laboratory; 2) Industrial design laboratory, and 3) Data centre. In addition to the mentioned spatial capacities, “Tehnopolis” will also have a Congress Centre.

Measure preparation/implementation current stance supported by relevant indicators:The Ministry of Science is implementing the project of establishing the Innovation entrepreneur centre “Tehnopolis” in Nikšić in cooperation with: the Ministry of Agriculture and Rural Development, Montenegro Investment Development Fund, Directorate for Public Works and Nikšić Municipality. The current implementation stance implies undertaking of activities on establishing the Innovation entrepreneur centre “Tehnopolis” in Nikšić and the tender procedure that is nearly completed.

Envisaged timetable for implementation of the measure:After the tender procedure has been completed, the finalisation of construction works is planned in 2015. The Innovation entrepreneur centre “Tehnopolis” will commence operating in 2016.

Contribution of the measure to the SSE 2020 Development Strategy targets: Implementation of the measure will contribute to fulfilment of the National Action Plan implementing SEE 2020 Strategy, within the pillar “Smart Growth”, i.e. completion of the activities under Dimension E.

Potential/specific risks to measure implementation: Potential risks of the measure are related to the timetable of tender procedures and performance of construction works and acceptance of the new organisational concept by SME.

Direct and possible indirect impacts of the measure on the budget/other financing sources (IPA, loans, own funds, etc): the Ministry of Science financed the development of the Detailed Design in 2014 with €40,000, and initial capital of “Tehnopolis” in the amount of €30,000. The funds for activities in 2015 are provided from the Capital Budget of Montenegro in the amount of €929,000, and €63,620 from the Budget of Montenegro for operations of “Tehnopolis”. In addition, the Investment Development Fund will finance “Tehnopolis” with €500,000.

Description of envisaged impacts of the measure and expected timing: This measure is expected to facilitate generation and commercialisation of innovative ideas. Also, the measure will bring about improvement of the existing and creation of new high technology goods and services and so contribute to increased competitiveness and overall economic development of the country. At the same time, the measure, in general, will facilitate increased research and innovative capacities and therefore increased number of successful projects in large European programs (H2020) in the period from 2014 to 2020.

II.3.2.3 Better Industrial Structures (small and medium-sized enterprises, tourism)

Core problems/obstacles to economic growth in the segment of »Better Industrial Structures «

Development of small and medium-sized enterprises: In Montenegro small and medium-sized enterprises (SMEs) are active in very diverse segments of economy. SMEs make 99% of the total number of enterprises; they participate with about 67% in the overall employment and their contribution to GDP is 60%. As such, SMEs make the foundations of the economic development of the country and competitiveness of Montenegrin economy will largely depend on the competitiveness of SMEs. A large number of SMEs are active in trade, tourism, consulting, and construction, but also in agriculture and processing industry. If Montenegro wishes to improve its industrial structure and to extend its export base, it has to make particular efforts in developing SMEs in tourism and tourism-related activities, e.g. agriculture and processing industry.

In addition to this, the SME sector in Montenegro faces all the problems related to the business environment and explained in more details in the sub-chapter of this ERP that deals particularly with this topic (3.2.4). On top of these general problems, the SME sector is also faced with additional problems specific for their sector. These primarily refer to the limited support schemes from the public sector to the SME sector, as well as to the insufficiently developed administrative capacities and support measures aimed at using the programmes of financial and non-financial support to SMEs in the most effective way.

Tourism: Montenegrin tourism possesses a huge development potential. This is confirmed by the WTTC 2013 report where Montenegro is ranked as the first among 184 countries according to two criteria: the speed of its growth in 2014 and the long term growth forecast (2014-2024). However, in order to achieve competitiveness and to see these forecasts coming true, Montenegro has to undertake certain activities aimed at overcoming several obstacles. Some of the key obstacles include the lack of high-end accommodation, insufficiently developed tourism infrastructure and diversification of tourism products, and short tourism season based on the "sun and beach" offer. It is also necessary to undertake certain activities in order to improve air access to the destination beyond the peak summer season, as well as to work on the further development of the mountain tourism (in the North of Montenegro), better

training of people employed in the tourism and catering sector and better participation of the local population.

Core objectives in the segment of "Better industrial structures"

According to the Montenegro Development Directions 2013-2016 (MDD), the core objective of the SME sector development is a competitive SME sector in the entrepreneurial economy based on knowledge, technology innovations and modernized capacities. This objective is in full compliance with the objectives of the SME sector development defined in the SME Development Strategy 2011-2015, particularly the strategic goals related to the strengthening of financial support, competitiveness and support to start-ups. It is also in line with the Strategy for Enhancement of Competitiveness at the Micro Level 2011-2015, Strategy for Sustainable Economic Growth through Introduction of Business Clusters 2012-2016, Strategy for Lifelong Entrepreneurial learning 2015-2019; as well as with the National Action Plan (NAP) for the SEE 2020 Strategy for 2014-2015, i.e. with the national priorities that will contribute to achieving one of the key targets of the SEE 2020 Strategy in the "Sustainable Growth" segment - raising the level of competitiveness of the private sector. Montenegro is also implementing the Small Business Act (SBA) and the measures and activities that are in line with the SBA recommendations, that are, in their turn, complimentary to the reform measures within the ERP.

Tourism: Due to its importance for the increase in the number of SMEs, generating new jobs, increasing the standard of living and balancing regional development, tourism has been recognized as one of the top priority branches of Montenegrin Economy. According to the MDD 2013-2016, the core objective of this sector is to increase revenues and employment, which can be achieved, *inter alia*, through the improvement of the tourism infrastructure, i.e. of the overall quality of the tourism offering.

Economic policy measures aimed at achieving the set objectives in the segment of "Better industrial structures"

Development of small and medium-sized enterprises: Montenegro plans to achieve the goals set for the SME sector in the MDD 2013-2016 and other strategic documents through various groups of economic policy measures. The most important among them are the financial and non-financial measures of support to SMEs to achieve competitiveness and growth of economy (**priority measure no. 10: Financial support to the SME sector** and **priority measure no. 11: Enhancement of institutional and administrative capacities for SMEs support**, described in more details below).

Tourism: Montenegro plans to implement various economic policy measures to achieve the goals set in the tourism sector in the MDD 2013-2016 and in other strategic documents, particularly the Strategy for Development of Tourism by the end of 2020. Among the most important measures are those that refer to development of tourism infrastructure and other infrastructure aimed at raising the level of competitiveness and growth of economy. This will also impact the increase in the number of SMEs and the reduction of regional imbalances. That is why it is particularly important to build the necessary infrastructure in the ski resorts in the North of Montenegro (**priority measure no. 12: "Enhancement of the tourist offer in the north of Montenegro through construction of required infrastructure in ski resorts"**, described in more details below). In addition to this measure, a measure of general importance for the development of tourism and for raising its competitiveness is also the improvement of air-accessibility of the destination.

Another set of measures in the field of improvement of competitiveness of tourism include: **tax policy reforms in this field** (through the introduction of the reduced VAT rate of 7% for all hospitality services in hotels and restaurants and abolishment of property tax for hospitality facilities - hotels with 3, 4 and 5 stars that operate 12 months a year and have a planned category in line with the Decision on the Priority Tourism Sites); amendments to the legislative framework - amendments to the Law on Tourism and its secondary legislation (for the further harmonization with the EU *acquis* aimed at improving competitiveness); as well as **the improvement of credit support to the development projects in tourism**.

„Priority measures" in the segment of "Better industrial structures"

There are three priority measures identified within the segment "Better industrial structures" that have been selected through the selection process presented in the sub-chapter 3.1 of this chapter: "Financial support to the SME sector"; " Enhancement of institutional and administrative capacities for SMEs support " and "Enhancement of the tourist offer in the north of Montenegro through construction of required infrastructure in ski resorts ".

Priority measure no. 10: Financial support to the SME sector

Description and classification of the measure: Improved availability of funds is a significant factor for improving competitiveness of the SME sector. This measure is consistent with the SME Development Strategy 2011-2015 in terms of the strategic goals related to the strengthening of financial support, competitiveness and support to business start ups. It is also in line with the recommendations of the Small Business Act.

Contribution of the measure to the strengthening of competitive capacity of the country: In the area of SMEs development the contribution of this measure is aimed at designing better industrial structures for providing support to the dynamic SME development through improving the financial support. In the field of financial support to the SME sector, the reform process should in the future be focused on improving the availability of funds and instruments, in terms of the types and scope of available funds and favourable conditions for as broad range of target groups as possible.

Current state-of-play of the preparation/implementation of the measure, supported by relevant indicators: National institution for providing support to SMEs is the Investment Development Fund (IDF). Credit support is aimed at small and medium-sized enterprises, farmers, the young, beginners and women in business. The terms and conditions for the credit support of this type are more favourable than the market conditions in terms of the interest rate level, loan repayment period and grace periods. At the same time additional incentives have been ensured for the investments in the North of Montenegro and less developed areas and for the employment of more than 5 people, as well as for the loans that are approved with the guarantee of some of the commercial banks. By 31 December 2014, the amount of the approved 279 loans was 41.5 million €. As for the factoring arrangements the total amount of 29.7 million € of claims were purchased within the 28 factoring arrangements for domestic producers, and the sectors of trade and services.

In addition to the above measures, there are several programmes aimed at providing continuous support to the strengthening of competitiveness of Montenegrin SMEs. These programmes support innovations, introduction of standards, and development of clusters and they are mostly supported within the state aid support system. With aim to granting financial support to entrepreneurs, micro, small and medium-sized enterprises, as members of clusters for overcoming "bottlenecks" in business through purchase of equipment, the Programme for encouraging development of clusters in the Northern region and less developed municipalities of Montenegro for 2012-2016 allocated grants in the amount of 0.045 million € to 6 clusters in 2013/2014. The Programme for increasing local and regional competitiveness through harmonization with international standards for business for the period 2014-2016 also approves grants aimed at meeting international standards for obtaining accreditation for assessment of conformity, as well as for implementation of the standards/recertification.

Envisaged timetable for implementation of the measure: The measure of improving financial support to SME sector will be implemented in the period 2015-2017, with the planned innovations related to availability of funds and instruments for financial support to SMEs. Since the financial support programmes for SMEs (loans, factoring, grants) and the limited budget funds for their implementation are not sufficient for any significant increase in business performances of SMEs, additional support is expected from international sources. This implies new credit arrangements with international financial

institutions (EIB, EIF, EBRD, etc.), and involvement of financial intermediaries in the implementation of the COSME programme financial instruments. There is a possibility to ensure guarantees and counter-guarantees for financial institutions (guarantee funds, banks, leasing companies) through the instruments of the credit guarantees within the COSME programme. The goal is to ensure more financing for SMEs through loans and leasing. Within IPA programme technical support in designing the grant scheme for improving competitiveness is planned (IPA 2014) and accordingly later on support in direct implementation of the grants for the improvement of competitiveness of SMEs (the beginning of implementation is expected end 2015/beginning 2016).

Contribution of the measure to the SEE 2020 Development Strategy targets: Implementation of the planned measures of financial support will contribute to the achievement of the goals defined in the Montenegrin National Action Plan for the SEE 2020 Strategy for 2014/2015 within the pillar "Sustainable Growth", Dimension K - Competitiveness.

Potential/specific risks in the implementation of the measure: The potential risks in the implementation of the measure of financial support to SMEs include signing the agreements on guarantee arrangements of financial institutions within the COSME programme and absorption capacities of SMEs.

Direct and possible indirect impact of the measure on the budget/ other financing sources (IPA, loans, own funds, etc.): Regarding to national resources of funding, implementation of measures of financial support to SMEs in 2015 will require funding in the amount of approx. 80,1 million EUR. Estimates are that the financing from the IDF and the state budget continue in the same or slightly higher amount in the coming years, which indicates that the amount of funds for 2016/2017 year will be at least at the level of financial allocations²⁴ for 2015. The possible signing of new agreements of financial institutions in terms of available programs and initiatives for Montenegro, it can be expected a greater scope and easier access to finance for SMEs.

Description of the foreseen impacts of the measure and the expected timing: The effects of the planned financial support measures on the SME sector will include: contribution to the increase in the number of SMEs, i.e. establishment of new enterprises, new employment, improvement of business performances, innovativeness and competitiveness of SMEs. The impact of the measures covers the period 2015-2017.

Priority measure 11: Enhancement of institutional and administrative capacities for SMEs support

Description and classification of the measure: Improving the institutional and administrative capacities for providing support to the SME sector is a segment of a comprehensive and multi-dimensional non-financial support to SMEs. Among other things, it assumes providing support services to the businesses in the field of provision of information, advice and support in establishing a business and improving its operation with a view to enhance competitiveness of SMEs in the market. An important precondition for availability and quality of the provided advisory services is the strengthening of administrative capacities of the providers of services to SMEs and development of clusters, through trainings. The priority measure 8 includes such activities in 2015. This measure is consistent with the SME Development Strategy 2011-2015, i.e. with its strategic goals that refer to the strengthening of competitiveness and support to start-ups, and also with the recommendations of the Small Business Act. In addition to that, according to the Progress Report recommendations, administrative capacities and support measures should be strengthened so that the programmes of financial and non-financial support to SMEs can be used as effectively as possible, and the measures of non-financial support to development of clusters and other structures to support businesses should be continued.

²⁴ Most of them from the loan agreements of IDF with international financial institutions.

Contribution of the measure to the removal of obstacles to economic development and to the strengthening of the competitive capacity of the country:Improvement of the measures of non-financial support to SMEs in area of strengthening institutional and administrative capacities is aimed at ensuring more dynamic development of the SME sector. The goal of reform process should be to achieve the models of institutional support to businesses and to strengthen capacities of the employees on the local level to provide services of business advice for establishment and further development of SMEs. Internationalization of SMEs, in terms of better business connections and their breakthrough to new markets, will be improved through the use of the services (Enterprise Europe Network - EEN Montenegro) within the COSME programme.

Current state-of-play of the preparation/implementation of the measure supported by relevant indicators: Construction of the Regional Business Centre (RBC) and incubator in Berane, as well as the improvements to the institutional capacities for the support to SMEs have been started within the IPA 2011 project "Establishment of the Regional Business Centre and Incubator in the North-East of Montenegro". EEN Montenegro continuously provides services of support for internationalization of SMEs. In addition to this, certain activities on the strengthening of capacities for supporting cluster development have been initiated within the IPA 2011 project: "Strengthening of competitiveness of the small and medium-size enterprises in Montenegro through cluster development".

Envisaged timetable for implementation of the measure:The measure of improving institutional and administrative capacities for supporting SME sector will be implemented in 2015. It will be focused on building the institutional infrastructure and strengthening of the capacities for providing support services to businesses (trainings) within the Regional Business Centre and Berane incubator, as well as on the strengthening of the capacities for development of clusters through trainings for cluster agents and members of clusters. From 2015 on, the scope of the provision of the services of the EEN Montenegro is planned to be in line with the planned measures of the COSME programme. It is expected that in the period 2015-2017, through IPA programmes (specifically IPA 2014), Montenegro implements the activities aimed at strengthening administrative capacities for innovating and implementing SME policy and more efficient use of the COSME programme and other programmes of support to the SME sector in various segments, taking into account the SBA recommendations. Technical support for designing and implementing the grants for improvement of competitiveness of SMEs is also planned through IPA 2014 and will be implemented in 2016 and 2017.

Contribution of the measure to the SEE 2020 Development Strategy targets:Implementation of these measures will contribute to meeting the goals defined in Montenegrin National Action Plan for SEE 2020 Strategy for 2014 and 2015, within the pillar Sustainable Growth, dimension K - Competitiveness. These measures include implementation of the measures defined in the SME Development Strategy 2011-2015, Strategy for Enhancement of Competitiveness at the micro level 2011-2015 and ensuring advisory support to start-ups.

Potential/specific risks in the implementation of the measure: Potential risks that can slow down the implementation of the measures of non-financial support to SMEs include possible unavailability of funds for implementation and the level of participation of the providers of advisory services to the SME sector.

Direct and possible indirect impact of the measure on the budget/other sources of financing (IPA, loans, own funds etc.):Implementation of the measure of non-financial support to SMEs in 2015 will require funds for strengthening of the capacities for provision of support services to businesses in the form of national contribution in the amount of 0.025 million € and IPA 2011 projects (development of RBC, incubators and support to clusters) in the amount of 0.22 million €. The planned amount of funds from IPA 2014 for designing and implementing the grants for improvement of competitiveness of SMEs in the period of 2016-2017 (IPA 2014) amounts to 0.3 mil €.

The amount of funds planned for 2016 and 2017 is on the level of approximately 0.1 mil € from the national sources. The planned amount of the financial support for 2016 and 2017 amounts 1 mil € from IPA 2014 funds and it will include key activities in the implementation of the Small Business Act (SBA) recommendations.

Description of the foreseen impacts of the measure and the expected duration: Effects of the planned measures should contribute to the following: construction of inter-municipal infrastructure for supporting SMEs in the form of RBC and incubator; further strengthening of administrative capacities for providing advisory services to small and medium-sized enterprises and clusters with a view to supporting the establishment and further growth; as well as the increase of the absorption capacity for using the financial support instruments and other programmes of support to SMEs. Impact of the measures covers the period 2015-2017.

Priority measure 12: Enhancement of the tourist offer in the north of Montenegro through construction of required infrastructure in ski resorts

Description and classification of the measure: It is obvious that currently there is an imbalance in the regional distribution of the tourism offering in Montenegro. The North is in the "less favourable" position than the coastal region. Nowadays Montenegro has 5 fully operating ski resorts: "Savin kuk" and "Javorovača" in Žabljak, "Kolašin 1450" in Kolašin and "Vučje" in Nikšić, while the ski resort "Lokve" in Berane operates from time to time.

Given the natural preconditions and insufficiently used potentials of the North, Montenegro has set the goal to improve the quality of services in the existing ski resorts as well as to build new ski resorts. Thus, in 2015 the priority measure is the planned construction of the infrastructure for the ski resorts »Kolašin 1600« in the Municipality of Kolašin and »Cmiljača« in the Municipality of Bijelo Polje, as well as the construction of the accumulation lake in »Vučje« in Nikšić. This measure can be classified as an investment measure.

Contribution of the measure to the removal of obstacles to economic development and strengthening competitive capacity of the country: The project of constructing new ski resort facilities and investing into the existing ones has been recognized as a priority for 2015. Montenegro envisages investments that will contribute to the improvement of the overall business environment in the North of Montenegro through the extension of the tourism season. These activities are in line with the Montenegro Tourism Development Strategy by 2020, and the Regional Development Strategy for 2015-2020.

Current state-of-play of the preparation/implementation of the measure supported by relevant indicators: Project documentation has been prepared for the projects of the ski resorts »Kolašin 1600« Kolašin and »Cmiljača« Bijelo Polje, as well as for the project of the construction of the accumulation lake in "Vučje" Nikšić. The plan is to finance these investments from the budget of Montenegro.

Envisaged timetable for implementation of the measure: Implementation of this investment is planned for the period 2015-2019 within the multiannual capital budget in total amount of € 40 million. Out of this amount, € 6,695,000 is planned to be invested in 2015.

Potential/specific risks in the implementation of the measure: Given the geographic features of the locations for the ski resorts and the possibility for the snow to remain there for a couple of months a year, there is a potential risk of delays in the envisaged timetable of the implementation of the projects, which could lead to the delay in the final works on the projects.

Direct and possible indirect impact of the measure on the budget/other sources of financing (IPA, loans, own funds etc.): 2015 Law on Budget allocates the funds for the implementation of the works on the construction of the skiing infrastructure in the ski centre "Kolašin 1600" in Kolašin and the ski centre "Cmiljača" in Bijelo Polje. The allocated funds amount to **6,440,000** €. There are also 255,555.00 € that

are planned for the construction of the accumulation lake in the location of the Ski Centre "Vučje" in Nikšić. The goal of this activity is to create preconditions for artificial refreshment of the ski tracks. The total amount of the funds allocated for the investment in the ski resorts infrastructure in 2015 is 6,695,000.00 €.

Description of the foreseen impacts of the measure and the expected duration: Implementation of this measure will contribute to the increase in the competitiveness of tourism in the North and to the reduction of regional differences in Montenegro. It will also create preconditions for the increase in the number of SMEs, increase in the revenues from tourism and related activities, increase in the number of employees in the North of Montenegro, as well as to the increase of the budget revenues from VAT, profit tax, etc. These investments will make Montenegrin tourism product more competitive in comparison to the tourism product of the countries in the region. But they will also have a similar impact on the overall tourism offering of Montenegro and ensure that Montenegro is in the future promoted as a genuine year-round destination.

II.3.2.4 Good Business Environment

Core problems/obstacles to the economic growth in the segment of »Good Business Environment«

Strengthening of the regulatory framework through better transparency and establishment of closer cooperation between citizens, sectors of economy and Government authorities improves the overall quality of life and social cohesion in the country. If inadequate, regulatory framework in any country has a negative impact on the market competitiveness and contributes to operations that are outside of the legal framework. Regulatory reform and improvement of the business environment create a better basis for development of entrepreneurship, establishment and development of small and medium-sized enterprises, new investments and jobs in the private sectors. Montenegro is still characterized by insufficiently short deadlines for execution of contracts and insufficiently clear and transparent procedures, certain fiscal burdens that should be further reduced, insufficiently efficient procedures before administration bodies, problems with electronic communication and online application procedures, as well as the necessity of further reforms of public administration and increasing its efficiency in servicing citizens and economy.

The efforts invested in the reform aimed at improvement of business environment have been recognized by the World Bank. This resulted in the progress of Montenegro in the Doing Business Report 2015. In the global ranking presented in this report, namely, Montenegro has improved by six positions - from the position 42 to the position 36 among 189 countries. The most significant progress has been achieved within the indicator "issuing construction permits" where the World Bank has recognized the reforms implemented in the field of reduction of fees for providing utility services and abolishment of the fees to municipalities for issuing urban and technical development requirements. Still, in order to remove the obstacles for improvement of competitiveness in this field, Montenegro has to continue the process of simplification of the procedures for issuing construction permits, and to ensure faster execution of contracts, improvements in the field of inspection supervision, development of electronic services, harmonization of legislation in the field of services with the Services Directive, as well as in the implementation of the remaining recommendations from the Guillotine of Regulations.

Core objectives in the segment of "Good Business Environment"

One of the priorities and an important economic policy instrument for strengthening the capacities of Montenegrin economy is the improvement of its business environment. Creating favourable business environment, regardless of whether it is aimed at strengthening entrepreneurial ventures or at attracting new investments, contributes to the economic development of the state, i.e. to the GDP growth. At the same time, competitiveness of economy is decisive for its position on the international level, in terms of its attractiveness for foreign investors.

Economic policy measures aimed at achieving set objectives in the segment of »Good Business Environment«

Montenegro plans to achieve the goals in the field of good business environment defined in the MDD 2013-2016 and in other strategic documents by using various groups of economic policy measures. Among them, particularly important is the "Guillotine of Regulations" as the ex-post analysis of the impact of the existing regulations. It is the basis for amending or repealing certain pieces of legislation with a view to shortening deadlines, minimizing administrative costs and simplifying the procedures. In the period between the adoption of the Action Plan for the implementation of the recommendations envisaged in the "Guillotine of Regulations" (it was adopted in 2012 and revised in 2013) and the end of the III quarter of 2014, out of the total number of 1,446 recommendations, 987 recommendations were implemented (implementation rate 68.3%). It is envisaged that 172 recommendations will be implemented in 2015, while the remaining recommendations are to be implemented in 2016 and 2017.

In the process of development of this year's ERP, given the latest information about the obstacles in the business environment, particular attention was dedicated to the following: more efficient execution of contracts (**priority measure no. 13: Strengthening institutional framework for execution of contracts**, presented in details below); improvement of the procedures for issuing construction permits (**priority measure no. 14: Improving the process of issuing building permits through upgrade of the existing ICT solutions**, presented in details below); and online availability of public services (**priority measure no. 15: Online availability of public services and the implementation of the information system for the exchange of data from the registries of state authorities**, presented in details below).

The second group of measures aimed at improving the business environment is related to the integration of inspections in the field of education, sports, archiving, cultural goods and cultural heritage, as well as in the field of preventing money laundering and financing terrorism, into a single administration for inspection affairs. In this way Montenegro wants to improve the efficiency of work of the inspection bodies and to ensure their uniform practice; to use in a better way its human and other resources and to relax economic and other entities that are subject to supervision. The measures in this group include improvement of the information system that will support the work of certain inspections (standardization of procedures in the work of individual inspections; forming a single data base that will ensure higher quality planning of the inspection supervision including the risk analysis, high quality statistics on the published inspection supervision, as well as the improvement of the horizontal and vertical communication).

The third group of measures in this field includes activities of harmonization with the *acquis communautaire* in the fields related to the free provision of services and protection of competition. In that context, the important activity was the adoption of the **Action plan for transposition of the Services Directive in the internal market**. By the adoption of the horizontal Law on Services, which transposes the fundamental provisions of the Services Directive into the national legislation, Montenegro will establish a general and legal framework for the services that the Directive refers to. Since the services market very dynamic, this will also ensure the rules for its development and for the emerging services.

»Priority measures « in the segment »Good Business Environment «

Using the selection process presented in the sub-chapter 3.1, the Government has identified three "priority measures" in the segment "Good Business Environment": "strengthening institutional framework for execution of contracts", "Improving the process of issuing building permits through upgrade of the existing ICT solutions" and "online availability of public services and the implementation of the information system for exchange of data from the registries of the state authorities".

Priority measure no. 13: Strengthening institutional framework for execution of contracts

Description and classification of the measure:With a view to increasing competitiveness of economy through the process of execution of contracts, the Government of Montenegro opted for a radical reform of the system of execution by introducing public enforcement officers (bailiffs) whose status, competences and organization of their activities is regulated in the Law on Public Enforcement Officers adopted in December 2011. Adoption of this law is one of the key elements of the measure aimed at contributing to more efficient execution of contracts. That is why this measure can be classified as a legal measure.

Contribution of the measure to the removal of obstacles to economic development and strengthening of the competitive capacity of the country:As for the implementation of the Law on Public Enforcement Officers, the Ministry of Justice timely adopted the secondary legislation, organized the exam for public enforcement officers and published the call for their appointment, adopted the decisions on their appointment and conducted the procedure for admission of their offices. In cooperation with the OSCE, the Ministry of Justice also organized 6 training conferences for public enforcement officers and continuously provided expert support aimed at strengthening their activities and the activity of their Chamber. The Rulebook on the number of positions and official seats of the public enforcement officers provides for the total number of 32 public enforcement officers for the territory of Montenegro. So far, the Ministry has published four public calls for public enforcement officers and got 37 candidates, out of whom the Ministry appointed 29. Thus, there is an adequate number of appointed public enforcement officers, which contributes to better efficiency in the enforcement of contracts, which in its turn contributes to higher competitiveness of economy and attracts investments.

Current state-of-play of preparation/implementation, supported by relevant indicators: In addition to the Law on Public Enforcement Officers, and with a view to improving the enforcement system, the Ministry of Justice composed a Proposal Law on Amendments to the Law on Enforcement and Securing of Claims which was sent to the Parliament of Montenegro for adoption. The key goal of the amendments is to improve the existing law in terms of changing the functional competence for deciding upon legal remedies lodged against the decisions of public enforcement officers. According to the amendments, the complaints against the decision adopted on the basis of an enforcement document shall be decided upon by an individual judge, while the complaints against the decision based on an authentic document shall remain within the competences of a three-judge panel. In this way the individual judges will also have power to decide upon complaints against the decisions of the public enforcement officers adopted on the basis of an enforcement document. This will contribute to better efficiency of the enforcement procedure.

Envisaged timetable for implementation of the measure: The measure will be implemented in 2015, while certain activities will continue in 2016 and 2017.

Contribution of the measure to SEE 2020 Development Strategy targets:Implementation of this measure is related to the pillar "Integrated Growth", dimension B, "Competitive Economic Environment".

Potential/specific risks in the implementation of the measure:The identified risks are related to the possibility of untimely implementation of the planned reforms.

Direct and possible indirect impact of the measure on the budget/other financing sources (IPA, loans, own funds, etc.):Implementation of this measure does not require any additional funds from the state budget.

Description of the foreseen impacts of the measure and expected timing:Amendments to the Law on Enforcement and Securing of Claims and implementation of the proposed reforms are aimed at improving the existing solutions, which will lead to a faster, higher-quality and more efficient procedures.

Priority measure no. 14: Improving the process of issuing construction permits through upgrade of the existing ICT solutions

Description and classification of the measure: Improving the process of issuing construction permits through upgrade of existing ICT systems that will integrate all spatial information, i.e. enable easier implementation of investments, as well as the construction of the infrastructure for municipal utilities, energy, transport and other infrastructure. This measure is of administrative character.

Contribution of the measure to the removal of obstacles to economic development and strengthening of the competitive capacity of the country: Improving the existing ICT system in the area of spatial development and construction of structures – Unidocs, and using the e-government portal and EDMS archive – *Origami* (e-plans, e-construction permit, e-archives, e-inspection) will make the business environment simpler and more predictable, while the transparency of the process will ensure implementation of the measures provided for in the Action Plan for preventing and combating corruption. Upgrade of the existing systems will consolidate all the data related to spatial planning and construction of structures and make them accessible to the public, potential investors and others. Moreover, the advancement of this system will improve the business environment for all and reduce administrative procedures in provision of public services.

Current stance of preparation/implementation of the measure supported by relevant indicators: State planning documents have been published in the Geo-portal of the Ministry of Sustainable Development and Tourism and GIS is currently being integrated with the documentation base, and a web-service for exchange of data with the Chamber of Engineers will be implemented through the integration project. A service for electronic filing of requests for issuing urban-development and technical requirements is in a test phase at the e-government portal, in accordance with the Law on E-government. All requests lodged with the Ministry of Sustainable Development and Tourism by parties concerning the area of spatial development and construction of structures could be lodged electronically after amendments to legislation governing the area of spatial development and construction of structures.

Envisaged timetable for implementation of the measure: The following activities are planned for 2015: (i) adoption of the Rulebook on detailed contents and manner of keeping the Central Register of planning documents, (ii) establishment of the Central Register of planning documents, (iv) adoption of the Law on Spatial Planning and Construction of Structures which will define electronic operation on the level of spatial development and construction of structures; (v) adoption of the secondary legislation for electronic operation, and (vi) implementation and development of the information system that will support electronic operation.

Contribution of the measure to the SEE 2020 Development Strategy targets: One of the key pillars defined in the SEE 2020 Development Strategy is "Governance for Growth" aimed at developing good business environment and providing public services necessary for economic development, i.e. Dimension N - "Effective Public Services".

Potential/specific risks in the implementation of the measure: The information system is to connect a large number of authorities, both at the state and local level, and institutions that participate in the process of issuing construction permits needs to be developed in accordance with the Law on Spatial Development and Construction of Structures. Pursuant to provisions of the Law on e-government, the state authorities and the state administration authorities will exchange data through an Integral Information System for data exchange, while the communication with other institutions taking part in the construction permits issuing process will take place through the upgrade of the existing information system. As an umbrella institution, the Ministry of Sustainable Development and Tourism will need to connect: 23 local authorities responsible for the activities of spatial planning and construction of structures, the Administration for inspection affairs, the Water Administration, the Administration for Protection of Monuments of Culture, all regional units and the central office of the Real Estate Administration, all regional units and the headquarters of the EPCG, the Public Company Maritime Domain Management, the Public Company National Parks of Montenegro, the Environmental Protection Agency and the local level authorities responsible for the environmental protection affairs, 23 local enterprises that manage water supply and sewerage infrastructure, the Agency for Civil Aviation

Safety, the Telecommunication Agency and the Directorate for Transport. Therefore, one of the potential risks is the very implementation of this information system, i.e. ensuring the funds for connecting so many entities. Another problem is the time in which it will be possible to publish all the planning documents in the Central register of planning documents.

Direct and possible indirect impacts of the measure on the budget / other sources of financing (IPA, loans, own funds, etc.): Funds for implementation of this measure are request from the Budget. The implementation is envisaged for 2015, 2016 and 2017 (the prices amount will be submitted after IT experts have completed evaluation).

Description of foreseen impacts of the measure and the expected timing: Introduction of the electronic operation will first ensure that planning documents development and development of the technical documentation will not be prepared in the voluminous paper form, meaning that the e-operation contributes to reduction of costs, improvement in work efficiency and simplification of procedures. Furthermore, contact between investors and employees in the administration is avoided in this manner and the very procedure is transparent, which eliminates corruption.

Priority measure no. 15: Online availability of public services and implementation of the information system for exchange of data from the registers of state authorities

Description and classification of the measure: In the context of a strong domination of information technologies further modernization of public administration is a must. The goals of the adoption of the Law on Electronic Administration are: simpler communication of citizens and economic entities with the state administration; more efficient exercise of rights by the users of the state administration services and development of preconditions for the administration to be a service to citizens and economy through establishment of G2B and G2C services. Implementation of this law should contribute to the removal of administrative barriers, since the users of the state administration services will be able to communicate with the administration at any time and from any place, while establishment of the information system for the exchange of data from the registers of state authorities will impact the efficiency of the collection of data from the state authorities that they collect *ex officio* in the procedure for the exercise of the rights of their users. This practically creates the conditions for electronic issuance of construction permits, electronic registration of companies, and electronic issuance of certificates in the field of civic rights, etc.

Contribution of the measure to the removal of obstacles to economic development and strengthening of the competitive capacity of the country: The opportunity offered to citizens and economic entities to communicate with the state and local administration through one electronic point (electronic government portal), which is regulated in the legislative and technical way, ensures easier access to services of the state administration. On one side, this contributes to the strengthening of the respect for human rights and improvement of the business environment, and to more efficient proceeding of the authorities on the other. Establishment of the information system for the exchange of data between state authorities through more efficient communication between institutions (improvement of the G2G segment of electronic administration) will also lead to the simplification and better efficiency of the procedures.

Current state-of-play of the preparation/implementation of the measure supported by relevant indicators: Electronic administration portal, as the central point of access to the administration services, has been in operation since 2011. Through this portal the technical conditions for development of electronic administration in Montenegro have been created. This field is regulated in the Law on Electronic Administration. The goal is to encourage development of electronic administration through inspection supervision, because electronic administration is a key precondition for the improvement of business environment through the removal of administrative barriers. The electronic administration

portal currently includes 70 on-line services provided by 24 institutions. With a view to ensuring full "automation" of the work of the state administration and development of G2G services, Montenegro plans to establish a single information system for the exchange of data between the information systems of the state authorities. Given the fact, namely, that, in the process for exercising the rights and duties of their users, the state bodies and the state administration authorities are obliged to collect ex officio the data about the facts that they keep the official records of according to the law, the establishment of the information system will significantly simplify and accelerate such collection of data contributing in such a way to the efficiency of the procedure. In addition to this, the implementation of this information system will lead to the increased efficiency of the public administration.

The envisaged timetable for the implementation of the measure: According to the Law on Electronic Administration, all the authorities that communicate with citizens and economic entities are obliged to ensure that all the services that they provide in the conventional way are also available electronically. They have to ensure this within 18 months from the day of coming of the Law into effect (by February 2016) if it is in compliance with the laws that stipulate the work of their core activities. The strategic goal is to have 200 state administration services in the portal by the end of 2016. The legislation has created the conditions so that the goal set in the Strategy for Development of Information Society 2012-2016 is not only achieved, but even exceeded. In 2015 the priority will be the services that are most attractive for citizens and businesses. The single information system for the exchange of data between state authorities will be implemented by August 2016.

Contribution of the measure to the SEE 2020 Development Strategy targets: Implementation of this measure is connected to the pillar "Smart Growth", Dimension F - Digital Society in the National AP for the SEE 2020 Strategy.

Potential/specific risks in the implementation of this measure: The experience related to the provision of administration services in an electronic way shows that the risks connected to this measure include: resistance of the state authorities and local self-government to changes, since they are reluctant to make the transition from the counter system to the on-line world; non-compliance of the Law on Electronic Administration; lack of inspection supervision; long tender procedures for development of the information system for the exchange of data from the registers of the state authorities.

Direct and possible indirect impact of the measure on the budget/ other financing sources (IPA, loans, on funds, etc.):The required budget funds amount to 500,000 € for the first stage of development of the information system (IS) for the exchange of data between the state authorities. These funds are for 2015, while no additional funds are required for development of the electronic administration in the part that refers to provision of services through the electronic administration portal.

Description of the foreseen impact of the measure and the expected timing: The envisaged effects of the measure are: an easier access to the administration services; faster and more efficient exercise of the rights by citizens and commercial entities; and lower administrative barriers. These effects will be continuously visible as they depend on the pace of establishment of the state administration at the electronic administration portal. More efficient communication between institutions will be obvious from the moment of release of the IS for the exchange of data between the state authorities.

II.3.2.5 Trade integration

Core problems /obstacles to the economic growth in the segment of "Trade Integration"

Montenegro is a very small and open market economy where the overall export (of goods and services) in 2013 made only 44% of the GDB, while the current account deficit in the balance of payment made 14.6% of the GDP. All of this indicates to significant weaknesses of the external sector of Montenegrin economy. Thus, for example, if only import of goods is analysed, its share in the GDP (12.1% in 2013) is among the lowest in the region. However, if services are added, primarily tourism, then the share in the GDP is significantly improved, but it is still relatively low in comparison to some other small EU countries. The value of Montenegrin export is relatively low, which is not the only problem. The problem is rather that export is very concentrated. While metal, electricity and food products dominate in the export of goods, tourism determines the overall trends in the field of services. These characteristics clearly show that Montenegro has a very narrow production base of goods and services, which is largely a consequence of a relatively low international competitiveness. This makes the country additionally sensitive to international trends in this field. In addition to this, the merchandize trade of Montenegro with abroad is characterised by a high dependence on imports. Certain specific features are characteristic also for the financial part of Montenegrin balance of payment. It is dominated by foreign direct investments (FDI), but in their structure there is a high share of the investments in property and it is realistic to expect that it will not remain on that level in a long run.

On the basis of the above it can be concluded that **diversification of export** is one of the key challenges of the country in the future period. This is even more important since the export of metal will be further reduced, while the export of food and drinks is related to objective production restrictions. Export of electricity shows a growth trend, but it also depends on the season and trends in the prices of electricity in the world market. Tourism definitely has huge potentials for further growth, particularly in the context of its orientation to high-end tourism, but in this context it is necessary to have in mind its large dependence on other sectors, i.e. factors of influence - first of all, availability of the adequate physical infrastructure, good business environment and quality of the human factor. The second great **challenge for Montenegro is related to foreign direct investments**. Since in the future they are to remain the key source of financing of the current account deficit in the balance of payment, the key challenge is to change the FDI structure in terms of increasing the share of investments into the productive segments of national economy.

Core objectives in the segment of "Trade Integration"

Strategic goal in this area is to enhance international competitiveness of Montenegrin economy and to reduce the negative impacts of external imbalance on the economic development of the country. Operationally speaking, national objectives in this segment are to increase and diversify export, and to create conditions for the stable FDI inflow into production sectors of Montenegrin economy. In that context, EU integration process is perceived as one of the key segments for achieving these objectives.

Economic policy measures for achieving the goals set in the "Trade Integration" segment

Montenegro has significant potentials for the increase of both "traditional" export and export of new products and to increase FDI. Achieving these objectives requires active economic policy oriented primarily to the removal of various barriers in all the segments we tackled in the four sub-chapters above (3.2.1 - 3.2.4). The enhancement of international competitiveness of Montenegrin economy will thus require better connections with the region and broader international environment through the establishment of high quality physical infrastructure. It will also require high-quality labour, which is the objective that can be achieved with the support of the education system adapted to the demands of economic entities. Montenegro also has to continue working on the removal of the remaining obstacles in the business environment segment and with maintaining of the flexibility in the labour market. All of

these are "infrastructural preconditions" that will enable Montenegro to strengthen its integration into international and financial flows.

In the context of its WTO and CEFTA membership, and particularly in the process of EU integration, Montenegro will continue removing the remaining trade barriers, like those related to the standardization (**priority measure no. 16: increasing competitiveness of business organisations through harmonization with the requirements of international quality standards and quality improvement**, presented in more details below) branding of products etc.

The set of measures related to the **continuation of the process of harmonization of technical legislation with the EU legislation and implementation of EU standards** will be particularly important in the future period. Both of these sets of measures are of key importance for the inclusion of Montenegro in the free movement of goods in the single EU trade market, harmonization of technical legislation and mutual recognition. Strategy for the implementation of the EU *acquis* in the field of free movement of goods 2014-2018 defines the dynamic for the implementation in this field. Timely harmonization with the EU legislation is not only a condition for the concluding of negotiations in this field but, above all, the instrument that will ensure development of economic activities and the increase of competitiveness of production aimed at easier access to the EU single market. This contributes to the development of more favourable environment for FDI. In accordance to the Strategy and the Action Plan for its implementation for 2015, the adoption of approximately 58 laws and secondary legislation pieces for certain groups of products is planned. The proposal law on budget for 2015 allocates 2.8 million € for the implementation of the Strategy.

Amending the Customs Law and adopting the Decree on the conditions and manner of **acquiring the status of an authorised economic entity**, Montenegro continues the process of liberalization of trade in this field. World Bank, EC, and OECD reports recognize the administrative barriers to trade, such as long time and a large number of documents required for customs clearance. (World Bank Report for 2014, Progress Report for Montenegro for 2013, OECD Report on administrative trade barriers for 2013). The envisaged changes in the Law will additionally harmonize national legislation with the EU legislation in this field, which will create a framework for simplifications in the customs procedures. Allocation of the status of an authorized economic entity ensures simplification of the customs procedures and lowering of the costs, which will lead to higher competitiveness of companies. The activities on amending the Law and adopting the Decree are currently in progress.

In addition to the legislative and institutional approximation, Montenegro is also working on some other economic policy measures that are aimed at stimulating export and strengthening of international competitiveness. These are the instruments like development i.e. strengthening of the links between agriculture, processing industry and tourism, as well as promotion of the agricultural- and foodstuffs products as well as other products. Bearing in mind the basic feature of the agricultural, i.e. food processing industry in Montenegro - diversity of production but in small production series, the need to provide support to producers to ensure better promotion of their products is recognized. This is primarily due to the fact that domestic producers cannot finance these activities themselves. Through the rural development measures, funds are allocated in the budget and used to promote agricultural products and agriculture. Goals of this measure are to increase competitiveness of domestic products in the domestic and international markets, but also to establish and strengthen the link between agriculture and tourism. According to the defined requirements the entities entitled to support are those that deal in production and processing of agricultural products, local communities, non-governmental organizations and registered associations in agriculture. This measure can also support advertising through various communication channels. Priority is given to the activities of provision of information within the registered quality schemes. Support is given in the form of co-financing of the activities, like participation in local, regional and international fairs. Within the ERP 2015, the priority measure within this set of measures is the participation in the fair EXPO 2015 (**priority measure no. 17: Promotion of agricultural and foodstuffs products: project EXPO 2015**, presented below).

Another set of measures in the field of trade integration, aimed at contribution to the increase of competitiveness, is related to the **promotion and encouragement of foreign and domestic direct investments**. Direct investments are important generators of economy, and in order to strengthen them, which will consequently influence development of SME sector, employment and increase of production and export, Montenegro has to continue with the improvement of the business environment. Montenegro currently has an active policy of promotion of foreign investments which is institutionally supported through the activities of the Montenegrin Investment Promotion Agency (MIPA). These activities will become stronger in the future period, and therefore new institutional solutions are envisaged (**priority measure no. 18: Improvement of the institutional framework for the promotion and encouragement of investments with an emphasis on the manufacturing industry**, presented below).

With a goal to improve new investment development policies, the projects designed in 2014 were aimed at strengthening managerial capacities within the business zones and defining promotional activities. In line with this, the "Programme for strengthening capacities of the local municipalities in the field of management and promotion of business zones" has been prepared. The key goals of this project are to attract foreign investments, as well as to simplify the process of establishing and managing business zones in the local municipalities in Montenegro. It envisages development of a new legislative framework aimed at attracting investors. In addition to this, a programme of support has been designed. Its aim is to ensure subsidies if the investors meet the pre-defined criteria when they express their interest to invest in Montenegro. The measures proposed for the improvements include amendments to the legislation, changes in the institutional framework and adoption of the Decree on encouraging direct investments and Decree on business zones. Adoption of these legislative pieces is expected in 2015.

"Priority measures" in the segment of Trade Integration

Using the selection process presented in the sub-chapter 3.1, the Government has identified three "priority measures" in the segment of "Trade integration": "increasing competitiveness of business organizations through the harmonization with the international standards and quality improvement"; "promotion of agricultural and food products (EXPO 2015) and "Improvement of institutional framework for the promotion and encouraging of investments with an emphasis on the manufacturing industry".

Priority measure no. 16: Increasing competitiveness of business organizations through the harmonization with the international standards and quality improvement

Description and classification of the measure: This measure is an administrative measure that is implemented through subsidies. International community and European Union recognize standardization as a precondition for taking part in the international and European integration flows and the basis for removing technical barriers in trade, i.e. ensuring free flow of goods and services.

The existing quality infrastructure in Montenegro is composed of the line ministries, Institute for Standardization of Montenegro, Accreditation Body of Montenegro, Bureau of Metrology, as well as other institutes and laboratories that deal with the examination of product quality.

Contribution of the measure to the removal of obstacles to economic development and strengthening of the competitive capacity of the country: Among other things, this measure should contribute to the strengthening of export capacities through the increase of competitiveness and improvements of the quality of products. Implementation of standards is significant for raising the competitiveness of companies, and economy in general.

Current situation /implementation of the measure supported by relevant indicators: A very small number of economic entities in Montenegro have the certificates for different types of standards and therefore the Government of Montenegro adopted the Programme of strengthening regional and local

competitiveness through the harmonization with the requirements set in the international standards for business operation for the period 2014-2016. The goal of this Programme is to ensure support to companies, particularly from underdeveloped municipalities and from the Northern region, to increase their competitiveness as much as possible through the harmonization with the requirements set in the international quality standards for products. Support is also provided through the Agro-budget, since it contains the Programme for enhancing competitiveness of agriculture. This programme supports improvements in the quality of agricultural products through the introduction and certification of the system of quality and food safety management, as well as through the support to producers that take part in some of the quality schemes (organic production, geographical indication of the product origin, etc.)

Envisaged timetable for implementation of the measure: The programme of increasing regional and local competitiveness through harmonization with the requirements of international standards of business operation and the Programme for strengthening competitiveness of agriculture provide support for the improvement of the quality of products. These programmes will be implemented in the period 2014-2016. They contain the following components:

- Support to SMEs in terms of reimbursement of costs for accreditation of the bodies for conformity assessment;
- Support to SMEs in terms of reimbursement of costs for the implementation of standards/certification/re-certification
- Support for improving the quality of agricultural products, which will continue after 2016 too.

Direct and possible indirect impacts of the measure on the budget/other financing sources (IPA, loans, own funds, etc): The budget funds required for the implementation of the first two components in 2015 amount to 100,000 € (the assessment is that approximately the same amount will be allocated in 2016). The amount of cca.185,000 € is planned for the Programme of support to improving quality of agricultural products in 2015.

Contribution of the measure to the Strategy SEE 2020 targets: This measure is aimed at supporting the implementation of the National Action Plan for the SEE 2020 Strategy and it is related to the pillar "Sustainable Growth", Dimension K "Competitiveness".

Potential/specific risks in the implementation of the measure: The risks in the implementation of this measure include insufficient activity of the producers on the recognition of advantages brought by introduction of the quality standards and schemes. New integration processes of Montenegro (accession to WTO and EU) will bring to even stronger changes in the conditions for economy. The conditions will be more liberal and therefore require stronger competitiveness of the products. This means that companies have to be aware that if they fail to meet the quality standards they will be excluded from international markets.

Description of the foreseen impacts of the measure and the expected timing:The effects of the implementation of this measure are reflected in the increase of the number of SMEs that have introduced international standards of business operation, enhancing thus their competitiveness and the compliance with the compulsory standards in the field of food safety. These effects can be achieved already in 2015. In the future period Montenegro should continue working on the promotion of the producers who introduce the so-called quality schemes for agricultural products. Mid-term effect of this measure include the growth of production of the companies certified for various standards and increase of exports.

Priority measure no. 17: Promotion of agricultural food products: EXPO 2015

Description and classification of the measure: In the fair Expo Milan 2015 Montenegro will be presented within the Bio-Mediterranean cluster focused on the topics related to health, harmony and beauty. The motto of Montenegrin presentation is: "A small country of great opportunities". Priority elements of the presentation will be the healthy food, ecology and tourism. This is the measure that actually combines several other measures.

Contribution of the measure to the removal of obstacles to economic development and strengthening of the competitive capacity of the country: The contribution is reflected in the implementation of the following promotional goals: (1) distributing information about Montenegro; (2) distributing information about Montenegro as an ecological state; (3) raising awareness of the international community about Montenegro as a destination; (4) creating the brand of Montenegro as a tourism destination; (5) presenting Montenegrin natural potentials/intact nature, clean rivers and lakes, sandy beaches, mountain ridges, forests; (6) presenting Montenegro as a synonym for organic food, healthy food and clean water, drinking water; (7) presenting Montenegrin products that have the status of organic food; (8) presenting companies and products with the collective trademark "Good from Montenegro".

Current state-of-play of the preparation/implementation of the measure, supported by relevant indicators: The construction of Montenegrin pavilion is currently in progress. A part of it, according to the project, will be the kitchen for preparation of the selected traditional Montenegrin dishes. It will be an opportunity to inform the guests about our high quality agricultural products that will be used for the preparation of the dishes. Participating in this World exhibition is going to promote Montenegro as a destination worth visiting and attractive for investing. Although the majority of visitors in the exhibition and our pavilion will be the Italians, visitors are also expected from a large number of other countries since Italy is one of the five most visited tourism countries in the world. Particularly important will be the visits of the state and business delegations from all over the world.

Envisaged timetable for implementation of the measure: The exhibition takes place from 1 May to 31 October 2015.

Direct and possible indirect impacts of the measure on the budget/other financing sources (IPA, loans, own funds, etc.): The envisaged costs of financing the presence of Montenegro in EXPO Milan 2015 amount to 1,800,000 €. The Government paid 500,000 € for the costs of renting the pavilion from its Budget for 2014. A number of Montenegrin companies should secure the rest of the funds.

Contribution of the measure to the SEE 2020 Development Strategy targets: Contribution of this measure to the implementation of the National AP for SEE 2020 Strategy is linked to the pillar "Integrated Growth", Dimension C "Integration into the Global Economy".

Potential/ specific risks of the implementation of the measure: No potential risk has been identified.

Description of the foreseen impacts of the measure and the expected timing: This is a particularly good opportunity to present Montenegro and to open the space for improvement of international cooperation, as well as for increasing the trade exchange with the host country and other participants in the fair and for attracting new tourists.

Priority measure no. 18: Improvement of the institutional framework for the promotion and encouraging investments with an emphasis on the manufacturing industry

Description and classification of the measure: This is an administrative and legal measure aimed at defining new development and investment policies. Ministry of Economy in cooperation with the UNDP started developing this project in order to define mechanisms for attracting new investments, related

particularly to business zones and incentives to investors. This measure is aimed at: strengthening managerial capacities within the business zones; defining promotional activities for attracting foreign investments; and simplifying the process of establishing and managing the business zones in the local self-government units in Montenegro.

In addition to the activities of the Ministry of Economy, and with a view to improve the institutional framework for promotion and stimulation of investments with a special emphasis on **metal processing, wood processing and food processing industry**, the cabinet of the Deputy Prime Minister for Economic Policy will propose to the Government the Law on Public-Private Partnership. This Law will be proposed in the first quarter of 2015 and it will envisage the establishment of an Agency for Investments. Establishing of this Agency will bring to the centralization of the state activities aimed at supporting investments.

Contribution of the measure to the removal of obstacles to economic development and strengthening of the competitive capacity of the country: This measure will contribute to the improvement of the institutional framework on the central and local level as well as of the system of incentives for investors, which will make Montenegro a more attractive place for domestic and foreign investors. Implementation of the Decree, precisely utilising funds for investment incentives will additionally enable financing of investment projects providing for opening of new jobs and strengthen the Montenegrin economy and manufacturing industry, as it is established under the Action Plan for the Development of Manufacturing Industry of Montenegro 2014-2018.

Current state-of-play of the preparation/implementation of the measure, supported by relevant indicators: At the moment two decrees are drafted: decree on business zones and decree on encouraging direct investments. This process started in 2014. The Ministry of Economy proposed to the Government the decree on encouraging direct investments in January 2015, while the decree on business zones will be proposed by the end of the first quarter 2015). . The process of drafting the Proposal Law on Public-Private Partnership is also in progress. The Deputy Prime Minister the economic policy and financial system will propose this law to the Government in the first quarter of 2015.

Key characteristics of the decrees which are proposed by the Ministry of Economy in 2015 include:

- Proposal of the **Decree on Encouraging Direct Investments** defines financial incentives for new investments in Montenegro. It is aimed at improving the business environment of the state and increasing competitiveness of economy. Thus, the adoption of this decree is aimed at attracting new investors, increasing the level of employment, particularly in underdeveloped areas of Montenegro, and at reducing of regional differences. Implementation of the provisions stipulated in the Proposal Decree will directly influence potential investors that plan to find their position in Montenegrin market. It will be done through ensuring adequate subsidies that will depend on different pre-defined criteria in line with the state aid rules. Furthermore, implementation of the said Decree is expected to affect also the manufacturing industry sectors, since the Decree will provide subsidies to investors interested for development of cost-effective investment projects, and the Decree defines precisely area in which the said subsidies could be used. The goal of this decree is to regulate the conditions and the mode of development through attracting and encouraging foreign investments, and through setting the criteria for allocation of funds for encouraging direct investments, and the pace for payment of the funds. All of this is to contribute to raising competitiveness and generating new jobs.
- **Proposal Decree on Business Zones** defines the conditions for opening of business zones in Montenegro, as well as the classification of business zones based on their strategic importance, their establishing, maintenance and management. All of this is aimed at providing support to the SME sector particularly in manufacturing industry through larger direct investments, generating of new jobs and more balanced regional development.

In addition, an important element of the measure is **Proposal Law on PPP**, which is to be proposed to the Government by the Deputy Prime Minister for Economic Policy and Financial System, and which proposes establishment of the Investment Agency that will put the activities of several institutions in this field under one roof. This authority will be in charge of privatization, promotion of investments, improvement of competitiveness, PPPs, monitoring investment agreements and post-investment activities.

Contribution of the measure to the SEE 2020 Development Strategy targets: Contribution of this measure to the implementation of the National Action Plan for the SEE 2020 Strategy is related to the pillar "Integrated Growth" and its dimension C "Integration into the Global Economy".

Direct and possible indirect impacts of the measure on the budget/other financing sources (IPA, loans, own funds, etc.): Funds envisaged in the 2015 Law on Budget for the implementation of the Decree on stimulating direct investments amount to € 1million.

Potential/specific risks in the implementation of the measure: Potential risk of the changes contained in the Decree on stimulating direct foreign investments lies in the possibility that investors/economy in various municipalities will not have sufficient absorption capacity to use the opportunities offered by the decree. As for the proposal law on PPP, i.e. proposal to establish the new Agency, there is a possibility that further discussions will be required within the Government about the optimum solution for putting the competences of several institutions under the same roof.

Envisaged timetable for implementation of the measure: The measure will be implemented in 2015.

Description of the foreseen impacts of the measure and the expected timing: Impact of this measure will be seen in the development of a competitive business environment for attracting investments, which will have a direct impact on increasing employment, production and export. All this will contribute to the introduction of new knowledge and technologies in the metal processing, wood processing and food industry, precisely to the increase of the competitiveness of the economy, which will also affect an improved image of the country. This measure will affect an increase in investments and production in the manufacturing industry, such as the introduction of green production and high operating standards.

II.4 INSTITUTIONAL ISSUES AND STAKEHOLDERS INVOLVEMENT

First chapter of this Part of the ERP presents how this document is based on several strategic national documents Montenegro has lately prepared and adopted. This principally refers to the following documents: the Development Directions of Montenegro 2013-2016 and the South East Europe Development Strategy by 2020, as well as to numerous sectoral strategies and to the Regional Development Strategy 2014-2020. Broad public consultations were held about drafts of those documents, both with professional circles and social partners, as well as with local communities. At the beginning of 2013, a conference was held in Podgorica about the draft Development Directions of Montenegro for 2013-2016, where all stakeholders have taken part.

In September 2013, a round table was organised by the Ministry of Economy and the Regional Cooperation Council (RCC) about the draft South East Europe Development Strategy by 2020, whereat the representatives of the state administration authorities, local self-government units, associations of employers, non-governmental organisations, the EU Delegation to Montenegro, and other relevant stakeholders in this segment, have taken part; while in April 2014, a round table was held, with the OECD support, about the National Action Plan for implementation of the said Strategy in 2014 and 2015, which was also attended by all previously mentioned stakeholders that have provided important inputs for the further improvement of the draft document at the time. The Regional Development Strategy 2014-2020 was also a subject of broad consultations in 2014, with representatives of local self-governments, the state administration authorities, representatives of the economy and non-governmental sector, in form of three round tables, as well as of the public consultations that lasted 40 days.

The content of the previous chapter is amply based on directions contained in the previously mentioned strategic documents of Montenegro, which have undergone broad public consultations with various groups of stakeholders. From the operational point, the draft text for Part II of the ERP was prepared based on the consultative process carried out through cooperation among line ministries, thus the priority measures were identified and articulated through structure of the working group for development of the ERP for 2015, which was appointed by the Government. Certain informal consultations were carried out with some stakeholders outside of the Government, such as the Chamber of Economy and like, about the concept for the Chapter 3 of this Part of the ERP.

As it is known, the EC Guidance for NERP was submitted to the Government of Montenegro only in October 2014. This practically meant that there was much less time to produce ERP, which is to be sent to the EC by the end of January 2015, then it was the case in previous years for preparation of EFP/PEP, even though ERP is much more comprehensive conceptually than the preceding documents. Likewise, it is important to mention as well that a preparation of Part II of ERP is essentially a brand new document in a dialogue of candidate countries with the EC and EU as whole, which implied adjustments in the very organisation process for preparation of this document in the country by comparison with the process which was established for preparation of EFP/PEP.

Consultations with various stakeholders groups about the very draft of the document were limited, due to objectively very limited time available for preparation of this-year ERP, as well as due to certain methodological dilemmas concerning the preparation of Part II of the documents. High representatives of the Government have presented a new concept of the economic management, as well as priority areas at the event **Montenegrin Economy in 2014, with proposals for measures for the business environment advancement**, organised by the Chamber of Economy and during the event **Talks to EU** organised by the EU Delegation to Montenegro. In line with consultations with the EC during the ERP preparation, in particular during the meeting held on 11 and 12 December 2014 in Podgorica about the

document, a proposal of the ERP for 2015 was published on the Government's website more than 3 weeks before it was planned for adoption at the session of the Government – and so was subject to suggestions from the wider public.

As it was mentioned in the EC Guidance for NERP, work for Part II could be considered this year as a pilot phase, and not only in terms of the content but also in terms of the document preparation. Certainly, as the Guidance for the document preparation become available earlier in the forthcoming years, the ERP development process will commence in timely manner and thus create prerequisites for a more comprehensive consultations process.

III ANNEX TO I PART OF THE DOCUMENT

GDP (in mill €)	3327,1		3393,2		3547,0		3737,0		3964,0	
Public expenditure	2013		Estimate 2014		Plan 2015		Estimate 2016		Estimate 2017	
	mil. €	% BDP	mil. €	% BDP	mil. €	% BDP	mil. €	% BDP	mil. €	% BDP
Current revenues	1431,90	43,04	1492,88	44,00	1520,80	42,88	1547,80	41,42	1596,71	40,28
Taxes	863,52	25,95	912,44	26,89	945,69	26,66	958,77	25,66	988,91	24,95
Personal Income Tax	124,15	3,73	135,76	4,00	139,93	3,94	133,26	3,57	137,24	3,46
Corporate Profit Tax	40,64	1,22	45,72	1,35	46,64	1,31	47,80	1,28	49,38	1,25
Immovable property transactions tax	14,13	0,42	16,10	0,47	15,96	0,45	16,28	0,44	16,63	0,42
Value added tax	429,20	12,90	459,67	13,55	480,25	13,54	492,25	13,17	508,50	12,83
Excise duties	161,45	4,85	162,46	4,79	167,71	4,73	171,90	4,60	177,58	4,48
Tax on international trade and transactions	22,27	0,67	22,43	0,66	22,88	0,64	23,45	0,63	24,22	0,61
Local taxes	66,60	2,00	64,68	1,91	66,62	1,88	67,95	1,82	69,31	1,75
Other revenues of the Republic	5,09	0,15	5,61	0,17	5,72	0,16	5,86	0,16	6,06	0,15
Contributions	398,49	11,98	428,37	12,62	417,49	11,77	427,93	11,45	442,05	11,15
Duties	33,30	1,00	23,37	0,69	23,84	0,67	24,40	0,65	25,04	0,63
Fees	68,24	2,05	69,44	2,05	68,44	1,93	69,88	1,87	71,46	1,80
Other revenues	50,01	1,50	45,82	1,35	50,67	1,43	51,87	1,39	53,40	1,35
Receipts in respect of repayment of loans and funds carried over from previous year	8,63	0,26	4,97	0,15	5,07	0,14	5,20	0,14	5,37	0,14
Donations	9,72	0,29	8,46	0,25	9,59	0,27	9,76	0,26	10,48	0,26
Public expenditure	1608,41	48,34	1515,14	44,65	1709,41	48,19	1733,68	46,39	1754,49	44,26
Current public expenditure	1484,02	44,60	1371,32	40,41	1384,72	39,04	1400,08	37,47	1415,55	35,71
Current expenses	668,86	20,10	694,25	20,46	695,64	19,61	697,56	18,67	700,16	17,66
Gross wages and contributions at expense of employers	407,05	12,23	423,33	12,48	415,63	11,72	417,75	11,18	420,96	10,62
Other personal earnings	14,60	0,44	14,83	0,44	13,93	0,39	13,07	0,35	12,62	0,32
Expenditures for supplies	33,32	1,00	35,51	1,05	35,68	1,01	36,75	0,98	37,13	0,94
Expenditures for services	58,82	1,77	51,03	1,50	49,37	1,39	49,85	1,33	50,34	1,27
Expenditures for current maintenance	24,27	0,73	25,60	0,75	25,06	0,71	25,16	0,67	25,42	0,64
Interests	71,27	2,14	74,57	2,20	79,90	2,25	80,36	2,15	80,89	2,04
Rent	8,36	0,25	8,74	0,26	8,80	0,25	8,55	0,23	8,41	0,21
Subsidies	18,18	0,55	21,45	0,63	21,83	0,62	22,30	0,60	21,49	0,54
Other expenditures	24,92	0,75	27,25	0,80	31,59	0,89	31,20	0,84	30,97	0,78
Capital expenditures in the current budget	8,08	0,24	11,95	0,35	13,85	0,39	12,56	0,34	11,93	0,30
Social protection transfers	483,40	14,53	507,12	14,95	505,46	14,25	516,25	13,81	526,32	13,28
Social welfare benefits	64,47	1,94	62,10	1,83	61,15	1,72	62,46	1,67	62,79	1,58
Funds for redundant labour	13,09	0,39	25,70	0,76	19,44	0,55	18,86	0,50	18,29	0,46
Pension and disability insurance benefits	383,19	11,52	397,32	11,71	402,45	11,35	412,51	11,04	422,82	10,67
Other health care benefits	14,79	0,44	14,75	0,43	15,00	0,42	15,00	0,40	15,00	0,38
Other health insurance related benefits	7,86	0,24	7,25	0,21	7,42	0,21	7,42	0,20	7,42	0,19
Transfers to institutions, individuals, non-governmental and public sector	122,04	3,67	135,67	4,00	163,06	4,60	163,86	4,38	165,81	4,18
Capital expenditures	124,39	3,74	143,82	4,24	324,70	9,15	333,59	8,93	338,94	8,55
Borrowings and loans	4,13	0,12	4,34	0,13	4,49	0,13	4,43	0,12	4,37	0,11
Reserves	15,94	0,48	14,67	0,43	16,06	0,45	17,99	0,48	18,90	0,48
Repayment of guarantees	107,23	3,22	15,26	0,45	0,00	0,00	0,00	0,00	0,00	0,00
Net increase in liabilities	21,87	0,66	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00
Surplus/ Deficit	-176,51	-5,31	-22,26	-0,66	-188,61	-5,32	-185,87	-4,97	-157,78	-3,98
Primary deficit	-105,24	-3,16	52,31	1,54	-108,71	-3,06	-105,51	-2,82	-76,89	-1,94
Debt repayment	286,04	8,60	311,24	9,17	455,79	12,85	436,34	11,68	244,97	6,18
Debt repayment to residents	119,92	3,60	100,86	2,97	51,21	1,44	63,36	1,70	49,84	1,26
Debt repayment to non-residents	52,89	1,59	115,08	3,39	326,77	9,21	316,98	8,48	143,13	3,61
Repayment of arrears	113,24	3,40	95,30	2,81	77,81	2,19	56,00	1,50	52,00	1,31
Shortfall/financing needs	-462,55	-13,90	-333,50	-9,83	-644,40	-18,17	-622,21	-16,65	-402,75	-10,16
Financing	462,55	13,90	333,50	9,83	644,40	18,17	622,21	16,65	402,75	10,16
Borrowings and loans from domestic sources	151,29	4,55	102,41	3,02	5,00	0,14	15,00	0,40	15,00	0,38
Borrowings and loans from foreign sources	191,43	5,75	194,16	5,72	637,08	17,96	607,91	16,27	391,07	9,87
Privatisation proceeds	26,78	0,80	11,00	0,32	10,00	0,28	10,00	0,27	10,00	0,25
Increase/reduction of deposits	93,04	2,80	25,92	0,76	-7,68	-0,22	-10,70	-0,29	-13,31	-0,34

Source: Ministry of Finance of Montenegro

GDP (in mill €)	3327,1	3393,2	3547,0	3737,0	3964,0
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Budget of Montenegro	2013		Estimate 2014		Plan 2015		Estimate 2016		Estimate 2017	
	mill €	% GDP	mill €	% GDP	mill €	mill €	% GDP	mill €	% GDP	mill €
Current revenues	1243,53	37,38	1307,06	38,52	1329,18	37,47	1352,41	36,19	1397,04	35,24
Taxes	755,70	22,71	801,87	23,63	832,67	23,48	843,49	22,57	871,32	21,98
Personal Income Tax	95,62	2,87	104,45	3,08	107,93	3,04	100,63	2,69	103,95	2,62
Corporate Profit Tax	40,64	1,22	45,72	1,35	46,64	1,31	47,80	1,28	49,38	1,25
Immovable property transactions tax	1,44	0,04	1,53	0,04	1,56	0,04	1,59	0,04	1,65	0,04
Value added tax	429,20	12,90	459,67	13,55	480,25	13,54	492,25	13,17	508,50	12,83
Excise duties	161,45	4,85	162,46	4,79	167,71	4,73	171,90	4,60	177,58	4,48
Tax on international trade and transactions	22,27	0,67	22,43	0,66	22,88	0,64	23,45	0,63	24,22	0,61
Other revenues of the Republic	5,09	0,15	5,61	0,17	5,72	0,16	5,86	0,16	6,06	0,15
Contributions	398,49	11,98	428,37	12,62	417,49	11,77	427,93	11,45	442,05	11,15
Contributions for pension and disability insurance	241,95	7,27	262,64	7,74	246,41	6,95	252,57	6,76	260,90	6,58
Contributions for health insurance	134,70	4,05	143,82	4,24	145,46	4,10	149,09	3,99	154,01	3,89
Contributions for unemployment insurance	10,77	0,32	11,55	0,34	12,72	0,36	13,04	0,35	13,47	0,34
Other contributions	11,07	0,33	10,36	0,31	12,91	0,36	13,23	0,35	13,67	0,34
Duties	27,18	0,82	16,57	0,49	16,90	0,48	17,33	0,46	17,90	0,45
Administrative duties	7,99	0,24	7,93	0,23	8,09	0,23	8,29	0,22	8,57	0,22
Court duties	4,56	0,14	5,07	0,15	5,17	0,15	5,30	0,14	5,48	0,14
Temporary residence duties	0,77	0,02	0,67	0,02	0,68	0,02	0,70	0,02	0,72	0,02
Other duties	13,86	0,42	2,90	0,09	2,96	0,08	3,03	0,08	3,13	0,08
Fees	13,23	0,40	15,22	0,45	13,48	0,38	13,82	0,37	14,27	0,36
Other revenues	33,68	1,01	33,59	0,99	36,97	1,04	37,89	1,01	39,14	0,99
Receipts in respect of repayment of loans and funds carried over from previous year	8,63	0,26	4,97	0,15	5,07	0,14	5,20	0,14	5,37	0,14
Donations	6,61	0,20	6,46	0,19	6,59	0,19	6,76	0,18	6,98	0,18
Expenditures	1459,23	43,86	1371,72	40,43	1564,97	44,12	1586,98	42,47	1604,13	40,47
Current budgetary expenditures	1382,01	41,54	1269,90	37,42	1280,27	36,09	1293,39	34,61	1305,20	32,93
Current expenses	605,64	18,20	632,04	18,63	631,83	17,81	632,29	16,92	632,60	15,96
Gross wages and contributions at expense of employers	371,00	11,15	388,12	11,44	379,36	10,70	380,58	10,18	382,48	9,65
Other personal earnings	12,12	0,36	12,56	0,37	11,62	0,33	10,71	0,29	10,18	0,26
Expenditures for supplies	27,27	0,82	29,36	0,87	29,41	0,83	30,36	0,81	30,51	0,77
Expenditures for services	49,87	1,50	43,34	1,28	41,53	1,17	41,85	1,12	42,06	1,06
Expenditures for current maintenance	20,42	0,61	21,43	0,63	20,81	0,59	20,83	0,56	20,93	0,53
Interests	67,92	2,04	70,52	2,08	75,77	2,14	76,14	2,04	76,53	1,93
Rent	7,93	0,24	8,29	0,24	8,33	0,23	8,08	0,22	7,91	0,20
Subsidies	17,43	0,52	20,87	0,62	21,25	0,60	21,71	0,58	20,88	0,53
Other expenditures	23,61	0,71	25,60	0,75	29,90	0,84	29,48	0,79	29,19	0,74
Capital expenditures in the current budget	8,08	0,24	11,95	0,35	13,85	0,39	12,56	0,34	11,93	0,30
Social protection transfers	482,97	14,52	506,52	14,93	504,85	14,23	515,62	13,80	525,67	13,26
Social welfare benefits	64,04	1,92	61,50	1,81	60,53	1,71	61,83	1,65	62,14	1,57
Funds for redundant labour	13,09	0,39	25,70	0,76	19,44	0,55	18,86	0,50	18,29	0,46
Pension and disability insurance benefits	383,19	11,52	397,32	11,71	402,45	11,35	412,51	11,04	422,82	10,67
Other health care benefits	14,79	0,44	14,75	0,43	15,00	0,42	15,00	0,40	15,00	0,38
Other health insurance related benefits	7,86	0,24	7,25	0,21	7,42	0,21	7,42	0,20	7,42	0,19
Transfers to institutions, individuals, non-governmental and public sector	94,31	2,83	102,13	3,01	128,29	3,62	128,36	3,43	129,00	3,25
Capital Budget	77,22	2,32	101,82	3,00	284,70	8,03	293,59	7,86	298,94	7,54
Borrowings and loans	2,75	0,08	2,14	0,06	2,25	0,06	2,14	0,06	2,03	0,05
Reserves	14,13	0,42	11,81	0,35	13,06	0,37	14,99	0,40	15,90	0,40
Repayment of guarantees	107,23	3,22	15,26	0,45	0,00	0,00	0,00	0,00	0,00	0,00
Net increase in liabilities	14,44	0,43	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00
Surplus/ Deficit	-215,70	-6,48	-64,67	-1,91	-235,79	-6,65	-234,57	-6,28	-207,10	-5,22
Primary deficit	-147,78	-4,44	5,85	0,17	-160,02	-4,51	-158,43	-4,24	-130,57	-3,29
Debt repayment	158,59	4,77	246,24	7,26	398,29	11,23	379,34	10,15	189,97	4,79
Debt repayment to residents	107,62	3,23	92,86	2,74	46,71	1,32	58,36	1,56	43,84	1,11
Debt repayment to non-residents	50,97	1,53	108,08	3,19	317,77	8,96	304,98	8,16	129,13	3,26
Repayment of arrears	60,54	1,82	45,30	1,33	33,81	0,95	16,00	0,43	17,00	0,43
Shortfall/financing needs	-374,29	-11,25	-310,91	-9,16	-634,08	-17,88	-613,91	-16,43	-397,07	-10,02
Financing	374,29	11,25	310,91	9,16	634,08	17,88	613,91	16,43	397,07	10,02
Borrowings and loans from domestic sources	145,35	4,37	98,41	2,90	0,00	0,00	10,00	0,27	10,00	0,25
Borrowings and loans from foreign sources	188,52	5,67	192,16	5,66	634,08	17,88	603,91	16,16	387,07	9,76
Privatisation proceeds	11,95	0,36	5,00	0,15	0,00	0,00	0,00	0,00	0,00	0,00
Increase/reduction of deposits	14,04	0,42	15,33	0,45	0,00	0,00	0,00	0,00	0,00	0,00

Source: Ministry of Finance of Montenegro

cGDP (in mill €)	3327,1	3393,2	3547,0	3737,0	3964,0
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Local-government	2013		Estimate 2014		Plan 2015		Estimate 2016		Estimate 2017	
	mil. €	% BDP	mil. €	% BDP	mil. €	% BDP	mil. €	% BDP	mil. €	% BDP
Current revenues	188,37	5,66	185,83	5,28	191,62	5,40	195,40	5,23	199,67	5,04
Taxes	107,82	3,24	110,57	3,14	113,02	3,19	115,28	3,08	117,58	2,97
Personal Income Tax	28,53	0,86	31,31	0,89	32,00	0,90	32,64	0,87	33,29	0,84
Immovable property transactions tax	12,69	0,38	14,58	0,41	14,40	0,41	14,69	0,39	14,98	0,38
Local taxes	66,60	2,00	64,68	1,84	66,62	1,88	67,95	1,82	69,31	1,75
Duties	6,12	0,18	6,80	0,19	6,94	0,20	7,07	0,19	7,15	0,18
Administrative duties	1,51	0,05	1,87	0,05	1,91	0,05	1,95	0,05	1,97	0,05
Local municipal utility services duties	4,33	0,13	4,77	0,14	4,86	0,14	4,96	0,13	5,01	0,13
Other duties	0,28	0,01	0,16	0,00	0,16	0,00	0,17	0,00	0,17	0,00
Fees	55,00	1,65	54,22	1,54	54,96	1,55	56,06	1,50	57,18	1,44
Fee for use of goods of common interest	9,30	0,28	9,00	0,26	9,18	0,26	9,36	0,25	9,55	0,24
Free for equipping and development of buildable land	37,03	1,11	37,00	1,05	37,44	1,06	38,19	1,02	38,96	0,98
Fee for construction and maintenance of local roads and other public structures of municipal interest	2,93	0,09	2,36	0,07	2,41	0,07	2,46	0,07	2,51	0,06
Other fees	5,75	0,17	5,86	0,17	5,93	0,17	6,05	0,16	6,17	0,16
Other revenues	16,33	0,49	12,24	0,35	13,71	0,39	13,98	0,37	14,26	0,36
Revenues from capital	1,80	0,05	2,28	0,06	2,55	0,07	2,60	0,07	2,65	0,07
Pecuniary fines and seized property gains	0,60	0,02	0,68	0,02	0,76	0,02	0,78	0,02	0,80	0,02
Revenues generated by own activities of authorities	2,66	0,08	3,93	0,11	4,40	0,12	4,49	0,12	4,58	0,12
Other revenues	11,27	0,34	5,35	0,15	6,00	0,17	6,12	0,16	6,24	0,16
Donations	3,10	0,09	2,00	0,06	3,00	0,08	3,00	0,08	3,50	0,09
Expenditures	153,89	4,63	145,57	4,14	146,44	4,13	148,69	3,98	152,36	3,84
Current budgetary expenditures	106,72	3,21	103,57	2,95	106,44	3,00	108,69	2,91	112,36	2,83
Current expenses	63,22	1,90	62,22	1,77	63,82	1,80	65,27	1,75	67,56	1,70
Gross wages and contributions at expense of employers	36,04	1,08	35,21	1,00	36,27	1,02	37,17	0,99	38,47	0,97
Other personal earnings	2,48	0,07	2,27	0,06	2,31	0,07	2,36	0,06	2,44	0,06
Expenditures for supplies	6,05	0,18	6,15	0,17	6,27	0,18	6,40	0,17	6,62	0,17
Expenditures for services	8,95	0,27	7,69	0,22	7,84	0,22	8,00	0,21	8,28	0,21
Expenditures for current maintenance	3,85	0,12	4,17	0,12	4,25	0,12	4,34	0,12	4,49	0,11
Interests	3,35	0,10	4,05	0,12	4,13	0,12	4,21	0,11	4,36	0,11
Rent	0,44	0,01	0,46	0,01	0,47	0,01	0,48	0,01	0,49	0,01
Subsidies	0,76	0,02	0,57	0,02	0,58	0,02	0,59	0,02	0,62	0,02
Other expenditures	1,30	0,04	1,65	0,05	1,69	0,05	1,72	0,05	1,78	0,04
Social protection transfers	0,44	0,01	0,60	0,02	0,62	0,02	0,63	0,02	0,65	0,02
Social welfare benefits	0,44	0,01	0,60	0,02	0,62	0,02	0,63	0,02	0,65	0,02
Transfers to institutions, individuals, non-governmental and public sector	32,44	0,97	35,70	1,02	36,77	1,04	37,50	1,00	38,81	0,98
Transfers to institutions, individuals, non-governmental and public sector	19,09	0,57	20,56	0,58	21,17	0,60	21,60	0,58	22,35	0,56
Other transfers	13,35	0,40	15,14	0,43	15,59	0,44	15,91	0,43	16,46	0,42
Capital expenditures	47,17	1,42	42,00	1,19	40,00	1,13	40,00	1,07	40,00	1,01
Borrowings and loans	1,38	0,04	2,20	0,06	2,24	0,06	2,29	0,06	2,34	0,06
Reserves	1,82	0,05	2,85	0,08	3,00	0,08	3,00	0,08	3,00	0,08
Repayment of guarantees	7,43	0,22		0,00		0,00		0,00		0,00
Surplus/ Deficit	39,19	1,18	42,41	1,21	47,18	1,33	48,70	1,30	49,31	1,24
Primary deficit	42,54	1,28	46,46	1,09	43,05	1,21	52,92	1,42	53,68	1,35
Debt repayment	66,91	2,01	65,00	1,85	57,50	1,62	57,00	1,53	55,00	1,39
Debt repayment to residents	12,30	0,37	8,00	0,23	4,50	0,13	5,00	0,13	6,00	0,15
Debt repayment to non-residents	1,92	0,06	7,00	0,20	9,00	0,25	12,00	0,32	14,00	0,35
Repayment of arrears	52,69	1,58	50,00	1,42	44,00	1,24	40,00	1,07	35,00	0,88
Shortfall/financing needs	-27,72	-0,83	-22,59	-0,64	-10,32	-0,29	-8,30	-0,22	-5,69	-0,14
Financing	27,72	0,83	22,59	0,64	10,32	0,29	8,30	0,22	5,69	0,14
Borrowings and loans from domestic sources	5,94	0,18	4,00	0,11	5,00	0,14	5,00	0,13	5,00	0,13
Borrowings and loans from foreign sources	2,91	0,09	2,00	0,06	3,00	0,08	4,00	0,11	4,00	0,10
Privatisation proceeds	14,83	0,45	6,00	0,17	10,00	0,28	10,00	0,27	10,00	0,25
Increase/reduction of deposits	4,02	0,12	10,59	0,30	-7,68	-0,22	-10,70	-0,29	-13,31	-0,34
Transfers from the Central Budget	4,71	0,14	2,16	0,06	2,00	0,06	2,00	0,05	2,00	0,05

Source: Ministry of Finance of Montenegro

Fiscal framework (u mill €)	Outturn	Estimate	Base scenario			Low-growth scenario		
	2013.	2014.	2015.	2016.	2017.	2015.	2016.	2017.
Public revenues	1.431,9	1.492,9	1.520,8	1.547,8	1.596,7	1.487,4	1.520,0	1.577,3
Central budget revenues	1.243,5	1.307,1	1.329,2	1.352,4	1.397,0	1.295,7	1.324,6	1.377,6
Local self-government revenues	188,4	185,8	191,6	195,4	199,7	191,6	195,4	199,7
Public expenditure*	1.608,4	1.515,1	1.709,4	1.733,7	1.754,5	1.709,4	1.733,7	1.754,5
Central Budget expenditures	1.459,2	1.371,7	1.565,0	1.587,0	1.604,1	1.565,0	1.587,0	1.604,1
Local self-government expenditures	153,9	145,6	146,4	148,7	152,4	146,4	148,7	152,4
Interests	71,3	74,6	79,9	80,4	80,9	79,9	80,4	80,9
Central Budget	67,9	70,5	75,8	76,1	76,5	75,8	76,1	76,5
Local self-governments	3,3	4,1	4,1	4,2	4,4	4,1	4,2	4,4
Capital Budget	124,4	143,8	324,7	333,6	338,9	324,7	333,6	338,9
Central Budget	77,2	101,8	284,7	293,6	298,9	284,7	293,6	298,9
Local self-governments	47,2	42,0	40,0	40,0	40,0	40,0	40,0	40,0
Public Finance surplus/deficit	-176,5	-22,3	-188,6	-185,9	-157,8	-222,0	-213,7	-177,2
Central Budget	-215,7	-64,7	-235,8	-234,6	-207,1	-269,2	-262,4	-226,5
Local self-governments	39,2	42,4	47,2	48,7	49,3	47,2	48,7	49,3

*Public expenditure is consolidated with transfers of the Central Budget to the local self-government

Fiscal framework (as % of GDP)	Outturn	Estimate	Base scenario			Low-growth scenario		
	2013.	2014.	2015.	2016.	2017.	2015.	2016.	2017.
Public revenues	43,0	44,0	42,9	41,4	40,3	42,7	41,8	41,4
Central budget revenues	37,4	38,5	37,5	36,2	35,2	37,2	36,4	36,2
Local self-government revenues	5,7	5,5	5,4	5,2	5,0	5,5	5,4	5,2
Public expenditure	48,3	44,7	48,2	46,4	44,3	49,1	47,7	46,1
Central Budget expenditures	43,9	40,4	44,1	42,5	40,5	44,9	43,7	42,1
Local self-government expenditures	4,6	4,3	4,1	4,0	3,8	4,2	4,1	4,0
Interests	2,1	2,2	2,3	2,2	2,0	2,3	2,2	2,1
Central Budget	2,0	2,1	2,1	2,0	1,9	2,2	2,1	2,0
Local self-governments	0,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1
Capital Budget	3,7	4,2	9,2	8,9	8,6	9,3	9,2	8,9
Central Budget	2,3	3,0	8,0	7,9	7,5	8,2	8,1	7,9
Local self-governments	1,4	1,2	1,1	1,1	1,0	1,1	1,1	1,1
Public Finance surplus/deficit	-5,3	-0,7	-5,3	-5,0	-4,0	-6,4	-5,9	-4,7
Central Budget	-6,5	-1,9	-6,6	-6,3	-5,2	-7,7	-7,2	-6,0
Local self-governments	1,2	1,2	1,3	1,3	1,2	1,4	1,3	1,3

Identified projects		Funds to be invested in factors of production in 2015 (in €)
TURIZAM		
1.	Hilton	20.600.000
2.	"Euromix trade" doo Petrovac and "Budvanska rivijera" ad Budva; Crystal Rivijera Petrovac	6.585.376
3.	Construction of the tourism resort Luštica (Tivat)	30.000.000
4.	Kumbor	80.000.000
5.	Porto Montenegro	32.000.000
6.	Hotels&Restaurant "Primorje" AD; reconstruction of the Center for Leisure, Recreation and Treatment "Igalo"	1.000.000
7.	"Nivel Invest" doo and "Luzitanos Invest CO" doo; construction of the First phase of a condo hotel and garage	7.151.005
8.	"Porto Sole" doo; hotel construction	1.393.614
9.	Peković Ivan and Nikolić Tomislav, condo hotel in Tivat	1.403.832
10.	"Praxis" doo , hotel	1.098.158
11.	"Čelebić" doo, construction of the Second phase of the facility for sports and reaction and hotel facility	2.543.036
12.	Marko Marković, hotel reconstruction	589.758
13.	"Hungest Hotels Montenegro", hotel reconstruction in Herceg Novi	1.460.503
14.	Sekulić Vladimir, hotel in Sutomore	1.362.605
15.	"Operatio trading Montenegro" doo, Budva; condo hotel	15.932.822
16.	Filotić Goran, hotel reconstruction in Budva	3.556.850
17.	Kharkin Vladislava, hotel annex reconstruction part of Hungest hotels "Sun resort"	565.705
18.	"Politropus alternative" doo Tivat, hotel reconstruction in Herceg Novi	9.699.783
19.	Arsić Rade, hotel reconstruction in Tivat	2.040.511
20.	"Ruža vjetrova" d.o.o, construction of the sub-phase A and phase of the tourism resort Ponta- Ruža vjetrova	403.572
21.	"INC" doo and Ivanović Nikola and Ivan, hotel reconstruction in Budva	1.015.817
TOTAL-TOURISM		220.402.948
TRANSPORT		
22.	Trebaljevo Bridge reconstruction works	2.500.000
23.	Supervision of works for the Trebaljevo bridge reconstruction	200.000
24.	Railroad track overall of the section Kos - Trebješica - works	4.470.000
25.	Supervision of Railroad track overall of the section Kos - Trebješica	130.000
26.	Decommissioning of the existing, procurement and installation of the new power substation Trebješica - works	700.000
27.	Review and supervision of works for power substation Trebješica	160.000
28.	Reconstruction of the tunnel No 5 - works	1.100.000
29.	Railroad track overall of the section Kolašin - Kos - works	1.300.000
30.	Development of the Main design for modernization of signal cabin in Podgorica and inspection of concrete bridges	1.000.000
31.	Installation of heating for railroad switches in stations Nikšić and Ostrog and slope remediation	500.000
32.	Highway Bar-Boljare	53.000.000
TOTAL - TRANSPORT		65.060.000
INDUSTRY		
33.	Construction of wind turbines Krnovo and Možura	30.042.320
34.	EPCG projects	18.000.000
35.	Project concerning the connection of electric power systems of Montenegro and Italy via a submarine cable (part of the project implemented by CGES)	20.200.000
36.	Construction of small hydro-power plants on watercourses	13.241.651
37.	Investment Plan of Tosčelik	10.000.000
38.	Investment of the Coal Mine Pljevlja	5.000.000
39.	EEPB – Energy Efficiency in Public Buildings Program	5.300.000
40.	MEEP – Montenegro Energy Efficiency Program	2.500.000
TOTAL - INDUSTRY		104.283.971
AGRICULTURE		
41.	Projects financed from MIDAS	1.500.000
42.	Projects financed from IPARD LIKE	4.500.000
43.	Projects financed from ADFD	12.000.000
44.	Projects financed from the Agro-budget	4.500.000
TOTAL AGRICULTURE		22.500.000
TOTAL (TOURISM, TRANSPORT, INDUSTRY, AGRICULTURE)		412.246.919

The amount of invested funds is a conservative assessment of the line ministries concerning investments in the factors of production in 2015 by projects presented by the line ministries as contracted or certain in terms of realisation. Risk identification exists for each project, which in case it is effectuated may lead to realisation of the low-growth scenario. As it could be noted from the total amount of investments, 53% is planned for tourism, 16% for transport, while the sectors energy and industry account for 25% and agriculture for 5%.

IV ANNEX TO II PART OF THE DOCUMENT

Table reporting table on Sectoral Structural Reform Measures

Recommendation/ country specific policy guidance (1)	Number and title of the measure and the sector (2)	Description of main measures of direct relevance to support competitiveness and growth, and to address country-specific policy guidance (if applicable)					Link to SEE 2020 targets	Challenges/ Risks	Budgetary implications/ including committed IPA funds	Quantitative elements
		Main policy objectives and relevance for competitiveness and growth (3)	Description of the measure (4)	Legal/ Administrative instruments (5)	Timetable onprogress achieved in the last 12 months (6)	Timetable on upcoming steps (up to three years) (7)	Estimated contribution to SEE2020 national action plan (8)	Specific challenges/ risks in implementing the measures (9)	Overall and yearly change in government revenue and expenditure (reported in mil. national currency) Contribution of IPA (source and amounts) (10)	Qualitative description of foreseen impacts and their timing (11)
Building the infrastructure to support of expansive growth of the economy	Segment 1: Physical capital Priority measure 1: Construction of the priority section Smokovac-Matešev of the Bar-Boljare Highway	Objective in line with the PRCG 2013-2016 “High quality and efficient transport, increase in transport efficiency and mobility, quality development of transport infrastructure, improvement of environmental protection, increasing safety in carriage of goods and persons”. - Highway Bar-Boljare (SEETO road route 4) should connect Montenegro, from the Adriatic coast through capital Podgorica with the border of Serbia, and via Požega-Belgrade road with TEN-T corridor X with Romania and the Central Europe.At the same time, the Bar – Boljare Highway will better connect main regional centres Sarajevo (Bosnia and Herzegovina), Tirana (Albania) and Skopje (FYRMacedonia).Therefore , this project has an important strategic role for the entire region and will	Investment measure, i.e. investment in construction of the priority section Smokovac – Uvač - Matešev of the Bar – Boljare Highway	– Design and Build Contract for the priority section Smokovac-Uvač- Matešev of the Bar – Boljare Highway; – Contract on preferential loan for financing the priority section Smokovac-Uvač- Matešev of the Bar – Boljare Highway; – Law on the Bar- Boljare Highway.	– On 26 February 2014, the Design and Build Contract for the priority section Smokovac- Uvač-Matešev of the Bar – Boljare Highway was signed; – On its session held on 7 August 2014, the Government of Montenegro has adopted a Decision on establishment of Project Management Unit for the construction Bar- Boljare highway as part of the company “Monteput” (Project Manager); – On 11 September 2014, a Consultancy Services Agreement was signed with the selected supervisory entity	Preparation of the Main Design and execution of work on the priority section Smokovac- Uvač-Matešev of the Bar–Boljare High will commence in 2015 and will last 48 months.	Contribution of this measure to the implementation of the National Action Plan for the SEE 2020 Strategy is reflected through the Dimension I – Transport, within the Pillar – Sustainable Growth.	<i>Risks may pertain to possible changes in the dynamic and quality of execution of works, which would possible affect completion deadlines and costs.</i>	Maximum guaranteed price for design and construction of the priority section Smokovac-Uvač- Matešev of the Bar – Boljare Highway is 809.57 million euro; (sources: 85% loan of the EXIM bank, and 15% the State Budget during 48 months of the project duration)	The execution of this project will create possibility for significantly easier communication between the relatively under-developed North and more developed Central and Coastal Region of Montenegro. In addition to increased internal connectivity within the country implying creation of assumptions for reduction of regional gaps, the project will also be a significant step towards better connectivity with Serbia and qualitative connectivity with the European transport corridors. All this will gain its full relevance when the Bar – Boljare Highway is fully constructed.

		increase its competitiveness.			<p>for supervision of development of the project documentation and execution of works;</p> <ul style="list-style-type: none"> – On 30 October 2014, the Contract on preferential loan for financing the priority section Smokovac-Uvač-Mateševo of the Bar – Boljare Highway was signed; – On 8 December 2014, the Parliament of Montenegro has adopted the Law on the Bar-Boljare Highway. 					
	<p>Segment 1.: Physical capital Priority measure 2: Preparation of spatial planning documents for the Adriatic-Ionian Highway</p>	<p>Adriatic-Ionian Highway should connect Montenegro with Bosnia and Herzegovina and Croatia and on the other side with Albania and Greece and contribute to substantially greater integration of the Montenegrin space into and then its connectivity with regional and European road network. Therefore, this project has important strategic role for the entire region. The highway will connect Western and Eastern Europe, and at the same time, it will be the shortest land connection between the Western Europe countries and Greece and Albania. This road direction should make accessible more than has been the case so far,</p>	<p>Adoption of the planning documentation, as a precondition for the project implementation</p>	<p>Spatial Plan of Montenegro by 2020</p>	<p>The detailed spatial plan is in the proposal stage and has undergone in the previous period all procedures envisaged by the Law for development and adoption of a planning document. In 2014, a proposal of the Plan was aligned with the spatial requirements around the Capital Podgorica and intersection with other infrastructure corridors in Montenegro.</p>	<p>The measure will be fully implemented in 2015</p>	<p>Contribution of this measure to the implementation of the National Action Plan for SEE 2020 Strategy is through the Dimension I – Transport, as part of the pillar – Sustainable Growth</p>	<p><i>Risks could prating to possible changes in the timing for completion of drafting the plan, which would possibly affect the deadlines for commencing with development of the project documentation and start with the construction.</i></p>	<p><i>Fund intended for completion of this measure are projects in 2015 under the budget of the Ministry of sustainable development and tourism, and amount approx. €14,000. Total budget funds for this purpose in 2014 were €275,000.</i></p>	<p><i>The Ministry of Sustainable Development and Tourism intends to create prerequisites for commencement of this infrastructure project which is important for Montenegro with implementation of this measure.</i></p>

		<p>tourist destinations on the coast, both for the European users and local needs. The Adriatic-Ionian Highway is around 94.40km long on the territory of Montenegro. The Adriatic-Ionian Highway Project is an important priority of the Government of Montenegro and one of the elements of our European Union integration strategy, which will facilitate greater and safer mobility of people, goods and services. The Adriatic-Ionian Highway Project is also identified as a project whose implementation will facilitate more balanced regional development of the country, exploitation of natural resources, tourism development, better transport connectivity and overall economic development.</p>								
	<p>Segment 1: Physical capital: Priority measure 3: Modernisation of the railway network</p>	<p>Objective under the PRCG 2013 -2016: "High quality and efficient transport, increase in transport efficiency and mobility, quality development of transport infrastructure, improvement of environmental protection, increasing safety in carriage of goods and persons".</p>	<p>- Railway infrastructure modernisation project is an investment measure.</p>	<p>Law on Budget; Transport Development Strategy.</p>	<p>Around 40% of Vrbnica-Bar track has been overhauled so far, and it has contributed the trains to operate at design speed from Vrbnica to Kolašin, and reduction of the train travel time and delays, and also the reconstruction of a part of the signal-safety system has been covered, as well as telecommunication equipment and</p>	<p>Measure will be implemented in 2015, whereby certain activities will also continue in the following years.</p>	<p>Contribution of this measure to the implementation of the SEE 2020 Strategy is linked to the Pillar – Sustainable Growth, Dimension I – Transport</p>	<p>Potential risks concerning the modernisation of the railway infrastructure deal with a possibility that the full amount of funds to finance realisation of the programmes and projects after 2015 will not be secured.</p>	<p>Total amount of €12.018 million is planned for 2015 to finance the realisation of the Programme and projects.</p>	<p>Effects of this measure could be measured after the realisation of the programme, which includes the very reconstruction or construction of the railway infrastructure. Generally, they will affect an increase in speed of the railway transport, and thus higher throughput of passengers and cargo, which has multiple effects on the economic operations.</p>

					replacement of a part of contact network.					
	Segment 1: Physical capital Priority measure 4: Execution of the project of undersea cable connecting of energy systems of Montenegro and Italy	Objective under the PRCG 2013-2016: "Meeting energy needs with minimum economic costs in the system of generation, supply and minimum impact on the environment, increase of energy efficiency, increase of reliability and quality of electricity supply, environmental protection during the entire life of the electricity generation." - The measure will contribute to: 1) the construction of substantially better and stronger transmission network in Montenegro; 2) the establishment of direct connection of Montenegro to the EU electricity market; 3) the positioning of Montenegro as an important energy hub in the region; 4) encouraging of investments in new electricity sources, particularly renewable energy sources.	Connecting electricity power systems of Montenegro and Italy via a submarine cable is an investment measure	Energy Development Strategy by 2030	International tenders were carried out in line with EBRD rules and contracts were signed with contractors for works for all three parts of the Project, with consent of these banks, and so as follows: 1) Lot 1 - Substation 400/110/35 kV Lastva; 2) Lot 2 – 400 kV power line Lastva - Pljevlja, section Lastva – Čevo; 3) Lot 3 – 400 kV power line Lastva - Pljevlja, section Čevo - Pljevlja.	The measure will be implemented in 2015 and beyond	Envisaged measure is in full compliance with key strategic objectives of the National Action Plan for implementation of the SEE 2020 Strategy, through the Pillar – Sustainable Growth, the Dimension H – Energy.	Since this is a project that envisages the construction of a 400 kV power line of around 150km in a rather challenging terrain, and construction of the transmission sub-station, as well as placement of the submarine cable, being by itself a rather complex part of the project, and depending on problems the contractors will encounter there is a possible risk of delay and impact on the dynamic of the project implementation.	According to plans, the allocated funds for implementation of the project in 2015 amount around 20 million euro, and later one will depend on the project implementation dynamic. Total value of investment for CGES is approx 105 million euro. (sources of financing for the project for CGES are: KfW loan of €25 mill and EBRD loan of €60 mill, while the part of funds comes from subscription of shares by Terna from new issue in the process of capital increase .)	The project of submarine cable connecting Montenegro and Italy will ensure fostering of electricity transmission system in Montenegro, establish direct connection with the EU electricity market and position Montenegro as an important electricity hub in the region. In addition, this project will have long-term effects on encouraging investments in the construction of generation capacities in Montenegro and creation of better conditions for electricity generation, which will contribute to increased competitiveness and export capabilities of Montenegrin economy.

<p>Progress report, page 69, Chapter 27 (“Strategic planning, substantial investment and significant further efforts are needed to ensure alignment with and implementation of environment and climate acquis”)</p>	<p>Segment 1: Physical capital Priority measure 5: Municipal utility infrastructure enhancement</p>	<p>Realisation of this measure will affect the better environmental protection in Herceg Novi, and Nikšić, increased level of municipal utility services, while over the long-term it will affect incentives for investments in construction of new facilities, tourism facilities in the first place.</p>	<p>Investment measure in the construction of infrastructure for the water supply needs and wastewaters management</p>	<p>Law on waters, Master Plan for wastewater treatment in Montenegrin Coastal Municipalities and the Cetinje Municipality Strategic Master plan for sewerage and wastewaters in the Central and Northern Region of Montenegro; The Urban Waste Waters Directive 91/271/EEC</p>	<p>Since these are the projects implemented over several years: (1) Project in Herceg Novi in the period 2012-2015, (2) Project in Nikšić in the period 2008-2015 Already commenced construction works have continued in the previous 12 months</p>	<p>Project covered by this measure are ending in 2015, but the implementation of new projects will commence, such as for construction of wastewaters treatment plant for municipalities Kotor and Tivat, construction of the wastewaters treatment plant and sewerage network in Bijelo Polje and other</p>	<p>Contribution of this measure to the National Action Plan for SEE 2020 in the pillar – Sustainable Growth, Dimension J – Environment</p>	<p>Possible risks may pertain to the timetable for execution of works, which could not affect sizeably the deadline for completion of works concerning the current degree of completion</p>	<p>Total funds for implementation of this measure are secured in the following manner: (1) for implementation of the project in Herceg Novi – loan funds and grant (for consulting services) of the KfW of €19.36 million, the State Budget – €4.26 million, the Municipal budget - €3.58 million; (2) for project in Nikšić from the EIB loan was secured €14.16 million. Out of the total funds, for the Herceg Novi Project for 2015 was planned €7.81 million from the loan and €3.58 million from the Municipal Budget; while for the <i>Nikšić project it remains 1.3 million euro to be paid-in from the EIB loan.</i></p>	<p>Realisation of this measure creates conditions for implementation of the EU environmental regulations, increasing the level of municipal utility services and thus creates a more favourable environment for construction of new facilities, in particular in the tourism area.</p>
<p><i>Progress Report, page 33, Chapter 11</i> (“The agriculture and rural development national strategy needs to be adopted and additional capacity building is required to ensure future implementation of the IPARD programme and to develop overall capacity for implementing the</p>	<p>Segment 1: Physical capital Priority measure 6: Construction and reconstruction of infrastructure in rural areas (water supply systems and road infrastructure)</p>	<p><i>Providing of good quality infrastructure in rural areas ensures achievement of the basic objective of agriculture development as specified in the Agriculture Development Strategy 2014-2020 and Montenegro Development Directions 2013-2016, which are related to ensuring adequate standard of living for rural population and increase of competitiveness.</i></p>	<p>This is an investment-type measure which includes; Identification of needs in the field (list of priority projects by municipality); Reconstruction, filling and building roads in rural areas; Resolving the matter of water supply in rural areas; Electrification of summer mountain pastures (<i>katun</i>) through grant support to agricultural producers who transhumance with herds to the Montenegrin katuns.</p>	<p>Strategy for Development of Agriculture and Rural Areas 2015–2020 Annual Agro-budget of the Ministry of Agriculture and Rural Development Program for incentives of water resource management projects</p>	<p>Measures will be implemented in line with the agro-budget, which is created annually (road and electricity infrastructure) and the Programme for incentives for projects of water resource management (water supply infrastructure); From 2018, the measure Reconstruction and</p>	<p>Continuously 2015-2020, while introducing new financial instruments; 2015 membership in the International Fund for Agricultural Development (IFAD), 2018-2020 commencement of implementation of measures through IPARD II program</p>	<p>Dimension I – Transport, Dimension J – Environment</p>	<p>Lack of financing of the second partner (local self-governments, local communities, villages)</p>	<p>Funds earmarked for realisation of this measure are projected under the Agro-budget for 2015, and they amount: TOTAL approx. €0.8 million; The Action Plan for implementation of the Strategy for Development of Agriculture and Rural Areas 2015-2020 envisages implementation of this measure through</p>	<p>Improve the quality of life in rural areas, prevent population outflow, increase agricultural production</p>

common agricultural policy.”)					Construction of village infrastructure will be carried out through IPARD II programme.				IPARD II programme form 2018, when the amount of allocated funds necessary for realisation of this measure will be decided.	
Progress Report for 2014, page 22: “Implementation of education reform in order to decrease skills gap, strengthening of active labour market policies, as well as introduction of higher flexibility in the labour market through special collective agreements for public and private sectors are essential for reduction of unemployment”	Segment 2: Human capital Priority measure 7: Enrolment policy reform at tertiary education intuitions	Development and implementation of appropriate admission policy, in accordance with the long-term development goals of the country	Continuous preparation of periodic analyses of labour market, in cooperation with the Employment Agency, Chamber of Economy, Employers’ Union, Human Resources Management Authority and other relevant institutions; using data obtained from the Program of Professional Training of Persons with Acquired Higher Education by HEIs and relevant authorities as good indicator for forecasting of qualifications aligned with real market needs	Law on Higher Education (Official Gazette of Montenegro, 44/2014); Strategy on Development and Financing of Higher Education 2011-2020; Admission Policy at the University of Montenegro	reduced number of students enrolled in some study programs in accordance with offers and demands at the labour market	It is continuous process. In accordance with the Law on Higher Education Government upon proposal of the University determines the final number of students to be enrolled at the University every year. One of the forthcoming activity in accordance with Law is re-licensing of HEIs and periodical analysis of the labour market needs.	Dimension L – Employment	Inconsistency in implementation of the enrolment policy from the labour market needs point	It is determined by the state budget and project budgets	Redesigned existing and created new study programs in accordance with labour market needs; prepared - long-term analysis and forecasts of human resources needs; Potentially some study programs are stopped.
Progress Report for 2014, page 22: “Implementation of education reform in order to decrease skills gap, strengthening of active labour market policies, as well as introduction of higher flexibility in the labour market through special collective agreements for public and private sectors are essential for reduction of unemployment” and Chapter 19, area of employment policies page 41	Segment 2: Human capital Priority measure 8: Programme of Professional Training of Persons with Acquired Higher Education	Development of a competitive society through education and higher employment of economically active population (PRCG 2013-2016)	<ul style="list-style-type: none"> Realisation of the Programme of Professional Training of Persons with Acquired Higher Education This is a measure that combines administrative, legal and investment elements 	Law on Professional Training of Persons with acquired Higher Education (Official Gazette of Montenegro, No 38/2012). Proposal of the Law on Professional Training of Persons with Acquired Vocational Education. National Employment Strategy with development of human resources 2012-2015 and the Action Plan for Employment and Development of Human Resources for 2014.	During 2014, 3,945 persons with university degree have participated in the Programme of Professional Training of Persons with Acquired Higher Education. The Law on Professional Training of Persons with Acquired Vocational Education is prepared and submitted for the EC opinion. During 2014, 360 employers have participated through active labour market policy measures – Program to purport seasonal employment of youth, which have hired 1,685 persons	1. Realisation of the Programme of Professional Training of Persons with Acquired Higher Education during 2015, as well as continuation of the programme during 2016 and 2017. 2. Adoption of the legal framework for implementation of the Programme of Professional Training of Persons with Acquired Vocational Education. Commencement of the programme is planned for 2016, as well as its continuation in	Dimension L – Employment	Realisation measures will be carried out in line with allocated funds for 2015.	National contribution for item 1 for 2015 is 8.5 million euro, while the planned funds for 2016 and 2017 amount 10 million Euros per year.	Increased number of persons with higher education with acquired knowledge, skills and competences for inclusion in the labour market; Increased participation of youth in seasonal-type jobs in order to acquire certain knowledge, skills and competences.

					up to 25 years of age.	2017. 3. Realisation of active employment policy measures with special focus on youth. Realisation of the measure will continue in 2016 and 2017.				
Progress Report for 2014, page 22: Availability of human and physical capital ("further efforts are required on research, development and innovation to strengthen the competitiveness of domestic companies")	Segment 2: Human capital: Priority measure 9: Construction of Innovation - Entrepreneur Centre "Tehnopolis" in Nikšić	In line with the objective from the PRCG 2013-2016: "Increasing the quality of scientific-research activity" "Tehnopolis" will enable generating and commercialisation of innovative ideas into a concrete product or service, which could be thereafter placed in the market, and this will be an ideal opportunity for everyone with good ideas and entrepreneur spirit. Also, conditions will be created for strengthening of cooperation between academic and scientific-research institutions from one side and private sector on the other, in view of strengthening innovative activities "Tehnopolis" may have multiple positive effects on the economy and innovative, scientific and business environment in Montenegro, given that it will support creating and attracting new SMEs and consolidation of the existing ones and because of that it will have impact on opening of new jobs.	Investment measure of the establishment/construction of the innovation-entrepreneur centre	Law on Scientific-Research Activity (2010) <i>Strategy for Scientific and Research Activities 2012-2016</i>	Realisation of the project for Construction of Innovation-Entrepreneur Centre "Tehnopolis" in Nikšić has commenced	Completion of the project and commencement of operation of the Innovation and Entrepreneurship centre "Tehnopolis", as a first impulse centre of the future Science and technology park.	Dimension E – R&D and Innovation	Timetable of tender procedures and performance of construction works; Risks of establishment and acceptance of the new organisational concept; Insufficient financial support which reduces the interest for participation in certain programmes, as well as low success rate when applying to competitions.	In 2015, total €1.5 million, and so as follows: €0.93 million from the Capital Budget of Montenegro; €0.06 million from the current budget for operation of "Tehnopolis"; €0.5 million from IRFCG;	Improvement in research and innovation framework, aimed at cooperation of scientific and research and economic sector will lead to strengthening of capacities of the SMEs, as well as of scientific and research institutors. It is expected that the measure will bring to the improvement of the existing and creation of new high technology products and services and thus contribute to increased competitiveness and overall economic development of the country.
Progress Report, page 42- Limited progress has been	Segment 3: Better industrial structures	Better industrial structures to support dynamic SMEs	Better access to loans and factoring facilities	SMEs Development Strategy 2011-2015, Strategy for	Until 31-Dec-2014, 279 loans – €41.5 mil 28 factoring facilities	Continuously 2015-2017, while introducing new	Dimension K – Competitiveness, Pillar -	Possibility to provide financing for implementation	2015 – €80,15 mil €80 mil	Availability of financing for SMEs improved – national and COSME, IPA;

made in the area of enterprise and industrial policy. Page 23 – Public-sector support schemes for small and medium-sized enterprises (SMEs) remain limited.	Priority measure 10: Financial support to SME sector	development by improving financial instruments for competitiveness and growth	Grant support to SMEs for alignment with international business standards Grant support to cluster development	Enhancement of Competitiveness at the Micro Level 2011-2015, Strategy for Sustainable Economic Growth through Introduction of Business Clusters 2012-2016; Manufacturing Industry Development Strategy 2014-2018	– €29.7 mil for redeemed receivables Implementation with one enterprise supported by the Programme for Introducing standards is underway – €0.005 mil 1 cluster-€0.01 mil	financial instruments 2016-2017 (EIB, COSME/EIF) Implementation of activities from the SMEs Development Strategy 2011-2015; Strategy for Life-long Entrepreneurial Learning 2015-2019; Development of the new SMEs Development Strategy 2016-2020	Sustainable Growth, No 1a/1b/1c/1d	Level of participation of financial intermediaries in implementation of COSME financial instruments	€0.1 million €0.05 million 2016/2017- At least on level financial allocation in 2015	Number of SMEs, employment and competitiveness increased.
Page 33- Administrative capacity and support measures need to be strengthened to make full use of programmes for financial and non-financial support to SMEs.	Segment 3 Better industrial structures Priority measure 11: s Enhancement of institutional and administrative capacities for SME support	Better industrial structures to support dynamic SMEs development by improving financial instruments for competitiveness and growth	This measure is combination of administrative and investment. Making operational RBC and incubator; Rendering services of internationalisation for SMEs by EEN Montenegro (COSME programme) Delivery of training for employees at the local level, aimed at improving support for SMEs and clusters	SMEs Development Strategy 2011-2015, Strategy for Enhancement of Competitiveness at the Micro Level 2011-2015, Strategy for Sustainable Economic Growth through Introduction of Business Clusters 2012-2016; Manufacturing Industry Development Strategy 2014-2018	Construction of RBC and incubator in Berane commenced; Services to SMEs provided by EEN Montenegro Activities to strengthen capacity for improving support for SMEs and clusters started	Implementation of activities from the SMEs Development Strategy 2011-2015; Strategy for Life-long Entrepreneurial Learning 2015-2019 Development of the new SMEs Development Strategy 2016-2020	Dimension K - Competitiveness – Pillar - Sustainable Growth, No 1a/1b/1c/1d	Availability of financing for implementation level of participation of providers of advisory services to support the SMEs sector	2015 – €0.245 million National contribution: €0.025 million €0.2 million IPA 2011 – RBC and incubator construction, equipping and training €0.02 million (IPA 2011 training for business clusters support) Listed IPA projects are being finalised in 2015 2016-2017 €0.1 million -National contribution (Budget) IPA 2014 in total amount of €1.5 mil for technical assistance (€0.3 million planned for preparation of the grant schemes to increase competitiveness)	Inter-municipal infrastructure to support SMEs in form of RBC and incubator established; Capacities for delivery of advisory services to small and medium-sized enterprises and clusters aimed at supporting start up and further growth of SMEs and increase of absorption capacities to use financial support instruments and other SMEs support programmes improved.
	Segment 3: Better industrial structures Priority measure 12: Enhancement of tourist offer in the north of Montenegro	Objective is linked to the PRCG 2013-2016, as well as to sectoral strategy.Objective deals with construction of a new and improvement of	Construction of the skiing infrastructure in locations "Kolašin" 1600 in Kolašin and "Cmiljača" in Bijelo Polje; Construction of a reservoir at the location of	Tourism Development Strategy by 2020; Regional Development Strategy 2014-2020;	Project documentation for execution of investment prepared	In line with the schedule the investments will be carried out in 2015;	Pillar - Sustainable Growth; Dimension K - Competitiveness;	Conditions in nature, precisely weather conditions	€6.69 million planned in line with the Proposal Law on Budget for 2015	Skiing infrastructure improved; Revenues from tourism and related activities increased; Number of employed in the North of Montenegro

	through construction of required infrastructure in ski resorts	existing skiing infrastructure to purport creation of a more favourable business environment, development of Montenegro and to enable more balanced regional development of Montenegro.	the skiing site "Vučje" in Nikšić							increased; Contribution to the Budget from VAT, corporate profits tax, etc increased;
Progress Report, page 21 "Overall, simpler and more predictable regulation of business and further efforts to tackle corruption are needed to improve the business climate"	Segment 4: Good business environment Priority measure 13: Strengthening institutional framework for enforcing contracts	One of the objectives under the PRCG 2013-2016 is "improving the business environment for investors (by reducing administrative barriers)". This is an administrative-legal measure delaying with streamlining the enforcement of contracts by reducing number of procedures, costs and duration of the procedure.	Make that the enforcement procedure is faster, higher quality and more efficient	Law on Enforcement and Securing of Claims; Law on Public Enforcement Officers	In cooperation with OSCE, the Ministry has organised 6 consultations for training of public enforcement officers and continuously provides professional assistance and support in order to strengthen the public enforcement activity and invigorates the bodies of the Chamber. The Ministry of Justice has published four announcements so far for appointment of public enforcement officers, and 37 candidates have applied of whom 29 were appointed. In order to advance the enforcement system, the Ministry of Justice has prepared a Proposal of the Law Amending and Supplementing the Law on Enforcement and Securing of Claims, which was submitted to the Parliament of Montenegro for adoption.	Improving the rank in the area "Enforcing Contracts" in the World Bank's Doing Business Report	Implementation of this measure concerns the Pillar – Integrated Growth, Dimension B - Competitive Economic Environment	Possible delays in implementation of planned reforms	It is not possible to calculate budgetary effects of the measure	Enforcement procedure improved by making it faster, of higher quality and more efficient. The measure will contribute to increase the state administration capacity in order to improve the business environment and provide public services necessary for economic development.
Progress Report, page 21 ("Overall, simpler and more predictable	Segment 4: Good business environment Priority measure 14:	Montenegro Development Directions 2013-2016 – objective "Improved spatial	Improving the existing ICT system in the area of spatial development and construction of structures –	State planning documents	State planning documents are published on the Geoportal of the	- Adoption of the Rulebook on Detailed Content and the Manner of	Dimension N - Effective Public Services	ICT system should connect large number of entities/bodies and	Funds for implementation of the measure are requested from the	Introduction of e-operations will primarily abolish paper format for development of planning

regulation of business and further efforts to tackle corruption are needed to improve the business climate”).	Improving the process of issuing building permits through upgrade of the existing ICT solutions	planning, high quality of building permits (sustainability), competitiveness of construction companies and incentives for entrepreneurship, foreign investments, integration of illegal structures into the formal housing” ... Improving the process of issuing building permits through upgrade of the existing ICT systems integrating all spatial information, which will facilitate implementation of investments in the space, as well as construction of municipal utility, energy, transport and other infrastructure.	Unidocs, and using the e-government portal and EDMS archive – Origami (e-plans, e-building permits, e-archive, e-inspection) will make the business environment simpler and more predictable, while the transparency of the process will ensure implementation of the measures provided in the Action Plan for preventing and combating corruption.		Ministry of Sustainable Development and Tourism, while the integration of GIS with documentation base is underway, and a web-service for exchange of data with the Chamber of Engineers will be implemented through the integration project. A service for electronic filing of requests for issuing urban-development and technical requirements is in a test phase at the e-government portal, in accordance with the Law on E-government. All requests lodged with the Ministry of Sustainable Development and Tourism by parties concerning the area of spatial development and construction of structures could be lodged electronically after amendments to legislation governing the area of spatial development and construction of structures.	Keeping the Central Registry of Planning Documents; – Establishment of the Central Registry of Planning Documents; – Adoption of the Law on Spatial Development and Construction of Structures, which will govern electronic operation for the area of spatial development and construction of structures; - Improvement of the ICT system to support the electronic operations		institutions participating in the process of obtaining a construction permit, thus a potential risk is recognised here.	Budget. <i>The implementation is envisaged for 2015, 2016 and 2017 (the prices amount will be submitted after IT experts have completed evaluation).</i>	documents and development of technical documentation, which are quite voluminous, meaning that the e-operation contributes to reduction of costs, improvement in work efficiency and simplification of procedures
Progress Report, page 21 (“Overall, simpler and more predictable regulation of business and further efforts to tackle corruption are needed to improve the business	Segment 4: Good business environment Priority measure 15: Online accessibility of public services and implementation of information system for the exchange of data from registries	Objectives are in line with the PRCG and sectoral strategy. The objective is to govern in a normative and technical manner the possibility for citizens and business entities to communicate with the	Measure is of administrative and legal nature and relates to streamlining and efficiency of procedures and will also affect the establishment of an information system for exchange of data among the state authorities via an efficient communication	Law on Electronic Communications	E-government portal, as a central point for access to the administration services, is operating since 2011, which has created technical assumptions for development of e-government in	All authorities communicating with citizens and business entities have the obligation to make also available in electronic form all services provided in conventional	Dimension F- Digital Society – Further development of e-government and development of cross-border cooperation	Resistance to changes, lack of compliance with the Law on Electronic Government, absence of inspection supervision	€0.5 million from the 2015 Budget – first phase of the ICT system development for exchange of data among the state administration authorities	More convenient access to services of the administration, faster and more efficient exercising rights of citizens and business entities, less administrative barriers

climate”).	of state authorities’	State and local-level administration using a single e-counter (e-government portal), while providing easier access to the public administration services which will contribute to the strengthening of human rights as well as to improvement of business environment, one hand, and to a more efficient practice of authorities, on the other hand.	among institutions (improving the G2G segment of the e-government). The measure creates preconditions for electronic issuing of building permits, electronic registration of companies, electronic issuing of certificates related to citizens’ rights, etc		Montenegro. This is regulated from the legislative point with the adoption of the Law on Electronic Government.	manner within 18 months as of the entry into force of the Law on Electronic Government (by February 2016). The strategic objective is to have 200 services of the state administration until the end of 2016, while legislative regulations have created prerequisites for the objective set under the Information Society Development Strategy 2012-2016 to be exceeded. An integrated information system for exchange of data among the state administration authorities will be implemented by August 2016.				
Progress Report, page 24: External position strengthening is necessary by strengthening export capabilities and the integration of Montenegrin businesses in the common market.	Segment 5: Trade integration Priority measure 16: Increase of competitiveness of business entities through harmonization with international standards and quality improvements	The objective is contribution to strengthening export capabilities by increasing competitiveness and improving the quality of products. Implementation of standards is important to advance the competitiveness of business entities and by doing so of the entire economy. The objective is aligned with the PRCG 2013-2016 dealing with the “Competitive SME sector in an entrepreneurial economy based on knowledge, technological	This is an administrative measure, implemented through subsidies aimed at purporting the quality system. Elements of the measure are: 1) Support to SMEs in form of refunding costs for accreditation body for compliance assessment; 2) Support to SMEs in form of refunding costs for implementation of standards/ certificates/ recertification; 3) Support for improvement of agricultural products quality, which will continue even beyond 2016.	Law on Budget; Law on Regional Development; Programme to increase regional and local competitiveness through alignment with international operational standards requirements for the period 2014-2016; - Agro-budget	In 2015, 10 applications to start the process of introducing standards linked with first two elements of the measure were approved. Based on contracts with the Ministry of Economy, funds were refunded per application, upon submitting required evidence and meeting other requirements of the contract (€0.003).	Implementation of the Programme in 2015 and 2016	Pillar - Sustainable Growth, Dimension K - Competitiveness	Adequacy of budgetary funds for the application of measure could be a risk	Fund envisaged under the budget for implementation of the first two components/elements of the measure in 2015 of €0.1 million (with an estimate that approximately the same amount will be also allocated in 2016), while the amount of €0.18 million was planned in 2015 for improving the quality of agricultural products.	Effects from implementation of this measure are in the increased number of SMEs that have introduced international operational standards and thus increased their competitiveness, as well as mandatory standards in the field of food safety, and these effects could be achieved as early as in 2015. Promotion of producers for introduction of so-called registered quality schemes for agricultural products should be continued in the forthcoming period. Medium-term effect of this measure pertains to

		innovations, and modernised capacities”.								the growth in production of enterprises that obtained certificates for various standards and increase of export.
Progress Report, page 24 (External position strengthening is necessary by strengthening export capabilities and the integration of Montenegrin businesses in the common market.)	Segment 5: Trade integration Priority measure 17: Promotion of exports of agricultural and food products: Project EXPO 2015	Improving cooperation in order to increase number and value of investments, increase trade with host country and other participants, and increase number of tourists, to utilise to a maximum participation at the fair.	At the EXPO Milano 2015 fair, Montenegro will be presented as part of the Bio-Mediterranean Cluster, which deals with emphasizing themes of health, harmony and beauty. The motto of Montenegro’s presentation is “A small country with large opportunities”. The priority element of the EXPO presentation will be healthy food, ecology and tourism.	Strategy for Attracting Foreign Direct Investments 2013-2015	A theme statement was signed as part of official obligations towards the Organiser, which defines objectives. Works to construct the Montenegrin pavilion have commenced and mostly completed (deadline for completion is January 2015)	Participation at the EXPO 2015 fair	Pillar – “Integrated Growth”, Dimension C - “Integration into the Global Economy”	Securing of lacking funds	Total needed funds amount to 1.8 million euro. Amount of €0.5 million was paid from the 2014 Budget. The remaining funds should be provided from donations i.e. mainly from business entities.	Improvement of international cooperation, increase of trade with the host country and other participants at the fair, and attracting new tourists.
Progress Report, page 24 (External position strengthening is necessary by strengthening export capabilities and the integration of Montenegrin businesses in the common market.)	Segment 5: Trade integration Priority measure 15: Improving the institutional framework for the promotion and encouragement of investments with an emphasis on the manufacturing industry;	Purporting direct investments and streamlining processes to establish and manage business zones in local self-government units in Montenegro, as well as improving the institutional framework for investments at the central level	This is and administrative and legal measure aimed at defining new development of development investment projects. It contains three elements: - Proposing a Decree concerning the incentives for direct investments; - Proposing a Decree on business zones, - Proposing a Law on PPPs.	Law on Budget; Montenegro Regional Development Strategy 2014-2020; Strategy for Attracting Foreign Direct Investments 2013-2015	In 2014, drafts of all three regulations were prepared, which represent elements of measures, and the Government has received for adoption, in January 2015, proposal of a decree for direct investments incentives	Adoption of decrees and defining a proposal of the Law on PPPs is envisaged for Q1 of 2015	Pillar - Integrated Growth, Dimension C - Integration into the Global Economy	Adequacy of budgetary funds	Up to € 1 million in 2015 from the Budget of Montenegro for implementation of the Decree on the incentives for direct investments; At the moment there is no method to accurately estimate funds for application of two other regulations.	- FID inflow; - GDP increase; - increase in number of employees; - strengthening competitiveness of local self-governments and the overall economy; - increasing production in the manufacturing industry (wood processing, metal processing and food industry) and export