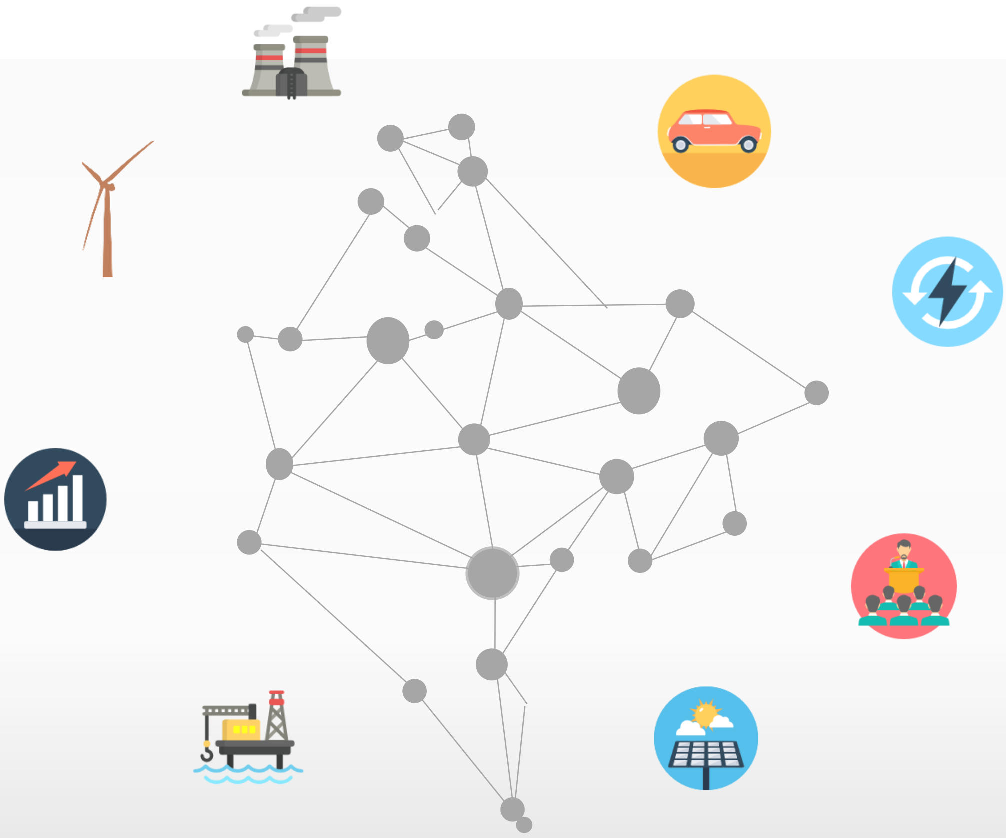
GOVERNMENT OF MONTENEGRO

ECONOMIC REFORM PROGRAMME FOR MONTENEGRO

2018 – 2020



PODGORICA, JANUARY 2018

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LIST OF ABBREVIATIONS

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

1. OVERALL POLICY FRAMEWORK AND OBJECTIVES

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

Similar to previous years, the topics covered by the Economic Reform Programme for the period 2018-2020 have been the subject of a wide consultative process with the most important stakeholders in the society, as well as the work of the inter-ministerial working group established by the Government of Montenegro to prepare it.

Montenegro's economic policy and the Euro-Atlantic integration process

The most important achievement of Montenegro with respect to foreign policy was that in 2017 it became the 29th member of the NATO alliance. In this way, we have ensured the security of our country, but also created the preconditions for a more accelerated economic growth and development.

We are also very dedicated to the implementation of our second foreign policy priority – membership of the European Union. So far, Montenegro has opened 30 and closed three negotiating chapters. This clearly brings us closer to the proclaimed goal of the country's 41st government to complete the negotiation process by the end of its term and prepare Montenegro for full membership of the European Union. On this path, the focus will continue to be on strengthening the rule of law and further strengthening the democratic capacities of the state and the society as a whole.

In the intensive work on these two integration processes, regional cooperation has not been neglected. Montenegro's proactive approach is reflected in the Berlin Process, which has brought significant benefits to the Western Balkan region in restoring and modernizing the outdated infrastructure. Through the Western Balkans Investment Framework, Montenegro has so far had 18 million euro approved for infrastructure projects. A new method of communication between the region's leaders has been promoted, through intensive dialogue at the highest level, not only in Brussels and European capitals, but also for the first time in the countries of the region, with the aim of strengthening regional economic cooperation and implementation of the Multi-Annual Action Plan for a Regional Economic Area of six countries of the Western Balkans within the CEFTA legal framework.

Also, as a member of the World Trade Organization (WTO), Montenegro is regularly fulfilling its obligations arising from the multilateral trading system and WTO agreements, with the aim of simplifying trade and increasing overall competitiveness.

Montenegro's strategic development goal in the next medium-term period and the economic policy directions for achieving it

Montenegro's strategic development goal defined in the Economic Reform Programme is sustainable and inclusive economic growth that will contribute to reducing the country's development gap relative to the EU average and increasing the quality of life of all its citizens. GDP per capita at current prices for 2017 is estimated at around 6,770 euro, while in terms of purchasing power parity it is currently at the level of 45 percent of the EU average. This indicates that Montenegro still requires real economic growth rates of around 4 percent in the forthcoming period, as the one in 2017, for GDP per capita to converge faster to the EU and consequently for the standard of living to converge faster with those of developed countires.

As described in the Economic Reform Programme for 2017, the Government of Montenegro is combining two sets of economic policy measures to achieve the mentioned strategic development goal. The first set of measures refers to strengthening macroeconomic stability of the country, fiscal and financial. The second set of economic policy measures is aimed at resolving structural problems in the economy, eliminating the key obstacles to improving the country's competitiveness and increasing the potential economic growth in the medium and long term.

Consistency between recommendations from the Ministerial Dialogue of May 2017 and the priorities of the Government of Montenegro

The Economic Reform Programme is a document fully consistent with the annual Budget Law and the Medium-Term Budget Framework, as well as Montenegro's strategic development documents. The European Commission annually assesses the reform measures and policies contained in this document and, in that context, in the May 2017 Ministerial Dialogue recommendations were given for its preparation for the 2018-2020 period on the basis of the 2017 ERP. These are the six recommendations contained in Table 1.1 of this chapter, which also conform to Montenegro's key development priorities defined in the strategic documents: Montenegro Development Directions for 2018-2021; South East Europe 2020 Development Strategy; National Strategy for Sustainable Development by 2030; as well as sector development strategies and policies. These priorities imply: *strengthening the fiscal stability and sustainability of the economy; preserving a predictable and competitive tax system; strengthening the physical infrastructure; systematic reduction of the informal economy; increasing the efficiency of the state administration; strengthening support for small and medium-sized enterprises with diversification of production and the export base; human resource development and increased labour market flexibility; strengthening social inclusion; and further strengthening the rule of law.*

Starting with the above, the document presents the medium-term macroeconomic and fiscal framework with the accompanying structural reform agenda with which Montenegro is responding to the joint conclusions given at the Ministerial Meeting between the EU and the Western Balkans and Turkey in May 2017. Table 1.1 below shows the reform measures implemented by the end of 2017 or planned for 2018, as a response to the abovementioned recommendations.

Table 1.1: Recommendations from the Ministerial Meeting in May 2017 and their implementation (already implemented or foreseen for 2018)

Recommendations for Montenegro	*Measures implemented by the end of 2017 and measures foreseen for 2018*
1. Fully implement the 2017 consolidation package and take additional fiscal measures if necessary to achieve the envisaged budget savings of around 3 percent of GDP. Adopt a comprehensive medium-term fiscal strategy with concrete revenue and expenditure measures in order to stabilize public debt and reduce debt-related vulnerabilities. Consider establishing an independent fiscal council.	*The Government of Montenegro implemented a package of fiscal consolidation measures for 2017, which contributed to reducing the budget deficit relative to GDP by more than 3 percentage points as it is contained in the Budget Deficit and Public Debt Recovery Plan until 2021,. The government also adopted an additional fiscal consolidation measures package contained in the* ***Fiscal Strategy 2017-2020 adopted in July 2017, which provides for additional consolidation of about 2.8 percent of GDP in the period 2017-2020. More concretely, th***e Fiscal Strategy envisages the central ***government budget deficit in 2017 of 5 percent of GDP without repayment of commitments from the previous period (or 5.9 percent GDP with the Repayment of commitments from the previous period).*** *The central government budget deficit envisaged by the budget revision for 2017 is planned at 4.1 percent of GDP,* ***without repayment of commitments from the previous period.*** *The public finance deficit envisaged by the budget revision in December is planned at 3.1 percent of GDP in 2017,* ***without repayment of commitments from the previous period, what is below the plan in the Fiscal Strategy.*** *The central government budget deficit planned by the 2018 budget is 2.66 percent of BDP , while the public finance deficit is planned at 1.6 percent in 2018,* ***without repayment of commitments from the previous period.*** *Also, in line with recommendation from the Ministerial Meeting in May 2017, analysis of the establishment of the Fiscal Council of Montenegro, the model of its oepraiton and its structure started and will be finalized in 2018.* *All of the above is at the same time the Montenegrin Government's response to Recommendation No. 1 from the Joint Conclusions of Montenegro and the EU at the Ministerial Meeting held in May 2017.*
2. Gradually reduce public spending on wages and pensions as a share of GDP. Ensure the availability of adequate financial resources for the	*The medium-term fiscal consolidation measures contained in the Fiscal Strategy are leading to a gradual reduction in public spending on wages and pensions as a share of GDP, and these two categories, cumulatively, range from 20.7 percent of GDP in*

implementation of new legislative measures. Strengthen tax revenues and review tax exemptions with a view to a further reduction of tax exemptions. Adopt measures in order to facilitate debt servicing by tapping the local debt markets, extending maturities, and advancing the privatisation agenda.	*2018 to 19.7 percent of GDP in 2020, bearing in mind that the nominal growth of these categories is slower than GDP growth.* *In accordance with the mentioned recommendation, the tax revenue (central government budget revenues) that Montenegro collected in 2017 was around 79 million euro (or 5.3 percent) higher than in 2016. At the same time, revenue was above the level planned for 2017 creating room for a budget revision in December 2017 and a reduction of the planned central government budget deficit in 2017 compared to the projection in the Fiscal Strategy.* *According to the same recommendation from the Ministerial Dialogue in May 2017, the Ministry of Finance analysed the tax exemptions and reliefs established by the Law on Value-Added Tax and the Law on the Highway.* *In addition, the Government will adopt he Public Debt Managament Strategy for the period 2018-2020, in the first half of 2018.*
3. Continue efforts to foster NPL resolution by developing a comprehensive strategy to that end, including participation by all relevant stakeholders, with the aim of reducing credit risks in the banking sector and removing impediments to credit extension in the economy. Consider to include corporate debt restructuring and tackle other underlying structural obstacles of resolution as part of the strategy. Enhance prudential and banking resolution frameworks to the end of buttressing financial stability.	*As a measure towards a further reduction of non-performing loans (NPLs), an amendment to the Law on Voluntary Financial Restructuring of Debts to Financial Institutions was adopted in 2017, which created the possibility of out-of-court resolution of NPLs, in the interest of the debtor and the creditor. For the implementation of this recommendation in 2018, the ERP for 2018 includes Priority Reform Measure No 9: Fostering NPL resolution by improving the prudential and banking resolution frameworks.*
4. Harmonise national rules with Directive 2014/61 on cost reduction measures for the development of high-speed electronic communication networks. Ensure effective, efficient and independent rail regulatory and safety authorities to implement the full opening of the rail market.	*In 2017, the legislation drafting activities started or continued in response to the abovementioned EC Recommendation. In that respect, the ERP 2018-2020 proposes two priority reform measures:* *Priority Reform Measure No. 4: Creating an efficient and independent rail transport regulatory and safety authority; and* *Priority Reform Measure No. 16: Improving the legislative and regulatory framework to reduce the cost of developing high-speed electronic communication networks.*
5. Continue to strengthen financial and non-financial support services for SMEs. Adopt legislation to ensure operational independence of the state aid authority.	*In response to this recommendation, in 2017 the Investment and Development Fund continued activities to provide financial support for SME development; the Ministry of Economy and other government departments continued to work on financial and non-financial support. In December 2017, a proposal for a new Law on State Aid Control was approved and forwarded into parliamentary procedure. This law provides operational independence of the state aid allocation authority, according to Recommendation No. 5 from the Ministerial Meeting in May 2017.* *In order to continue supporting the SME sector in 2018, two priority reform measures are proposed in the ERP 2018:* *Priority Reform Measure No. 12: Improving financial support for the small and medium-sized enterprise sector; and* *Priority Reform Measure No. 13: Improving non-financial support for the small and medium-sized enterprise sector.*
6. Reform the law on social protection to ensure cost-effectiveness, better targeting of assistance and the reduction of disincentives for women to work. Carry out a review of active labour market policies with a view to improving their coverage and targeting the long-term unemployed, women and youth. Improveschool-to-work transitions through work-based learning and	*In accordance with the mentioned recommendation, in June 2017, following the amendment to the Law on Social and Child Protection, which was a reform measure in the ERP for 2017, another amendment to the Law on Social and Child Protection was made after the Constitutional Court of Montenegro had declared the provisions of that law relating to benefits for mothers of three or more children unconstitutional. Those amendments increased the amount of child benefit and one-off benefits for new-born babies, merged the personal disability allowance and allowance for providing care and assistance to other persons, increased the amount of the monthly allowance for newborns up to the age of one year for children of unemployed parents or students etc., thus redirecting social funds to those who need it most. At the same time, part of the resources from social funds has been*

promoting the appeal of vocational professions.	*reallocated to active policies of employment of women on the unemployed register. Reform measures have been implemented in the education sector by adopting a set of new laws aimed at increasing the contribution of the education sector to employment growth. Drafting of the new Labour Law was also undertaken, as foreseen by the ERP for 2017, and it was prepared in the form of a draft and successfully passed through its public hearing. In meeting Recommendation No. 6 from the Ministerial Meeting in Brussels in May 2017, the ERP for 2018-2020 proposes reform measures in the area of education and skills, employment and labour market, social inclusion, poverty reduction and equal opportunities.* *These are:* *Priority Reform Measure No. 18: Developing qualifications in accordance with labour market needs;* *Priority Reform Measure No. 19: Carrying out practical education with employers; and* *Priority Reform Measure No. 20: Implementing legal provisions in the field of the labour market. With the focus on acitive employment policy.*

Macroeconomic projections for the period 2018-2020

Montenegro's model of economic growth in the period 2018-2020 will be based on strong investment activity, which will have a dominant effect on economic flows, with further growth in exports. The second key determinant of economic activity in the coming years will be the implementation of public finance consolidation based on the Montenegro Fiscal Strategy to 2020.

Starting from all the above, according to the baseline scenario for Montenegro contained in this year's Economic Reform Programme, the average annual rate of real economic growth in the period 2018-2020 will be about 2.8 percent, or 3 percent in 2018, 2.7 percent in 2019 and 2.6 percent in 2020. According to the low-growth scenario, the average annual rate of real economic growth in the period 2017-2020 will be 2.1 percent.

Fiscal framework for the period 2018-2020

The objective of Montenegro's fiscal policy for the period 2018-2020 is very significant consolidation of public finances, which began to be implemented in 2017, to create conditions for reducing the public spending deficit and setting a decreasing trend in the growth of public debt. This fiscal consolidation was certainly a key feature of economic policy in 2017. Starting from the legislated obligation and the need to reduce public debt, in January 2017 the Government started application of fiscal consolidation measures contained in the 2017 Budget. In July 2017, the Parliament of Montenegro adopted the medium-term Fiscal Strategy of the Government of Montenegro,. by which measures amounting to a total of 3.2 percent of GDP in 2017 were substantially improved by an additional package of measures for the period to the end of 2020, characterized by additional fiscal consolidation of 2.8 percent of GDP in the period 2017-2020. This has stalled the budget deficit growth trend and slowed down the public debt growth trend. The Economic Reform Programme for 2018-2020 therefore presents the medium-term projections for Montenegro's public finances contained in Montenegro's Budget Deficit and Public Debt Recovery Plan for the period 2017-2021 and the medium-term Fiscal Strategy until 2020, which are based on the assumption of financing current spending from the source budget revenues. Thus, the fiscal consolidation measures contained in Chapter 3 are in focus of the ERP for 2018-2020, and are accompanied by comprehensive structural reforms agenda contained in Chapter 4. These fiscal consolidation measures have contributed to receiving the World Bank Policy Based Guarantee in the amount of 80.0 million euro, which will enable the government borrowing in the range of 200.0 to 240.0 million euro under concessional terms and with lower interest rate. This will secure financing for the 2018 Budget with an option to be considered for repayment of and refinancing the existing debt in 2018, as well as a possibility to refinance part of liabilities resulting from Eurobonds which will become due in the period 2019-2021.

According to the previously described fiscal consolidation measures, the Economic Reform Programme 2018-2020, under the baseline scenario, envisages the public finance deficit to be 1.6 percent of GDP in 2018 and its transition to a surplus by 2020. At the same time, due to the construction of the first section of the highway, public debt will increase to 66.5 percent in 2018, after which its downward trend will be set to reach 66.1 percent of GDP in 2019 and 59.7 percent in 2020[1]. Also, ERP 2018 includes a medium-term public finance balance projection excluding the highway construction costs, with the aim of considering the difference in the public finance trend with and without these costs. In that respect, the projection under the baseline scenario (in the non-highway simulation) has shown that, *if borrowing for the highway construction is excluded, public finances could have a surplus of 3.2 percent of GDP as early as 2018*. Furthermore, Chapter 3 of this document presents fiscal indicators in the scenario of low economic growth in the medium term.

Table 1.2 (which is also included in Chapter 3 of this document) shows the projections of Montenegro's public finances in the period 2018-2020 in the baseline and low-growth scenarios.

Table 1.2: Summary of macroeconomic and fiscal projections of Montenegro for the period 2017-2020 (baseline and low-growth scenarios)

Macroeconomic framework		*Output*	*Estimate*	*Baseline scenario*			*Low-growth scenario*		
		2016	*2017*	*2018*	*2019*	*2020*	*2018*	*2019*	*2020*
Macroeconomic indicators	*GDP nominal (in mil. €)*	*3,954.2*	*4,202.1*	*4,397.7*	*4,569.4*	*4,729.6*	*4,323.6*	*4,440.3*	*4,590.0*
	GDP, nominal growth (%)	*8.2*	*6.3*	*4.7*	*3.9*	*3.5*	*2.9*	*2.7*	*3.4*
	GDP, real growth (%)	*2.9*	*4.0*	*3.0*	*2.7*	*2.6*	*1.8*	*1.9*	*2.5*
	Inflation (year-end) (%)	*0.4*	*2.5*	*2.6*	*1.9*	*1.5*	*2.0*	*1.9*	*1.5*
	Employment growth (%)	*1.1*	*1.5*	*0.7*	*0.4*	*0.3*	*0.0*	*0.0*	*1.8*
	Current account deficit (% GDP)	*-18.1*	*-18.0*	*-18.0*	*-16.5*	*-14.5*	*-16.9*	*-15.4*	*-13.6*

Fiscal framework (% GDP)		*Output*	*Estimate*	*Baseline scenario*			*Low-growth scenario*		
		2016	*2017*	*2018*	*2019*	*2020*	*2018*	*2019*	*2020*
Fiscal indicators	*Source public revenues*	*42.6*	*42.6*	*44.2*	*44.2*	*43.9*	*44.4*	*44.6*	*44.4*
	Public expenditure	*46.2*	*45.7*	*45.8*	*44.1*	*38.6*	*46.5*	*45.4*	*39.7*
	Deficit/Surplus	*-3.6*	*-3.1*	*-1.6*	*0.1*	*5.4*	*-2.1*	*-0.8*	*4.7*
	Deficit/ Surplus without highway	*-3.4*	*1.2*	*3.2*	*4.7*	*-*	*2.7*	*4.0*	*-*
	Interests	*2.2*	*2.4*	*2.0*	*2.1*	*2.0*	*2.1*	*2.2*	*2.1*
	Primary deficit/surplus	*-0.7*	*-0.8*	*0.4*	*2.2*	*7.4*	*0.0*	*1.4*	*2.6*
	Public debt (% GDP)	*63.4*	*65.5*	*66.5*	*66.1*	*59.7*	*68.2*	*69.5*	*63.8*

Source: Ministry of Finance

Structural reforms in the period 2018-2020

In parallel with measures to strengthen macro-fiscal sustainability contained in Chapter 3, as well as Chapter 2 of the document, the, priority reform measures have been defined in Chapter 4 of the Economic Reform Programme for 2018-2020, and they are expected to have a positive macro-fiscal effect and improve the country competitiveness in the medium term. The Government is focused on the reform measures to improve the business environment, develop small and medium-sized enterprises, precisely to increase employment in the real sector by increasing competitiveness and productivity. Improving the labour market flexibility and reducing informal employment are also in a strong focus.

The 2018 EPR contains several priority reform measures that will contribute to offsetting the narrow production base of the Montenegrin economy, featured also by insufficient economies of scale, as is one of the features of small economies. Likewise, the Programme is committed to continued structural reforms in sectors of energy, transport, telecommunications and manufacturing industries, and public

[1] Based on EDP tables

administration, after notable reforms were implemented in the previous period, especially those pertaining to energy supply, transparency of tariffs and obtaining building permits.

Thus, in the ERP for 2018 the key development priorities of the government have been elaborated in Chapter 4 trough nine structural reform areas defined in the European Commission's guidance note[2] for ERP 2018-2020, through 20 priority reform measures. ERP 2018 is certainly characterized by a focus on priority reform measures related to the adoption of new laws and strategic documents and their implementation, as well as programmes to support increasing of competitiveness, however, for compliance with the EC Guidance note, the investment-related measures in transport and energy sectors that characterized the previous ERPs of Montenegro, have been excluded. Due to their importance for the growth of competitiveness, these measures have been implemented following their own dynamism (specifically described in Table 11 of the Annex to ERP 2018).

These measures will address key structural obstacles in Montenegro in the following period, enabling return on investments over the medium term for small economy as is Montenegro.

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

[2] Public finance management; Energy and transport market reform; Sector development; Business environment and reduction of the informal economy; Research, development and innovation (RDI) and the digital economy; Trade-related reforms; Education and skills; Employment and labour market; Social inclusion, poverty reduction; and Equal opportunities.

2. MACROECONOMIC FRAMEWORK

The expected cyclical growth of investments, production and trade is what is driving global economic activity[3] in 2017 and 2018. It is expected that the global economy will grow by 3.6 percent in 2017, and 3.7 percent in 2018. The projected growth for developed economies during these two years is 2.2 and 2.0 percent, respectively, while the growth rate in emerging economies and developing economies will reach 4.6 percent in 2017 with an upward trend of up to 4.9 percent in 2018, which indicates a recovery by economies driven by exports of commodities. These countries went through a recession or a drop in growth rates due to a decline in commodity prices in 2015 and 2016.

These growth rates have somewhat different sources of growth by region, compared to the IMF's projections from April 2017. The growth rate for the US economy was reduced from 2.3 to 2.2 percent in 2017 and from 2.5 to 2.0 percent in 2018, as a consequence of uncertainties concerning its fiscal policy.

In contrast to that, the growth projections for 2017 were revised upward for the largest euro-area economies, including Germany, France, Italy and Spain, where growth rates in first half of 2017 were higher than expected. This dynamic is a consequence of stronger growth in domestic demand than previously forecasted. Rates were revised from 1.7 to 2.1 percent for 2017 and from 1.6 to 1.9 percent in 2018. Forecasts were also revised upwards for Japan, emerging Asian economies and Russia.

The IMF's forecasts were also revised upwards for European emerging and developing economies (Montenegro is part of this group) from 3.0 to 4.5 percent in 2017 and from 3.3 to 3.5 percent in 2018, which is primarily a consequence of revisions for Turkey, the largest economy in this group, for which the growth forecast for 2017 was increased from 2.5 to 5.1 percent.

Table 2.1: GDP projections for European emerging and developing economies

GDP growth (%)	*2016*	*2017*	*2018*
European emerging and developing economies – GDP growth in %	***3.1***	***4.5***	***3.5***
Turkey	*3.2*	*5.1*	*3.5*
Poland	*2.6*	*3.8*	*3.3*
Romania	*4.8*	*5.5*	*4.4*
Hungary	*2.0*	*3.2*	*3.4*
Bulgaria	*3.4*	*3.6*	*3.2*
Serbia	*2.8*	*3.0*	*3.5*
Croatia	*3.0*	*2.9*	*2.7*
FYR Macedonia	*2.4*	*2.5*	*3.2*
Bosnia and Herzegovina	*2.0*	*2.5*	*2.6*
Montenegro	*2.5*[4]	*3.0*	*2.8*

Source: World Economic Outlook, IMF October 2017

After low growth of 2.6 percent in 2016, it is projected that growth in worldwide trade in 2017 and 2018 (in goods and services) will reach levels of 4.2 and 4.0 percent, respectively.

According to the IMF projections for Montenegro, the real GDP growth will be 3.0 percent in 2017 and 2.8 percent in 2018. The identified risks for generating the projected growth rates for the world economy over the short term are equally distributed towards stronger and weaker growth. Stronger growth can be a consequence of a sharp upturn in the world economy in light of a stronger increase in consumer confidence and business confidence. The risks of weaker growth may come from the uncertain dynamic of legislation pertaining to fiscal incentives in the US economy, as well as trade

[3] World Economic Outlook, IMF October 2017.

[4] The IMF's projections in this report were not revised. Revised projections will be published soon.

restrictions. As for the Europe, the outcome of the EU–UK negotiations (Brexit) is uncertain. Political uncertainties are also present relating to resolving political crises in some member states.

Table 2.2: Real GDP growth projections of the World Bank for the Western Balkans countries (%)

	2017	2018	2019
Albania	*3.8*	*3.6*	*3.5*
Bosnia and Herzegovina	*3.0*	*3.2*	*3.4*
Kosovo	*4.4*	*4.8*	*4.8*
FYR Macedonia	*1.5*	*3.2*	*3.9*
Montenegro	*4.2*	*2.8*	*2.5*
Serbia	*2.0*	*3.0*	*3.5*
Western Balkans	*2.6*	*3.3*	*3.6*

Source: World Bank

According to the World Bank's forecasts, the medium-term outlook for the Western Balkans countries is positive. Projections for 2018 of 3.3 percent real growth are higher than the projections for 2017 of 2.6 percent, with continued growth in 2019 of 3.6 percent. This growth will be driven by private consumption, investments and exports.

Table 2.3: Comparative table of the macroeconomic projections of the Ministry of Finance of Montenegro and international institutions of real GDP growth rates (in %)

	2017	***2018***	***2019***
Ministry of Finance of Montenegro	*4.0*	*3.0*	*2.7*
European Commission	*3.9*	*3.0*	*3.3*
World Bank	*4.2*	*2.8*	*2.5*
IMF	*3.0*[5]	*2.8*	-

Technical assumptions on euro/US dollar exchange rate trends, commodities and other prices, global economic growth and global trade growth, as well as the real growth rate in the EU are taken from the Autumn Projections of the European Commission.

2.1 Recent Economic Developments

2.1.1 Gross Domestic Product

The Montenegrin economy recorded growth in the first half of 2017, driven by intensified work on the construction projects in transport infrastructure, as well as projects in the sectors of tourism and energy.

After solid growth in Q1 of 2017, the Montenegrin economy has seen accelerated growth as a result of intensified works on construction projects in transport infrastructure, as well as projects in the sectors of tourism and energy. According to preliminary MONSTAT data, the economy had real growth rates of 3.1, 5.2 and 4.7 percent annually respectively in Q1, Q2 and Q3 of 2017, thus the GDP growth rate for nine months of 2017 was 4.5 percent. Economic growth was driven primarily by increased domestic demand, resulting in an increase in employment and disposable income, and growth in investment spending as a result of implementing investments in the area of the transport and tourist infrastructure (the highway and hotels), and the energy sector. In terms of areas of spending, the most sizeable growth over the nine months was recorded in household spending (real growth 4.4 percent with a contribution to growth of 3.3 percentage points) and gross fixed capital formation (real growth 5.7 percent with a contribution to growth of 1.3 percentage points). Imports of goods and services recorded a growth of 5.4 percent, but due to its high share in GDP it had a negative contribution to the growth of the economy of 3.4 percentage points, which could not be offset by the sizeable growth of exports of goods and

[5] See footnote No. 2

services of 5.8 percent due to its lower share in the GDP structure. Based on the first nine months of output and the available indicators for the fourth quarter, it is expected that GDP growth will reach 4.0 percent in 2017, from the 2.9 percent published by MONSTAT for 2016. The assumption for this rate to materialize is for growth in Q4 to be around 2.5 percent, since the strong investment activity is expected to continue, but a negative contribution may come from higher-than-expected imports.

Table 2.4 shows a divergence between last year's and the updated GDP projections, by component.

Table 2.4: Difference between projections and estimates for 2017

	Projection for 2017 (%)	Estimate 2017 (%)	Difference (in p.p.)
Real GDP growth	3.2	4.0	0.8
Domestic demand	2.9	4.4	1.5
Household consumption	-1.3	5.3	6.6
Gross capital formation	19.6	6.6	-3.0
Government consumption	-1.7	2.1	3.7
Exports of goods and services	2.5	7.0	4.5
Imports of goods and services	2.1	6.6	4.5

Source: Ministry of Finance

When compared to projections from the previous ERP, significant divergences are evident. Almost all the consumption items were underestimated. The most significant divergence is evident in the case of household consumption, since the growth of disposable income was underestimated, which was driven by growth in employment, wages and lending activity to the household sector. Growth in gross capital formation was also sizeably overestimated, because even despite an important increase in activity in the construction sector there was a decline in imports of the equipment and machinery[6] required for carrying out investments. It is estimated that this decline will be around 40 million euro by the end of 2017.

Foreign demand is also underestimated, since the exports of services will be significantly higher due to the large contribution of tourism (a record tourist season), and on the side of exports of goods there will be higher growth caused by a one-off export of docks and an increase in the value of exports of bauxite. Imports of goods and services have been underestimated, since even despite the decline in the imports of equipment and machinery, stronger growth in the imports of goods for all segments is evident, in particular of energy sources (oil derivatives and electricity), chemical products and food.

It is estimated that the most significant impact on the GDP composition on the supply side (production method) will come from:

Tourism (accommodation and food services make up 8.6 percent of GVA in 2016): Montenegro was visited by 16.9% more tourists in the period January–September and there were 9.8 percent more overnight stays than in the same period of the previous year[7]. As for the composition of overnight stays, foreign tourists make up 90.0 percent and domestic tourists 10.0 percent. The majority of overnights stays were made by visitors from Russia (17.1 percent), Serbia (15.11 percent), France (6.1 percent), and Bosnia and Herzegovina (3.7 percent). According to the 2016 data, Montenegro's accommodation capacities consisted of 166,482 beds (2,246 beds more than in the previous year), while its accommodation capacities increased by an additional 1,685 beds at the beginning of 2017. As for the structure of accommodation capacities, 20 percent is hotel-type accommodation, while it is worth mentioning that more than 90 percent of the new capacities in 2016 and 2017 are hotels with 4 or 5 stars, creating the prerequisites for the arrival of tourists with higher purchasing power. According to the Central Bank's preliminary data, the revenue from tourism (foreign tourists) for the first nine months of 2017 was 859 million euro, which is 7.3 percent more than in the same period of the previous year.

[6] Equipment and machinery are part of gross fixed capital formation.
[7] In line with the new MONSTAT methodology, the data pertains only to collective accommodation, while the data on total turnover in tourism will be published only once a year, for the previous year.

Industrial production (making up 12.3 percent of GVA in 2016): In the period January–September 2017, industrial production recorded a decline of 6.7 percent as a result of the decline in the sectors of manufacturing (4.5 percent) and electricity, water and gas supply (28.8 percent). The drop in manufacturing was primarily caused by lower production of base metals (2.3%) and pharmaceuticals (30.8 percent), while the decline in the generation of electricity was a consequence of adverse weather conditions (a prolonged drought period). Production for the first nine months in the third sector of mining and quarrying recorded high growth of 115.3 percent as a result of the increased exploitation of coal, and the mining of bauxite ore being restarted.

Retail trade (trade makes up 14.8 percent of GVA in 2016): Retail trade during 2017 recorded stable growth, and for the first eight months was 4.9 percent in current prices and 3.1 percent in constant prices.

Transport (making up 4.9 percent of GVA in 2016): According to MONSTAT data, in the period January–June 2017 the transporting of goods by rail recorded growth (59.4 percent), as did the total transporting of passengers by air (23.0 percent), transporting of passengers by rail (0.7 percent) and transhipment in ports (50.6 percent), while there was a decline in the transporting of passengers by rail (20.3 percent), scheduled transporting of passengers air (5.6 percent), and minutes used in mobile telephony traffic (0.7 percent).

Construction (making up 6.8 percent of GVA in 2016): Construction activity in the period January–September 2017 recorded growth in the value of construction works of 43.4 percent and an increase in effective hours worked of 21.6 percent.

2.1.2 Inflation

Inflation in 2017, measured by the consumer price index, ranged from 2.0 percent in January to 2.8 percent in September, after which it fell to 1.9 percent in December. The impact of external factors on inflation in Montenegro is visible through a spill-over from global price developments in food and fuel, while internal factors impacting inflation have come from tobacco prices (the new increased excise tax on tobacco came into effect in August) and from the prices of accommodation services, which grew during the entire period, with the highest rate in July (17.1 percent). The average inflation rate during the period January–December was 2.4 percent. Inflation measured by the HICP in December was 2.9 percent, with the highest impact on the rate coming from the prices of accommodation services and of alcoholic beverages and tobacco. Based on the available data and estimates on price developments in Q4, it is expected that the average annual inflation rate in 2017 will be around 2.5 percent.

2.1.3 Employment and Wages

The labour market dynamics during the first three quarters of 2017 were characterized by a continuous increase in employment and a reduction in the number of unemployed. According to data from the Labour Force Survey (LFS), employment grew by 3.2 percent in the third quarter year-on-year, and unemployment grew by 2.1 percentage points. The unemployment rate in the third quarter was 14.8 percent. The activity rate[8] increased by 0.9 percentage points and was 56.4 percent. The number of employed increased in Q1 of 2017 compared to the same period of the previous year, thus the number of employed increased by 5,300, while the increase in Q2 was 7,800. This trend is primarily a consequence of an increase in employment in the construction sector. There was also an increase in the number of employees in Q3 by 7,400 when compared to the same period of the previous year.

According to the Employment Office’s records, the number of unemployed increased (by approximately 9,000), but this continuous trend of an increase in unemployment started in Q2 of 2015, triggered by the adoption of the Amendments and Supplements to the Law on Social and Child Protection (benefit for mothers of three or more children) and does not reflect the actual dynamics of the labour market’s developments. The Amendments to the Law incentivized the registration of individuals not previously

[8] The size of the active population (employed and unemployed) compared to the number of inhabitants of 15 years of age and more.

registered in order for them to utilize the benefits envisaged by that legal document. Data on the increase in employment by production sector shows a sizeable growth in employment in the sectors of construction, transport, retail trade and tourism. The increase in employment is a consequence of strong investment activity and an increase in tourist trade.

The average gross wage in the period January–November2017 was 765 euro and was 2.1 percent higher than the same period of the previous year, while the average wage without taxes and contributions was 510 euro and was 2.2 percent higher than in the same period of 2016.

2.1.4 Lending Activity of Banks

Banks with majority foreign ownership dominate in Montenegro's banking system, with a share of 74.5 percent of banking-sector assets. Increased competition in the market, caused by the entry of new banks, resulted in a decline in the market concentration. The six largest banks control 72.7 percent of the total assets and 73.5 percent of the total deposits in the system.

The performance of the banking sector is improving and strengthening continuously, primarily as a result of a significant improvement in asset quality and a recovery in lending growth. Features of the operation of banks in first nine months of 2017 are a growth in assets, loans, deposits and capital. The declining trend for non-performing loans continued. The high liquidity parameters show that lending activity continues to be limited due to the pronounced cautionary, risk-aversion approach of banks, which is reflected in the relatively high level of interest rates. The stability of the banking sector is supported with adequate capitalization, reflected in a solvency ratio of 16.64 percent, which is well above the statutory minimum of 10 percent.

The total deposits of banks are continuously growing, and reached a maximum of 3,137.4 million euro at the end of September, which represents growth of 9.8 percent annually. The maturity structure of deposits is unsatisfactory, considering that *a-vista* deposits make up 60.1 percent of total deposits, while term deposits make up 39.9 percent. As far as the availability of long-term sources of financing is concerned, the developments are unfavourable, given that short-term deposits (up to one year) make up 81 percent of total deposits, and term deposits of more than three years make up only 3.4 percent of total deposits.

The total assets of banks were 4.095 billion euro, which represents an increase of 9.5 percent when compared to the same period of the previous year. The majority of the structure of assets relates to loans and receivables from clients and banks (63 percent). The majority of lending is concentrated in the household sector (41 percent), the real sector (33 percent) and placements with banks (16 percent).

At the end of September, total loans and receivables from clients and banks amounted to 2,594.4 million euro and were 13.3 percent higher than at the end of the previous year, while they were 8.5 percent higher at the annual level. Out of the total loans and receivables from clients and banks minus corrections in value, long-term loans and receivables make up 72.6 percent.

The positive trend of the reduction in non-performing loans at the aggregate level has continued. Non-performing loans and receivables at the end of September were 199.8 million euro[9], or 7.4 percent of total gross loans and receivables. This indicator recorded a decline of 2.9 percentage points compared to December 2016, while it recorded a decline of 2.8 percentage points compared to the same period of the previous year. Despite a significant fall of 21.6 percent in the nominal amount annually, these loans are subject to continuous and increased supervisory oversight.

At the end of September 2017 out of a total of 65,314 legal entities and entrepreneurs, 16,068 (or 24.6 percent) of them were illiquid. The value of debt resulting from garnished accounts was 625.4 million euro, which is 0.5 of one percent lower than in December 2016.

[9] Interest and adjustment entries are not included in the stated amounts.

2.1.5 External Sector

2.1.5.1 Current Account

According to the preliminary data, the current account deficit in the period January–September 2017 was 385.8 million euro and was 9.2 percent lower than in the same period of the previous year. The reduction of the current account deficit is a result of an increased surplus on the accounts of services and primary and secondary income.

Goods balance: The deficit on the account of goods in the period January–September 2017 was 1.4 billion euro, or 6.9 percent more than in the previous year, due to increased imports of goods. Total exports of goods were 275.6 million euro, which represents an increase of 14.9 percent. The increase in exports of mineral ore and scrap metal, other means of transport and equipment and non-ferrous metals had the strongest impact on the increase in exports. Total imports of goods were 1.6 billion and were 8.1 percent higher than in the same period of 2016, as a result of increased imports of oil and oil derivatives, electricity and products from non-ferrous metals.

Services balance: A surplus of 807.9 million euro was recorded on the account of services during the observed period, which is 8.8 percent higher than in the same period of 2016. Total revenue from services was 1.2 billion euro, or 8.4 percent higher than in 2016, while expenditure was 377.2 million euro (an increase of 7.7 percent). Estimated revenue from travel and tourism for the first nine months of 2017 was 859.0 million euro, which is 7.3 percent more than in the previous year. The number of tourist arrivals and overnight stays by foreign tourists increased during the observed period.

Primary income: The primary income account recorded a surplus of 67.9 million euro, which is 47.2 million more than in the same period of 2016. Revenue from primary income was 202.9 million euro, which is 7.6 percent higher than in the previous year. Total expenditure fell by 19.6 percent during the observed period and amounted to 135.1 million euro, due to lower inflows from dividends payouts.

Secondary income: The secondary income account recorded a surplus of 95.2 million euro, which is 16.7 percent more than in the same period of 2016. The total inflow of remittances to Montenegro increased by 12.5 percent compared to the previous year, and was 149.1 million euro, of which the majority was made up of personal foreign transfers and amounted to 92.8 million euro. The total outflow of foreign transfers during the same period was 53.9 million euro, which is by 5.9 percent more than in the same period of 2016.

2.1.5.2 Capital and Financial Account

The account of **portfolio investments** recorded a net inflow of 13.6 million euro in the period January–September 2017, while the account of **other investments** recorded a net outflow of 24.6 million euro. A characteristic of the developments on this account is the increased repayment of loans that had been taken out.

According to the preliminary data, the net inflow of foreign direct investments (FDI) in the period January–September 2017 was 311.7 million euro, which represents an increase of 10.6 percent compared to the same period of the previous year, as a result of increased investments in the form of inter-company debt and real estate, along with considerably lower outflows compared to 2016. Total FDI inflow was 409.8 million euro, of which equity investments amounted to 223.8 million euro, while the inflow in the form of inter-company debt was 177.3 million euro or 31.4 percent more than in 2016. Investments in companies and banks amounted to 117.1 million euro, while investments in real estate were 106.7 million euro in the composition of equity investments, and were by 21.4 percent higher than during the same period of the previous year. The inflow from the reduction in the funds of residents invested abroad was 8.7 million euro. In the structure of total FDI inflows, the share of inflows from inter-company debt was 43.3 percent, followed by investments in companies and banks making a share of 28.6 percent, while investments in real estate constituted 26 percent. The total FDI outflow was 98.1 million euro, which is considerably lower than in the same period of 2016 (270 million euro).

2.2 Medium-Term Macroeconomic Scenario

The model of growth of Montenegro's economy in this period is based on strong investment activity, which will have a dominant influence on economic flows. Public finance consolidation measures will also have impact on the development of economic activities. The lack of diversification of the Montenegrin economy has a sizeable effect on derogating the positive effects of investments, since there are no capacities for the production of goods required for implementing investments, thus the high imports of goods and equipment that echo the investment cycle have a negative effect on the projected growth rates. Investments also have only a limited impact on employment due to a mismatch between labour force supply and demand. In order respond to these challenges, it is imperative for the government to carry out activities aimed at expanding production and the economy's export base, precisely in order to increase industrial production, in particular manufacturing, and to better utilize the prominent natural potential for the production of food and energy, which is all incorporated in the government's numerous development and sector-level strategies. At the same time, activities to improve the state of the labour market and education system are being carried out on continuous basis.

The next part of this chapter presents two macroeconomic scenarios for the period 2018-2020, whereby both scenarios take into account the economic policy measures required for implementation of the Fiscal Strategy for the period 2017-2020. The alternative scenario develops macroeconomic projections in the event that the economic growth turns out to be lower than that envisaged in the baseline scenario due to external and/or internal factors.

2.2.1 Baseline Macroeconomic Scenario 2018-2020 and Related Risks

2.2.1.1 Real Sector

The baseline macroeconomic scenario for the period 2018-2020, as a result of expected economic activity developments projected on the expenditure side, would result in real GDP growth of 3.0 percent in 2018, 2.7 percent in 2019 and 2.6 percent in 2020. During the period 2018-2020, the Montenegrin economy will record growth due to an increase in investment activity and in engaging domestic potential, primarily in the sectors of construction and transport, as well as due to a multiplicative effect on the related sectors. A strong contribution by the construction sectors is triggered by inclusion of the domestic construction industry in the construction of infrastructure, new tourist capacities and energy facilities. During the operational phase (supply effect) of the functioning of these projects, potential growth of the economy is expected, with multiplicative effects on the entire economy. A particular contribution is also expected from the agriculture sector, given the sizable investments in this sector, and the effects would be visible through food import substitution and an increase in exports. The average projected GDP growth rate for the period 2018-2020 is 2.8 percent.

Somewhat lower real growth in the economy in 2019 and 2020 will be a consequence of the high base for gross capital formation from previous years. Namely, the average share of gross fixed capital formation in the period 2010-2015 was at a level of around 20 percent of GDP or around 650 million euro, expected to reach an average value of around 23 percent of GDP or around 1.1 billion euro in the period 2018-2020. Constraints resulting from a lack of domestic savings needed for investment and fiscal consolidation are compensated for either by increased borrowing or by financing from foreign sources. Implementing fiscal consolidation measures with the constraints arising from the high level of debt and deficit compared to GDP limits the scope for further borrowing for investment projects, thus it is highly likely that Montenegro will have to adjust investments towards domestic saving, which implies an adjustment at the level of investment activities from public sources.

The macroeconomic scenario 2018-2020 has the following components on the expenditure side:

- Domestic demand will grow at a rate of 1.7 percent and household consumption will have a positive share with an average real growth rate of 2.4 percent and an average share in the real growth rate of 1.8 percent. The projected growth rate for household spending is triggered by the expected growth in disposable income from increased employment, wages and a growth in the revenue from tourism. Final government consumption will record a decline of 0.9

percent with a share in the real rate of -0.2 percent, due to fiscal consolidation measures. The projected average real growth of gross investments is 1.6 percent, whereby gross investments will grow at rate of 1.8 percent, while changes in the inventory will record a drop of 0.5 percent. Such an investment dynamic reflects the maintaining of a high level of investment activity at the level of 23 percent.

- The foreign demand dynamic (net exports) is driven by a growth in exports of goods and services at a real rate of 3.2 percent, whereby the projected real growth of revenues from tourism is 2.8 percent (a nominal growth rate of 4.8 percent). It is expected that with such growth rates the revenues from tourism will exceed 1 billion euro. Even though exports of goods make up around 20 percent of total exports (goods and services), it is expected that positive developments in this segment will contribute to a reduction in the foreign trade imbalance. Imports of goods and services will grow at real rate of 1 percent with an increase in imports of goods driven by increased imports for investment (imports of construction materials and equipment).

Table 2.5: Baseline macroeconomic scenario

Montenegro: Macroeconomic projections, 2017-2020

	2016	2017	2018	2019	2020
Nominal GDP in € millions	3,954.2	4,202.1	4,397.7	4,569.4	4,729.6
Nominal growth	8.2	6.3	4.7	3.9	3.5
Real growth	2.9	4.0	3.0	2.7	2.6
Inflation (average)	0.4	2.5	2.6	1.9	1.5
			(as % of GDP)		
Core characteristics:					
Current account deficit	-18.1	-18.0	-18.0	-16.5	-14.5
Exports	40.5	42.1	42.6	42.9	43.5
Imports	-62.9	-64.1	-64.6	-63.3	-62.0
Other	4.4	3.9	3.9	4.0	4.0
Household consumption	76.8	77.2	77.4	77.3	77.0
Gross fixed capital formation	23.2	23.2	23.9	23.1	22.1
Changes in inventories	2.9	2.2	2.1	2.0	2.0
Government spending	19.6	19.3	18.5	18.0	17.4
GDP deflator	5.1	2.1	1.6	1.1	0.9
			(real growth rates in %)		
Real GDP growth	2.9	4.0	3.0	2.7	2.6
Domestic demand	8.0	4.4	3.0	1.4	0.8
Household consumption	5.4	5.3	2.9	2.3	1.9
Gross fixed capital formation	27.5	6.6	7.0	0.0	-1.5
Changes in inventories	938.6	-20.7	-0.5	-0.5	-0.5
Government spending	0.8	2.1	-1.2	-0.5	-0.8
Exports of goods and services	6.2	7.0	4.0	2.6	3.0
Imports of goods and services	15.0	6.6	3.6	0.1	-0.5
			(share in real growth as % GDP)		
Real GDP growth	2.9	4.0	3.0	2.7	2.6
Domestic demand	9.5	5.4	3.6	1.7	1.0
Household consumption	4.2	4.1	2.2	1.8	1.5
Gross fixed capital formation	5.5	1.5	1.6	0.0	-0.3
Changes in inventories	-0.5	-0.6	0.0	0.0	0.0
Government spending	0.2	0.4	-0.2	-0.1	-0.2
Net exports	-6.5	-1.3	-0.6	1.1	1.6
Exports of goods and services	2.6	2.8	1.7	1.1	1.3
Imports of goods and services	-9.1	-4.2	-2.3	0.0	0.3
Main assumptions:			*Growth in percentage unless otherwise stated*		
Employment growth	1.1	1.5	0.7	0.4	0.3

Growth of wages	*3.6*	*2.1*	*1.7*	*1.7*	*1.8*
Unemployment (LFS)	*18.0*	*17.0*	*16.7*	*16.6*	*16.6*
FDI as % GDP	*9.4*	*12.0*	*11.4*	*10.9*	*8.5*
Domestic loans (corporate and household)	*6.0*	*6.3*	*4.7*	*3.9*	*3.5*

Source: Ministry of Finance projections

Macroeconomic indictors

- The balance of payments current account deficit will have an average of 16.3 percent of GDP, after which it will go down to 14.5 percent of GDP with a decline in imports and an increase in exports at the end of the period;
- Estimates of foreign direct investments over the medium term are still accompanied by a high degree of uncertainty concerning the investment dynamic in companies, financial sector and real estate. It is estimated that they will be at a level of around 10.3 percent annually;
- Loans to companies and the household sector will grow at an average rate of 4 percent in accordance with the nominal GDP growth rate;
- Employment will gradually increase during the entire period (at an average of 0.5 of one percent annually) as a consequence of growth of economic activity, whereby the unemployment rate at the end of the period will fall to 16.6 percent;
- An increase in wages at an average of 1.7 percent (nominally) is expected in the period 2018-2020, which is aligned with an increase in productivity;
- An average increase in prices of 2.0 percent is expected in this period, whereby the 2018 inflation will be at the level of 2.6 percent, which would then fall to the level of 1.5 percent in the following years. The somewhat higher level of inflation projected for 2018 is caused by the possible impact of a VAT rate increase from 19 to 21 percent. The estimated impact of this increase has lifted the inflation rate by up to 1 percentage point.[10] The projections are also based on the IMF's projections of stable energy and food prices for the forthcoming period, as well as inflation projections for the euro area. They also take into account that there will be a decline in demand due to a decline in investment activity at the end of the period that will have influence a reduction in the general level of prices.

GDP growth contains the following components on the production side:

- Projected real growth in the agriculture sector in the period 2018-2020 will be on average 3.0 percent. This growth is projected based on increased investment in agriculture and increased lending support to this sector in the period 2018-2020. Generation of a growth rate of 3.0 percent would also have influence an increase in exports and food imports;
- The mining and quarrying sector will grow at an average of 5.5 percent annually over the medium term, as a result of increased demand for materials required for the highway project (stone, various size classes of gravel and substrate materials), as well as growth in mining (exports of bauxite);
- The manufacturing industry will experience growth of 4.5 percent in the forthcoming period with the assumption that the measures proposed in the document Montenegro Industrial Policy by 2020 will yield results in terms of removing bottlenecks and revitalizing the sector. A special contribution is expected from growth in the subsectors of food processing and meat processing, the wood industry and complex metals;
- Construction will have an average growth of around 5.4 percent driven by the announced investments, going on to slow down in 2020 as a consequence of the high base from previous years, when the demand for the engagement of domestic construction companies will decline due to the completion of planned investments;
- This scenario envisages growth of 4.8 percent in accommodation and food services, which partially covers the tourist sector. The phased completion of the started investments in tourism

[10] The World Bank analysis estimates that the VAT rate increase will have an impact on the inflation rate of 0.5 of one percentage point.

will increase the supply of higher-category facilities, which is a prerequisite for strengthening the contribution of this sector to GDP growth. Hotel capacities account for 20 percent of the accommodation supply and their contribution has a many-times-higher contribution than that of private accommodation in the total revenue from tourism. Increasing supply in this segment will contribute to a faster growth in revenues, which is higher than that obtained by a straightforward increase in total capacities.

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

Table 2.6: Production sectors – real growth rates and share in GVA

	Real growth rates (%)				*Share in GDP growth (%)*				*Share in gross value added (%)*			
	2017	*2018*	*2019*	*2020*	*2017*	*2018*	*2019*	*2020*	*2017*	*2018*	*2019*	*2020*
Agriculture	*2.0*	*3.0*	*3.0*	*3.0*	*0.1*	*0.2*	*0.2*	*0.2*	*8.8*	*8.8*	*8.9*	*8.9*
Industrial production	*-0.2*	*5.3*	*5.3*	*3.8*	*0.0*	*0.5*	*0.5*	*0.4*	*11.8*	*12.1*	*12.4*	*12.5*
Construction	*30.0*	*10.0*	*3.3*	*3.0*	*1.7*	*0.7*	*0.2*	*0.2*	*8.5*	*9.1*	*9.1*	*9.1*
Services	*2.8*	*1.8*	*2.1*	*2.3*	*1.6*	*1.0*	*1.2*	*1.3*	*70.9*	*70.0*	*69.6*	*69.4*
of which accommodation and food	*4.5*	*4.5*	*4.5*	*5.5*	*0.0*	*0.0*	*0.0*	*0.0*	*8.6*	*8.7*	*8.9*	*9.2*
GVA (gross value added)	*4.2*	*3.0*	*2.7*	*2.6*	*3.4*	*2.5*	*2.2*	*2.1*	*100.0*	*100.0*	*100.0*	*100.0*
Taxes less subsidies	*4.2*	*3.0*	*2.7*	*2.6*	*0.7*	*0.5*	*0.5*	*0.4*				
Real GDP growth rate	*4.2*	*3.0*	*2.7*	*2.6*	*4.2*	*3.0*	*2.7*	*2.6*				

Source: Ministry of Finance projections

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

- Changes in the investments pace or a significant increase in costs for the highway section that would result from an unplanned increase if cost increases resulting from additional works have an impact on changes in the economic growth projections over the medium term. Macroeconomic stability would be jeopardized by a worsening in the fiscal position (debt and deficit) due to reduced public-sector revenues resulting from lower growth rates and consequently increased unemployment. This dynamic would require additional fiscal consolidation measures on the revenue side with multiple negative effects on the entire economic activity. The moderate materialization of this risk is taken as one of the assumptions for the low-growth scenario materializing;
- Considerable divergence in the implementation of measures set by the fiscal strategy in the form of an increase in expenditure and/or a reduction in revenue; such a development would destabilize the confidence of investors and international financial institutions, with a potential outcome in the form of a reduced credit rating, which would jeopardize the overall macroeconomic stability;
- Potential instability in the financial markets may increase the interest rates for sovereign borrowing or make difficult Montenegro's borrowing required to refinance due liabilities. Even though the current situation in the financial markets is favourable and stable, potential instability would increase rates for sovereign borrowing and reduced demand for risky sovereign bonds, which would present sizeable challenges to Montenegrin finances for the period 2019-2020;
- Adverse weather conditions could have a significant effect on the sectors of tourism, agriculture and electricity generation. If this risk materializes, which would reduce production in agriculture, it would also result in reduced electricity generation (even though a prolonged

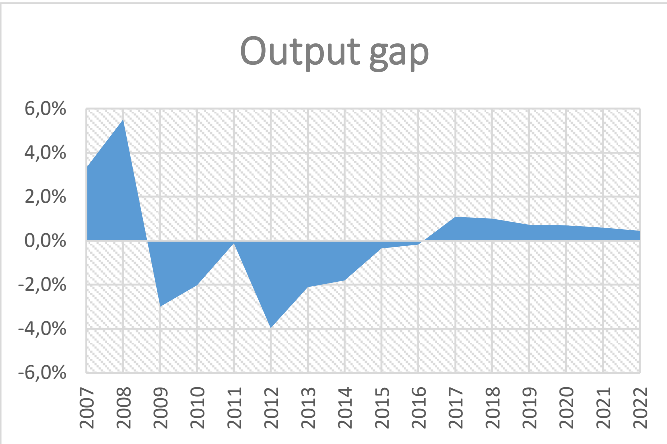
drought with low precipitation was recorded in 2017 which already resulted in a decline in electricity generation, thus this low base lowers the possibility of further decline). The tourist sector is prone to the impact from this risk materializing, thus negative developments could have a sizeable downward impact on projected growth rates, with multiplicative effects occurring everywhere, given the high share of tourism revenues in GDP;

- The geopolitical risks from the immediate or wider environment are the increasing security challenges which have an impact on the entire global economy through a reduction in investment, tourist trade or a reduction of total economic activity with the spill-over of potentially lower growth rates for all economies.

2.2.1.2 Potential Growth

This document comes up with an estimate of the potential growth and output gap using the CD[11] production function, which is a more precise way of representing sources of growth by production factors. Unavailable data on value of capital in the economy of Montenegro was substituted for by an estimated value of capital[12]. The core assumptions were that the proportion of production represented by labour is 65 percent and by capital 35 percent, while the annual capital amortization rate is 5 percent. Estimates of labour force development were performed using estimates of population trends by applying the median fertility rate and on the assumption that the legislative reforms being implemented or intending to be implemented will increase the present activity rate from its present value of 55 percent to 60 percent by 2020, thus contributing to an increase in the potential labour force.

Figure 2.1 Output gap



The results of the model show the well-known dynamic for the period 2007-2015, with a high output gap in 2007 and 2008, a double-dip recession in 2009 and 2012 and the strong investment cycle that started in 2016, which is assumed to expand until 2020. Even though the results of the model are taken with certain reservations, the average potential growth from 2007 until 2016[13] was 2.1 percent, while in the period 2017-2020 it grew by 2.9 percent, because completed investment projects increase the value of capital as one of the components of growth. After that period it is expected that the completion of infrastructure projects will primarily open up new possibilities for investment and that there will be further potential growth.

Analysis of the share of production factors and, along with them, of the total factor productivity indicates that the share of capital in the real growth rate, during the period 2007-2016, was at an average of 1.9 percent, the share of the labour force at 0.3 percent, while total factor productivity had a negative share of 0.5 of one percent. This indicates that the average potential for growth is caused primarily by the growth in physical capital, the weak contribution of the labour force and a negative contribution from total factor productivity. For the period 2017-2020, the contribution of total factor productivity changes to a certain degree, thus it remains at the same level for capital at an average of 1.9 percent, and the labour force share increases to 0.5 percent, while it increases for total factor productivity as residual to 0.8 percent. This data indicates that an increase in the technological dynamism of production factors in the Montenegrin economy is expected, which pertain to

[11] Cobb–Douglas

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

[13] In 2017th MONSTAT has revised data for the period from 2006 to 2009 and for 2015.

technological growth and labour force efficiency. Increased participation of allocations for science, envisaged by the 2018 budget, as well as the envisaged public administration reform, will impact the growth of the economy's potentials over the medium and long term. Even though the drivers of growth in the Montenegrin economy are sectors without high technological growth (construction, tourism, agriculture and energy), they have the potential to increase total factor productivity. In agriculture, these are the measures pertaining to the investments of agricultural producers, the adoption of production standards and the distribution of agricultural products in accordance with international standards. In construction, this refers to the use of new infrastructure building techniques (construction of the highway section). In the tourist sector, this refers to the strengthening of supply by constructing high-end facilities and the training of employees to work in such facilities. The construction of new energy facilities linked with renewable sources (wind turbines and small hydropower plants) requires new technological solutions that raise total factor productivity. Constant investment and following global standards in sectors with a high technological profile, primarily telecommunications and IT technologies, linked with this sector provide them with high-level services which are a basis for strengthening productivity in the entire economy.

2.2.1.3 External Sector and its Medium-Term Sustainability

The high level of the balance of payments current account deficit, which was estimated at 18.0 percent of GDP in 2017, indicates a deep foreign trade imbalance. The main negative contribution to the current account deficit pertains to the balance of goods, which is estimated at 43 percent of GDP, but is partially offset by a surplus from the services account (21 percent of GDP) and the balance from the accounts of primary and secondary income of 3.9 percent of GDP. The current account deficit is partially offset by foreign direct investments and borrowing by the state on the international and domestic financial market. Net errors and omissions, which is a residual item for the unrecorded part of the current account financing, indicates that some transactions are not included at all (errors) or are inadequately valued (omissions), and pertain to unrecorded revenue from tourism, remittances and other unregistered cash payments. In the case of Montenegro, because of the use of euro as the legal tender, as well as due to the sizeable level of cash payments, in particular in the tourist sector (grey economy), it is not easy to capture all transactions, since it is not possible to differentiate domestic euros from foreign euros.

The structure of the current account deficit and its financing represent a risk to the sustainability of the balance of payments position, given that it relies on a high inflow of foreign investment.

During the next medium-term period we expect a decline in the current account deficit, given that a continuous growth in exports of goods and services is projected, and stagnant and declining imports of goods and services, thus at the end of the period this will be around 14.5 percent of GDP. In the period 2018-2020, the expected FDI inflow is at an average of 10.3 percent, and it will make a significant contribution to financing the current account deficit.

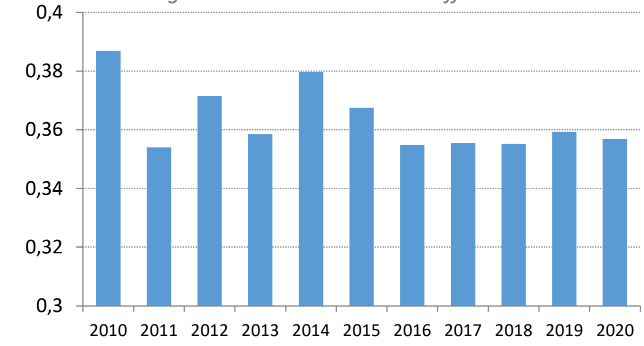
Table 2.7 presents data on the total debt, the composition of the debt and the development of the individual components in the previous period:

Table 2.7: Total external debt in € millions

	2010	*2011*	*2012*	*2013*	*2014*	*2015*	*2016*
Government of Montenegro	*912*	*1,064*	*1,295*	*1,433*	*1,562*	*1,956*	*2,003*
Banking sector	*930*	*787*	*683*	*705*	*664*	*725*	*814*
Other sectors	*1,741*	*1,936*	*1,992*	*1,930*	*2,000*	*1,787*	*1,918*
Total	*3,584*	*3,787*	*3,970*	*4,068*	*4,226*	*4,469*	*4,735*
Inter-company debt	*841*	*930*	*974*	*1,158*	*1,308*	*1,347*	*1,512*
Total including inter-company debt	*4,425*	*4,717*	*4,944*	*5,225*	*5,533*	*5,816*	*6,247*
As percentage of GDP	*141.6%*	*144.5%*	*155.4%*	*155.4%*	*160.0%*	*160.5%*	*158.0%*

Analysis of productivity developments, stated as a percentage of gross domestic product and the number of employed people (15+ years) at the level of the economy, indicates an upward trend in productivity, with average rate of 1.5 percent in the period 2010-2016, which corresponds to an average growth in overall economic activity during that period (21 percent). According to the GDP and employment projections for the period 2017-2020, it is expected that the productivity will see a mild increase, with an average annual growth of 1.8 percent.

Figure 2.2: Unit labour cost coefficient



Analysis of competitiveness based on the unit labour cost (ULC)[14], shows that price competitiveness has been stagnant in the period after 2015. The reliability of the analysis is limited due to a change in the data sources for the number of employees and the fight against the grey economy, i.e. legalizing employment. The stagnant unit labour cost in the period 2018-2020 is a consequence of a proportional growth in nominal GDP on one hand and a growth in employment and wages on the other. The analysis of the net international investment position cannot be processed since the CBCG does not have the data necessary for such an estimate.

2.2.1.4 Financial Sector

Key performances of the Montenegro financial sector are stability and pronounced bank-centricity, given the predominant position of banks in the composition of the financial sector assets. Capital market has lost its systemic importance in the post-crisis period, following the burst of the price bubble, which caused long-term negative consequences for its development. However, today is evident, as it was the case in the past, that primary stock and bond market is underdeveloped as source of the corporate sector financing, therefore banks continue to have dominant position in this segment operation. Thus, impact of financial sector intermediaries operating at capital market and insurance market (in its developing stage) on economic development is still below expected in spite of invested efforts and achieved results.

As for the banking sector, positive trend of almost continuous decline of non-performing loans and receivables from the previous period has continued. Non-performing loans and receivables at the end of Q3 of 2017 were 7.4 percent of total gross loans and receivables. Credit risk represents an increasing lower systemic challenge, which is more individual, and its resolution requires implementation of activities to rationalise operation and reduce operating costs of individual banks.

In 2017, the regulatory framework for resolving non-performing loans (NPL) was significantly improved, which represents a basis for the comprehensive strategy for NPL resolution in Montenegro, as part of the Podgorica Approach project. The two key regulations are the Law on the Voluntary Financial Restructuring of Debts towards Financial Institutions, with a two-year application (May 2015-May 2017) and the Decision Amending and Supplementing the Decision on Minimum Standards for Credit Risk Management in Banks, applicable from January 2014. Since these solutions have not yielded the expected results, the CBCG has prepared and the Parliament of Montenegro has adopted the Law Amending and Supplementing the Law on the Voluntary Financial Restructuring of Debts towards Financial Institutions[15], with a limited implementation period of one year. Essentially, the adopted

[14] The model for calculating the unit labour cost was developed by the Ministry of Finance. The coefficient indicates the share of gross wages in the gross production value, i.e. total economic output. A coefficient of 0.37 shows that for 1 euro of total production value the share of gross wages is 0.37 euro. This model was developed using the data on wages, employment (LFS) and the value of gross production published by MONSTAT. The gross production value for the period 2016-2019 was developed as an extrapolation based on the real GDP rate.

[15] The law was published in the Official Gazette of Montenegro, No 37/17.

solutions were aimed at expanding the coverage of loans that could be subject to the stated restructuring, simplifying the restructuring procedure, and securing additional tax relief for debtors. In order to make this law operational, the Central Bank adopted the Decision Supplementing the Decision on Standards for Credit Risk Management in Banks[16] in July 2017. The effects of the adopted solutions are visible already since the implementation of this law, as of 25 December 2017, had resulted in the restructuring of loans amounting to 17.55 million euro, of which 16.52 million euro, or 94.1 percent, was for legal entities, and 1.03 million euro, or 5.9 percent, for natural persons. This is also linked with the recommendation from the Ministerial Meeting held in May 2017, for Montenegro *"to foster NPL resolution by developing a comprehensive strategy to that end, including participation by all relevant stakeholders, with the aim of reducing credit risks in the banking sector and removing impediments to credit extension in the economy. Consider including corporate debt restructuring and tackling other underlying structural obstacles to resolution as part of the strategy. Improve the prudential and banking resolution frameworks with the aim of strengthening financial stability*." (See the section in Chapter 4 on Financial Services).

An increase in inter-company debt and increased illiquidity is evident in the economy, which is confirmed by the fact that 19.3 percent of business entities out of the total number of registered legal entities and entrepreneurs have blocked accounts. A total of 2,028 judgment debtors were under a continuous garnishment of up to one year, with the amount being blocked 30.0 million euro, which makes up 4.8 percent of the total blocked amount, while 14,040 judgment debtors were blocked for more than one year with the amount being blocked 595.4 million euro, which makes up 95.2 percent of the total blocked amount.

At the end of September 2017, the weighted average effective interest rate for the total loans of banks was 6.98 percent, and 7.01 percent on newly approved loans. The declining trend of weighted average nominal and effective interest rates (WANIR and WAEIR), which started in the last quarter of 2014, has continued into the next year. Thus at the end of September 2017, the interest rate of total bank loans was 0.74 percentage points lower, YOY. On the other hand, despite the volatility of the WAEIR for new loans from banks, this rate decreased by 0.60 percentage points per annum, during the observed period.

These developments, along with the multi-year downward trend in deposit interest rates, have resulted in a reduction in the interest rate, ranging from 7.61 percentage points in September 2015 to 6.23 percentage points at the end of September 2017, which reflects on the operations of some banks. If this trend continues, it is to be expected that additional pressure will be put on the profitability of banks, especially smaller ones, which will require faster adjustment of them to the new market conditions by reducing operating costs and redirecting business activities towards providing new competitive products and services. Considering the given circumstances, it is possible that acquisitions and mergers could take place in the banking market in the forthcoming period.

Continued growth in the lending activity of banks, triggered by a strong reduction of the level of non-performing loans and a high and growing level of liquidity in the banking sector, is expected in the next year. Likewise, it is expected that the downward trend of interest rates level will continue as a result of pronounced competition in the domestic banking market and a continuous decline in the prices for domestic funds. These statements are also confirmed by the CBCG survey carried out quarterly with banks, which indicates that 10 banks are expecting a decline in the nominal interest rate in 2018, four banks are expecting them to remain at the same level, while only one bank is expecting an increase in nominal interest rates.

2.3 Alternative Scenario

2.3.1 Low-Growth Macroeconomic Scenario 2018-2020

As a small and non-diversified economy, Montenegro is subject to external and domestic influences. The main growth driver in the baseline scenario is based on strong investment activity, adjusted with

[16] The decision was published in the Official Gazette of Montenegro, No 44/17.

fiscal consolidation measures, with a strong contribution from the tourist sector. Bearing in mind the possible risks, it is clear that activating any of them can jeopardize the projected growth rates to a greater or lesser degree. While acknowledging uncertain developments in investment activity, along with the high level of investment carried out in 2016 and 2017, the starting assumption for the low-growth scenario is based on a slowing down of the growth trend of investment activity during the observed period. This year's scenario takes on an additional risk – a reduction in revenues from tourism, due to a worsened geopolitical situation or adverse weather conditions. The alternative low-growth scenario envisages that, during the period 2018-2020, investment will be maintained at the level reached in 2017, and there will a decline in revenues from tourism in 2018 and 2019.

The assumptions of the scenario are:

- Gross fixed capital formation in 2018 will be maintained at the level reached in 2017 (estimated at 977 million euro or 23 percent of GDP). The average share of gross investment in GDP in the period 2010-2015 was at the level of 19 percent, thus this represents a reasonable assumption that the risks related to investments will materialize. In 2019 and 2020 investments remain at the same level as in 2018;
- Revenue from tourism in 2018 and 2019 is 2.0 percent lower in both years, due to geopolitical risks or adverse weather conditions.

This dynamic of the two key growth drivers causes a impact on all macroeconomic indicators.

GDP trends and components (expenditure approach):

- In 2018 the real GDP growth rate would reach 1.8 percent, 1.9 percent in 2019 and 2.5 percent in 2020;
- A reduction in disposable income for household consumption caused by the stagnant labour market (employment and wages), as well a reduction in revenue from tourism as part of the source of household consumption, would reduce the growth rate of household consumption to 1.5 percent on average over the medium term.
- Final government consumption would have a negative growth rate, as is also the case in the baseline scenario. A reduction in the budget revenues, due to a decline in aggregate demand, and thus in the taxation base, would require additional borrowing in order to finance the projected expenditure side. The level of the government debt as a proportion of GDP would increase because of the assumed increase in borrowing and reduced amount of nominal GDP. The alternative would require a further reduction in government spending in order to achieve the set fiscal objectives, with multiplicative effects on other sectors, which would lead to additional changes in the parameters in the low-growth scenario, with lower growth rates.
- Exports of goods and services would be stagnant on average in the medium term, whereby it would record negative values in the first two years due to a decline in revenue from tourism;
- Imports of goods and services would decline by an average of 2.1 percent due to these domestic and foreign developments. This decline would be pronounced during the first two years in particular. Changes in net exports, assuming that the other current account items remain unchanged, would lead to a decline in the deficit to 13.6 percent of GDP, at the end of the period.
- The materialization of this scenario would lead to a standstill in employment and an increase in the unemployment rate with stagnant wages during the first two years in the medium term. The unemployment rate would increase to 17.3 percent in 2018 from 17 percent in 2017. At the end of the period the rate would be 17.5 percent.
- Reduced domestic demand would have an impact on the materialization of lower rates of the general level of prices, thus inflation would reach 2.0 percent in 2018, with the assumption of a possible increase in taxes in 2018, as envisaged in the Fiscal Strategy.

Inflation would record rates in the following two years, of 1.9 percent and 1.5 percent respectively, as in the baseline scenario.

Table 2.8: Low-growth scenario

Montenegro: Macroeconomic projections, 2017-2020

	2016	2017	2018	2019	2020
Nominal GDP in € millions	3,954.2	4,202.1	4,323.6	4,440.3	4,590.0
Nominal growth	8.2	6.3	2.9	2.7	3.4
Real growth	**2.9**	**4.0**	**1.8**	**1.9**	**2.5**
Inflation (average)	0.4	2.5	2.0	1.9	1.5
			(% GDP)		
GDP deflator	5.1	2.1	1.1	0.8	0.9
			(real growth rates in %)		
Real GDP growth	**2.9**	**4.0**	**1.8**	**1.9**	**2.5**
Domestic demand	**8.0**	**4.4**	**0.8**	**0.5**	**0.8**
Household consumption	5.4	5.3	1.7	1.0	1.9
Gross fixed capital formation	27.5	6.6	-0.5	0.0	-1.5
Changes in inventories	938.6	-20.7	-0.5	-0.5	-0.5
Government spending	0.8	2.1	-1.2	-0.5	-0.8
Exports of goods and services	6.2	7.0	-2.4	-1.3	3.0
Imports of goods and services	15.0	6.6	-2.8	-2.9	-0.5
Main assumptions:			Growth in % unless otherwise stated		
Employment growth	1.1	1.5	0.0	0.0	0.3
Growth of wages	3.6	2.1	0.0	0.0	1.8
Unemployment (LFS)	18.0	17.0	17.3	17.5	17.5
FDI as % GDP	9.4	12.0	11.6	11.3	8.7
Domestic loans (corporate and households)	6.0	6.3	2.9	2.7	3.4

3. FISCAL FRAMEWORK

3.1 Policy strategy and medium-term objectives

The main fiscal policy objective in the period 2018–2020 is to strengthen fiscal stability as the key driver of overall macroeconomic stability, as well as to increase economic activity and the economy's competitiveness.

In order to stop adverse fiscal risks, which were a feature of the previous period, and to make public finances sustainable, two packages of fiscal consolidation measures have been adopted. The Budget Deficit and Public Debt Recovery Plan 2017–2021, which was adopted along with the 2017 Budget, defines the measures for the revenue and expenditure sides of the budget, amounting to a total value of 126.9 million euro, or 3.2 percent of GDP. In order for the consolidation measures to be significant and achievable in a short period, an additional package of measures was designed, which was further worked out in the Fiscal Strategy 2017–2020 adopted by the Parliament of Montenegro in July 2017. The measures envisaged in the Fiscal Strategy ensure additional fiscal adjustment of an amount of 117.0 million euro or 2.8 percent of GDP.

All the envisaged measures are designed so as not to slow down the dynamics of economic growth in the medium term, but to provide for a balanced distribution of the tax burden and an equitable distribution of social benefits, thus protecting socially sensitive categories of the population.

At the same time, from the aspect of the tax burden, Montenegro's need to remain a competitive destination for foreign investment was taken into account. In this way, the credibility of public finances is ensured, as is Montenegro's improved position on international financial markets, which facilitates borrowing under favourable conditions. In order to ensure successful fiscal consolidation, it will be necessary to tighten inspection supervision and increase the engagement of all the relevant competent authorities, thus, inter alia, disabling informal-sector operations. In this regard, an Action Plan for Suppression of the Grey Economy has been developed, which specifies preventive, restrictive and stimulating measures to be implemented through the coordinated activities of all the relevant institutions.

To support the strengthening of macroeconomic stability and economic competitiveness, as a prerequisite for increased potential economic growth, a structural reform agenda will also be implemented, i.e. measures of development and economic policy in the public and real sectors. A detailed overview of measures and projects is provided in Montenegro Development Directions, as an overarching development-implementing document. In support of the specified measures, reforms in the area of health will be concurrently implemented with a view to strengthening the sustainability of the health system, as well as in the areas of labour and social welfare and also pension system reforms, given the fact that it is these systems that mostly determine the state of public finances in Montenegro.

Also, implementation of the Public Finance Management Reform Programme 2016–2020 will continue (the reforms are reasoned in detail in section 3.7), as well as the Public-Sector Reform Strategy 2016–2020, so as to bring the number of public administration employees to an optimum level.

In accordance with the above, the main fiscal aggregates (deficit and public debt) will be brought back within the limits envisaged by Maastricht criteria, i.e. the Law on Budget and Fiscal Responsibility in the medium term, so that:

- The public finance deficit will decrease in 2018, with a balance (surplus) of 0.1 percent of GDP in 2019 and 5.4 percent of GDP in 2020;
- Public debt will gradually go down to the level of 59.7 percent in 2020; and
- Current budgetary expenditure, in all projected years, will be funded from current revenues, which even in years of deficit will facilitate borrowing to be made solely for the purpose of funding development projects, which will contribute to economic growth in the long run.

Table 3.1: Medium-term macroeconomic and fiscal framework

Macroeconomic framework		Actual	Estimate	Baseline scenario			Low-growth scenario		
		2016	2017	2018	2019	2020	2018	2019	2020
Macroeconomic indicators	GDP nominal (€ millions)	3,954.2	4,202.1	4,397.7	4,569.4	4,729.6	4,323.6	4,440.3	4,590.0
	GDP, nominal growth	8.2	6.3	4.7	3.9	3.5	2.9	2.7	3.4
	GDP, real growth	2.9	4.0	3.0	2.7	2.6	1.8	1.9	2.5
	Inflation (end-of-year)	0.4	2.5	2.6	1.9	1.5	2.0	1.9	1.5
	Employment growth (%)	1.1	1.5	0.7	0.4	0.3	0.0	0.0	1.8
	Current account deficit (% GDP)	-18.1	-18.0	-18.0	-16.5	-14.5	-16.9	-15.4	-13.6

Fiscal framework (% GDP)		Actual	Estimate	Baseline scenario			Low-growth scenario		
		2016	2017	2018	2019	2020	2018	2019	2020
Fiscal indicators	Current public revenues	42.6	42.6	44.2	44.2	43.9	44.4	44.6	44.4
	Public expenditure	46.2	45.7	45.8	44.1	38.6	46.5	45.4	39.7
	Deficit/Surplus[17]	-3.6	-3.1	-1.6	0.1	5.4	-2.1	-0.8	4.7
	Deficit/ Surplus excl. highway	-3.4	1.2	3.2	4.7	-	2.7	4.0	-
	Interest	2.2	2.4	2.0	2.1	2.0	2.1	2.2	2.1
	Primary deficit/surplus	-0.7	-0.8	0.5	2.2	7.4	0.0	1.4	2.6
	Public debt (% GDP)	63.4	65.5	66.5	66.1	59.7	68.2	69.5	63.8

The implementation of the Budget Deficit and Public Debt Recovery Plan 2017 and the adoption of the Fiscal Strategy 2017-2020, which contains additional fiscal consolidation measures, are in response to the first recommendation from the Ministerial Meeting held in Brussels in May 2017 in the area of fiscal policy regarding the assessment of the 2017 ERP. The mentioned recommendation invited Montenegro to fully implement the package of fiscal consolidation measures for 2017 and undertake additional fiscal measures in order to achieve budgetary savings of 3.0 percent of GDP and adopt an overall fiscal strategy aimed at public debt stabilization and the reduction of debt-related vulnerability, which has been carried out. The data on the assessment of the central government budget execution and public finances in 2017 is presented in section 3.3.

In one part of Recommendation 2 from the Ministerial Meeting held in Brussels, the medium-term projection contained in this Programme indicates a gradual reduction in the expenditure related to wages and pensions relative to GDP, so these two categories, viewed cumulatively, range from 20.7 percent in 2018 to 19.7 percent in 2020, given that the nominal growth of these categories is lower than GDP growth. Also, the redefined social welfare package, through adoption of the Law Amending the Law on Social and Child Care and of the Law Implementing the Decision of the Constitutional Court regarding the status of benefits in respect of giving birth to three or more children, contributes to the implementation of Recommendations 1 and 2, in terms of ensuring the fiscal sustainability of social welfare. At the same time, the aforementioned is related to Recommendation 6 which is responded to in Chapter 4 of this document.

The possibility of establishing a Fiscal Council in line with the recommendation of the European Commission will also be considered in 2018

As regards the recommendation related to the analysis of tax exemptions, the Ministry of Finance analysed the tax exemptions and concessions envisaged in the Law on Value-Added Tax and the Law on the Highway with regard to the following categories:

- Medication and medical supplies specified in the medication list, i.e. the medical supplies prescribed and issued at the expense of the Health Insurance Fund;
- Accommodation services in hotels, motels, tourist settlements, guest houses, camps and villas;
- The provision of goods and services for constructing and furnishing hospitality facilities with 5 stars and 5+ stars, energy facilities for the generation of electricity with an installed

[17] Without *repayment of commitments from the previous period.*

capacity exceeding 10 MW and capacities for the production of food products classified within sector C group 10 of the Law on the Classification of Business Activities (OGM 18/11), whose investment value exceeds 500,000 euro;

- The delivery of goods or services performed in line with a loan agreement made between Montenegro and an international financial organization;
- Servicing provided at marinas; and
- Value-added tax payable at a rate of 0.0 percent on the turnover of goods and services intended for the highway construction, carried out by a contractor or on behalf of the contractor commissioned to perform works on the highway construction.

Taking into account the fact that the mentioned tax exemptions are mostly related to support for investments that are the key driver of the growth of the Montenegrin economy, it can be concluded that the existence of the mentioned exemptions has a positive effect on the attractiveness of the Montenegrin investment environment and overall economic activity. Of course, in the coming medium-term period, pursuant to EU recommendations, the possibility of abolishing specific exemptions will be considered, in line with Montenegro's obligations under the negotiations for EU membership.

The following table provides an overview of consolidation measures according to the "Recovery Plan" and "Fiscal Strategy" with their effects in millions of euros:

Table 3.2: Overview of consolidation measures according to the "Recovery Plan" and "Fiscal Strategy", year-on-year measured effects

Recomm. No.	Fiscal consolidation measures adopted in the Recovery Plan – 2017–2019 ERP	Effects in 2017 (€ millions)	No.	Additional fiscal consolidation measures – Fiscal Strategy MNE 2017–2020	2017	2018	2019	2020	Effects in 2017–2020 (€ millions)
	Budget revenues	**59.3**		**Budget revenues**	**24.2**	**77.7**	**21.9**	**9.1**	**132.9**
1.	Tax debt restructuring	12.0	1.	Excise on cigarettes	5.3	20.6	13.2	15.3	41.2
2.	Abolition of tax exemptions	1.5	2.	Excise on carbonated water with added sugar	0.0	8.4	4.1	4.1	16.6
3.	Strengthening tax discipline of taxpayers	15.0	3.	Coal excise	/	/	2.7	2.7	5.5
4.	Reduction of wages of public officials	-1.2	4.	Excise on ethyl alcohol	0.9	1.7	1.8	2.2	6.7
5.	Increased excise on mineral oils	32.0	5.	Increase of standard VAT rate to 21% (2pp)	0.0	42.8			42.8
			6.	Tax debt restructuring	17[18]				17
			7.	Contributions for bridging periods of service for mothers	1	4.2	-2.1		3.2
	Expenses	**67.6**		**Expenses**	**10**	**-9.4**	**-2.4**	**-14.1**	**-15.9**
1.	Gross wages and contributions at the expense of employers (due to a reduction in the wages of public officials of 8% and deferred calculation of the years of service for the period 1 April 2017–December 2018)	4.9	1.	Reduction of gross wage bill	1	1.5	1		3.5
2.	Benefits in the area of social welfare (a reduction of benefits for mothers and a delay in the implementation of the provision of the law adopted in 2016, with regard to the payment of child allowance for the period through 1 July 2017 for children whose parents are registered with the Montenegro Employment Agency as unemployed and are not beneficiaries of any other kind of social benefits)	15.8	2.	Reduction of wage multiplier by 1%	2.1	2.8	-2.1	-2.8	0.0
3.	Capital budget	10.0	3.	Reduction of wages for ABC by 6% (gross effect)	0.9	0.9			1.8
4.	Other expenditures	37.0	4.	Benefits for mothers and the package of social welfare measures	6	13.5	5.7	0	25.2
			5.	Reduction in discretionary spending	0	4.0	4.0	3.0	11.0
			6.	**New liabilities**		**32.1**	**11.0**	**14.3**	**57.4**
	TOTAL FISCAL CONSOLIDATION	126.9		TOTAL CONSOLIDATION EFFECTS	34.2	68.3	19.5	-5.0	117
	PERCENTAGE OF GDP	3.23%		PERCENTAGE OF GDP					2.8%

[18] Revenues from tax debt restructuring in 2018, 2019 and 2020 are anticipated at the level of up to 24 million euro annually.

3.2 Budget implementation in 2017

In 2017, fiscal policy focused on elimination of the risks and imbalances that in the previous period threatened to lead to public finance instability, through aggravation of the key fiscal aggregates, due to increased current budgetary expenditure, and also the need to finance the highway construction project. In order to reverse this trend, in 2017 the fiscal consolidation measures previously specified in the Budget Deficit and Public Debt Recovery Plan 2017–2021 were implemented, and a new package of measures was created in view of achieving additional fiscal adjustment.

In this regard, activities were undertaken to rationalize public expenditure and create conditions for an increase in public revenues, so as to facilitate a reduction in the public expenditure deficit and a gradual reduction in public debt.

The fiscal adjustment measures that were implemented in 2017, in accordance with the Budget Deficit and Public Debt Recovery Plan, as well as the additional measures contained in the Fiscal Strategy, whose implementation began in August 2017, were aimed at increasing public revenue and were as follows:

- For the purpose of collecting outstanding tax debt, pursuant to the Law on Restructuring Tax Receivables, taxpayers were given the option of paying their tax debt in 60 equal monthly instalments with the interest being written off, as well as the cost of receivable-related procedures, but with the obligation to make a one-off payment of 10 percent of the total amount of tax receivables. Taxpayers for whom restructuring is approved are to regularly make payments of monthly instalments and regularly settle current liabilities related to public revenues;
- The Law Amending the Excise Law increased:
  - Excise on mineral oils to 0.09 euro/l as of 9 January 2017;
  - Excise on cigarettes and fine-cut tobacco as of 1 August 2017, so that the specific excise amounts to 30 euro per 1000 cigarettes, while the ad-valorem excise amounts to 32 percent;
  - Excise on ethyl alcohol as of 1 August 2017 increased to 850 euro/hl of pure alcohol;
  - The higher rate of personal income tax of 11 percent (in relation to the standard rate of 9 percent) was retained on the amount of wages above the average wage;
  - The strengthening of fiscal discipline of taxpayers through reduction of the grey economy and more regular collection of tax receivables; and
  - In the Law Amending the Law on Value-Added Tax, the standard VAT rate of 19 percent was applied to computer equipment, to replace the lower rate that had been previously applied.

On the expenditure side, measures are implemented that are mostly directed towards expenditure categories that are major determinants of the scope of public spending, as follows:

In order to prevent further growth of the overall gross wage bill, the following measures have been undertaken:

- The Law Amending the Law on Salaries of Public-Sector Employees reduced the wages of public officials (groups of work activities: A, B and C) by 8 percent as of 1 January 2017;
- The wages of all employees, except employees receiving the minimum wage, decreased by 1 percent as of March 2017;
- As of 1 July 2017, the wages of public officials (groups of work activities: A, B and C) decreased by an additional 6 percent;
- The fund for payment of the variable portion of wages reduced, so that the maximum monthly amount per employee decreased from 80 percent to 50 percent of the previous year’s average wage in Montenegro.

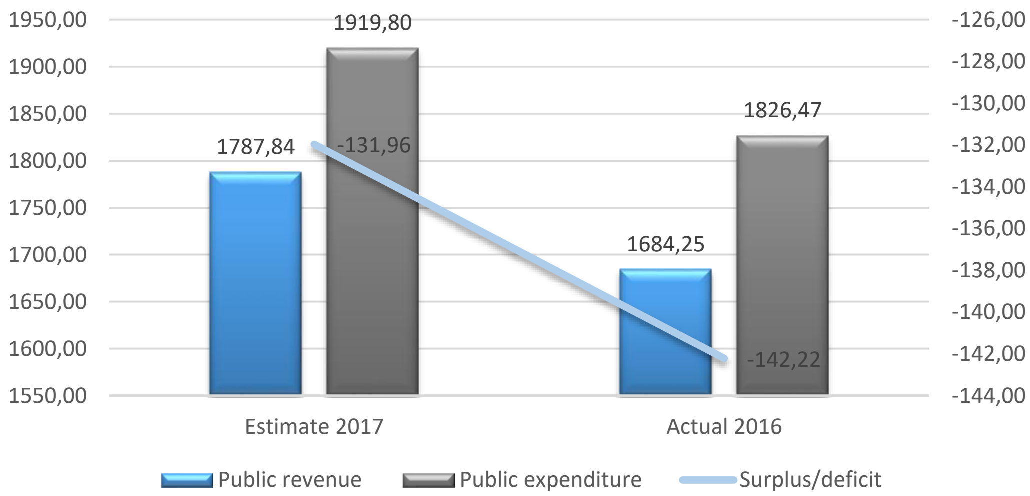
As regards the benefits from the area of social welfare, the original amendments to the Law on Social and Child Care decreased the benefits for mothers of three or more children from 336 euro to 264 euro and from 192 euro to 144 euro.

After the decision of the Constitutional Court of Montenegro regarding the non-constitutionality of the provisions of the Law on Social and Child Care related to the benefits for mothers, the Law Implementing the Decision of the Constitutional Court was prepared and adopted and it establishes the restoration of the state before the approval of payments to those beneficiaries who were previously entitled to a pension or who were included in the register of unemployed persons, while those beneficiaries who terminated their employment in order to exercise the right to this benefit will continue to be entitled to a temporary payout for a period not exceeding five years following the effective date of the law, in accordance with the criteria envisaged in this law.

For the purpose of the equitable distribution of social funds, i.e. the allocation of the funds saved in respect of the abolished benefits for mothers in favour of citizens who are really in a state of social need, the basic social care package was redefined and child allowance is envisaged to increase by 20 percent, as well as the benefit for newborn children, the benefit for unemployed persons on the unemployment register or for students, for the period until the first birthday of the child, etc.

Also, programmes were introduced under an active employment policy for the beneficiaries who were re-entered into the register of unemployed persons for the purpose of encouraging them to look for jobs more actively. The beneficiaries of payments who had previously exercised the right to a pension have been returned to the Pension and Disability Insurance Fund in order to exercise their previously acquired right to a pension.

Figure 3.2.1: Trend of fiscal parameters, in € millions



Current public revenue in 2017 was estimated at the level of 1,787.8 million euro or 42.6 percent of estimated GDP (4,202.1 million euro). The estimated revenue in 2017 is higher than the planned values by 21.8 million euro or 1.2 percent, compared with the revenue generated in 2016 of 103.6 million euro or 6.2 percent. The increase in revenue was caused by implementation of the previously mentioned fiscal consolidation measures and also by a growth in economic activity.

In this regard, it is estimated that, in relation to the plan, the most positive deviations in respect of revenues will be recorded in: value-added tax by 22.7 million euro, as a result of a growth in the collection of VAT; excise by 15.1 million euro (further harmonization of excise policy in line with EU standards); and local taxes by 7.5 million euro.

Public expenditure in 2017 was estimated to amount to 1,919.8 million euro, which makes up 45.7 percent of GDP and this is 84.4 million euro (4.2 percent) lower than the planned level. The total estimated level of expenditure is a result of the anticipated lower actual value of the *capital budget* caused by weaker execution, particularly with regard to projects financed from EU funds, so it is expected that the *capital budget's* actual value will be 17.9 million euro lower than originally planned. On the other hand, the estimate was that the costs planned for the needs of the highway would be executed at the level of 182.3 million euro, which is 12.0 million euro lower than planned.

As regards current public expenditure, negative deviations in relation to the plan will be recorded in *social care transfers* amounting to 10.7 million euro, of which 5.5 million euro relates to the reduction of costs due the amendments to the Law on Social and Child Care and implementation of the Law Implementing the Decision of the Constitutional Court, pursuant to which the benefits for mothers of three or more children were abolished, while the amount of 5.2 million euro is related to the funds planned for the settlement of redundancy liabilities. In addition, a lower actual value in relation to the planned amount is expected in *expenditure on materials and services* amounting to 5.0 million euro.

Public finance deficit in 2017 was estimated at 132.0 million euro or 3.1 percent of GDP and this is 106.2 million euro (or 44.6 percent) lower than planned. The primary public finance deficit is estimated at 32.4 million euro or 0.8 percent.

Table 3.3: Estimate of achieved public finances in 2017

Annual GDP *(in € millions)*	4,202.1		3,954.2				3,928.5			
	1		2		1-2		3		1-3	
Estimate of public finances in 2017	**Estimate 2017**		**Actual 2016**		**Deviation**		**Plan 2017**		**Deviation**	
	€ mill.	**% GDP**	**€ mill.**	**% GDP**	**€ mill.**	**%**	**€ mill.**	**% GDP**	**€ mill.**	**%**
Public revenues, *of which:*	1,787.8	42.5	1,684.2	42.6	103.6	6.2	1,766.0	45.0	21.8	1.2
Income tax	156.2	3.7	160.0	4.0	-3.8	-2.4	161.2	4.1	-4.9	-3.1
Value-added tax	550.5	13.1	500.7	12.7	49.8	9.9	527.7	13.4	22.7	4.3
Excise	225.6	5.4	182.7	4.6	43.0	23.5	210.5	5.4	15.1	7.2
Local taxes	85.2	2.0	77.4	2.0	7.7	10.0	77.7	2.0	7.5	9.6
Contributions	500.5	11.9	462.9	11.7	37.6	8.1	497.2	12.7	3.3	0.7
Public expenditure, *of which:*	1,919.8	45.7	1,826.5	46.2	93.3	5.1	2,004.2	51.0	-84.4	-4.2
Gross wages	485.1	11.5	467.6	11.8	17.5	3.8	486.7	12.4	-1.6	-0.3
Interest	99.5	2.4	85.7	2.2	13.8	16.2	101.36	2.6	-1.8	-1.8
Subsidies	28.1	0.7	27.8	0.7	0.2	0.8	25.9	0.7	2.2	8.4
Social care transfers	563.5	13.4	556.1	14.1	7.5	1.3	574.2	14.6	-10.7	-1.9
Capital budget	300.2	7.1	105.9	2.7	194.4	183.6	318.1	8.1	-17.8	-5.6
Guarantees	0.0	0.0	0.0	0.0	0.0	-	0.0	0.0	0.0	-
Surplus/deficit[19]	-132.0	-3.1	-142.2	-3.6	10.2	-7.2	-238.2	-6.1	106.2	-44.6
Primary surplus/deficit	-32.4	-0.8	-56.5	-1.4	24.1	-42.6	-136.8	-3.5	104.4	-76.3
Debt repayment	280.4	6.7	550.4	13.9	-270.0	-49.1	253.4	6.5	27.0	10.7
Financing, *of which:*	-412.4	-9.8	-692.6	-17.5	280.2	-40.5	-491.6	-12.5	79.2	-16.1
Borrowing abroad	296.4	7.1	332.0	8.4	-35.6	-10.7	363.2	9.2	-66.8	-18.4
Borrowing in the country	106.0	2.5	329.2	8.3	-223.2	-67.8	110.0	2.8	-4.0	-3.6

3.3 Medium-term budgetary outlook

The key fiscal policy objective in the medium term is to sustain the stability of public finances through implementation of the adopted fiscal consolidation measures in order to ensure the execution of the key objectives specified in the Fiscal Strategy, and they are as follows: a decrease in the deficit of public expenditures, i.e. generating a surplus as of 2019; and a gradual decrease in the level of public debt.

The Fiscal Strategy 2017–2020 specifies the measures and activities to be undertaken in the coming period for the purpose of ensuring achievement of the abovementioned objectives through the optimization of public spending on one hand, and an increase in public revenue on the other.

In the period 2018–2020, the following fiscal policy measures will be implemented:

- An increase in the general VAT rate from 19 percent to 21 percent as of 1 January 2018;
- An increase in excise on cigarettes, with a view to adjusting the excise policy to European Union standards, through adoption of a new excise calendar, according to which specific excise on cigarettes, as of 2018, will amount to 40, euro and, as of 2019, 50,euro per 1000 cigarettes,

[19] Without payment of commitments from the previosu period

while the ad-valorem excise will remain unchanged during the whole period at 32 percent of the retail price;

- An increase in excise on carbonated water with added sugar or other sweeteners or aromatization agents, whereby as of 2018 it will amount to 30 euro/hl, as of 2019 40 euro/hl, and as of 2020 it will amount to 50 euro/hl;
- As of 2019, an introduction of a coal excise amounting to 0.15euro /GJ is planned, which will gradually increase to 0.30 euro/GJ in 2020;
- An increase in excise on ethyl alcohol, gradually commencing on 1 January 2018;
- The establishing of electronic monitoring of fiscal registers commencing from mid-2019;
- The collection of outstanding tax debt through implementation of the Law on Restructuring Tax Receivables will be continued;
- The taxation of personal income (applicable to the portion of the wage exceeding the national average) will be continued at the rate of 11 percent until the end of 2019, while the portion of wages below the average in Montenegro will be subject to application of the rate of 9 percent;
- The created legal assumptions for the legalization of informally built facilities will affect the increase in revenues collected by local governments;
- The number of public administration employees will be optimized in line with the Montenegro Public Administration Reform Strategy 2016–2020;
- A redefined social policy that is fiscally sustainable and facilitates an equitable distribution of social funds will be implemented;
- Pensions will be adjusted according to the current and projected macroeconomic indicators which affect the level of pensions (average wage and inflation);
- A slowdown in the growth of expenditure, or the controlled growth of expenditure, through better distribution and efficient management.

In addition, activities will be intensified with a focus on: the reduction of the level of the informal economy; the reduction of tax receivables; and the prudential issuing of guarantees, which must predominantly enable development. At the same time, measures will continue to be undertaken to encourage the balanced development of the country, i.e. the faster development of underdeveloped regions.

Public finances in 2018 are planned so as to support increased competitiveness and economic growth concurrent with the continued implementation of the current fiscal consolidation measures, and also greater focus on support for health, science and education and on directing social funds to those in the greatest need.

Public revenues in 2018 are planned at 1,944.8 million euro or 44.2 percent of the estimated GDP (4,397.7 million euro) and they are 157.0 million euro (or 8.8 percent) higher than the estimate for 2017. Also, the largest growth is planned for VAT revenues, based on an increase in the standard VAT rate by 2 percentage points. At the same time, revenues from excise will go up, due to the alignment of the excise policy to EU standards, as a result of the anticipated more regular settling of tax debt liabilities, as well as the revenues due to the introduction of a new fee for connecting utilities on construction land for informal facilities, in accordance with the Law on Spatial Planning and Construction.

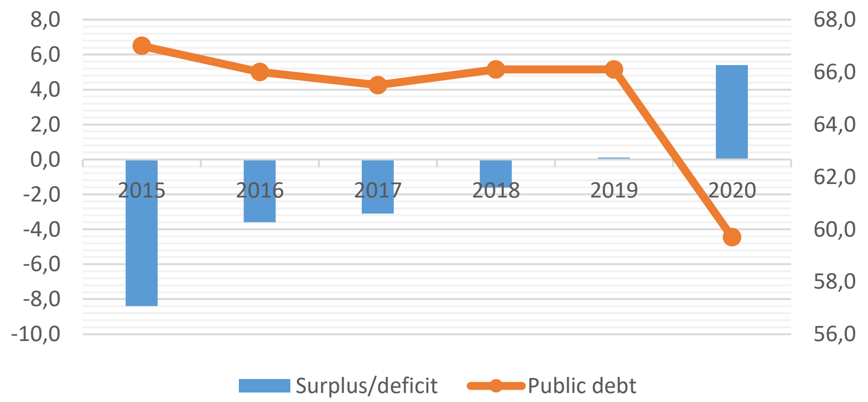
According to the medium-term framework, public revenues will range from 1,944.8 million euro in 2018 to 2,077.9 million euro in 2020. Despite only nominal growth of revenues, it is expected that due to the faster growth of GDP, revenues will decrease from 44.2 percent of GDP in 2018 to 43.9 percent of GDP in 2020. The main pillars of revenue will continue to be value-added tax and contributions, which on average make up around 58 percent of public revenue. Value-added tax will range from 617.3 million euro in 2018 to 675.6 million euro in 2020, while contributions will increase from 511.6 million euro to 529.6 million euro. Also, revenues from personal income tax will constitute a significant share of total revenue, while excise will record growth, in line with the adjustment process of Montenegro's excise policy towards European Union policy.

Public expenditure in 2018 is planned at 2,013.5 million euro or 45.8 percent GDP and this is 93.7 million euro (or 4.9 percent) higher than the estimate for 2017. The mentioned growth in public expenditure results from higher allocations related to the capital budget, which will be 53.0 million euro higher than the estimate for 2017, while current expenditure will be 40.7 million euro higher. Increased current expenditure results from higher allocations for the funding needs of the healthcare system, science and education, increased allocations for defence in line with NATO standards, as well as due to the funding activities planned within the European Integration Agenda.

Slight nominal growth in the total level of public expenditure is projected for 2019, when it will amount to 2,017.0 million euro or 44.1 percent, and thereafter it will decrease to a level of 1,823.7 million euro or 38.6 percent in 2020. Reduced public expenditure in the projected period primarily results from decreased allocations from the capital budget related to the completion of the highway construction project. For such purposes, there will be allocated funds of 210.0 million euro in 2018 and 214.25 million euro in 2019, when completion of the project is planned. On the other hand, current expenditure will be stable, taking into account that it is being put under observation due to fiscal consolidation measures, so its proportion of GDP will decrease during the observed period.

The public finance deficit in 2018 is projected to amount to 68.7 million euro or 1.6[20] percent of GDP and thereafter it will shift to a positive balance, given that in 2019 a slight surplus is projected of 2.91 million euro or 0.1 percent of GDP, while in 2020 the surplus of public finances will amount to 254.1 million euro or 5.4 percent of GDP.

Figure 3.3.1: Trend of fiscal parameters in medium term[21]



[20] Without payments of commitments form previuos period

[21] The presented overview does not include the railway debt or the outstanding debt for pensions, in order to make the report consistent with the EDP tables submitted to Eurostat.

Table 3.4: Trend of public finances in the period 2017–2020

Trend of public finances 2018-2020	Actual 2016		Estimate 2017		Projection 2018		Projection 2019		Projection 2020	
	€ millions	% GDP	€ millions	% GDP	€ millions	% GDP	€ millions	% GDP	€ millions	% GDP
Public revenues, *of which:*	*1,684.2*	*42.6*	*1,787.8*	*42.6*	*1,944.8*	*44.2*	*2,020.0*	*44.2*	*2,077.9*	*43.9*
Income tax	*160.0*	*4.0*	*156.2*	*3.7*	*173.4*	*3.9*	*176.8*	*3.9*	*180.3*	*3.8*
Value-added tax	*500.7*	*12.7*	*550.5*	*13.1*	*617.3*	*14.0*	*647.0*	*14.2*	*675.6*	*14.3*
Excise	*182.7*	*4.6*	*225.6*	*5.4*	*246.4*	*5.6*	*271.8*	*5.9*	*284.6*	*6.0*
Local taxes	*77.4*	*2.0*	*85.2*	*2.0*	*91.5*	*2.1*	*93.3*	*2.0*	*95.2*	*2.0*
Contributions	*462.9*	*11.7*	*500.5*	*11.9*	*511.5*	*11.6*	*519.4*	*11.4*	*529.6*	*11.2*
Public expenditure, *of which:*	*1,826.5*	*46.2*	*1,919.8*	*45.7*	*2,013.5*	*45.8*	*2,017.0*	*44.1*	*1,823.7*	*38.6*
Gross wages	*467.6*	*11.8*	*485.1*	*11.6*	*485.9*	*11.0*	*489.4*	*10.7*	*491.2*	*10.4*
Interest	*85.7*	*2.2*	*99.5*	*2.4*	*89.7*	*2.0*	*95.8*	*2.1*	*95.8*	*2.0*
Subsidies	*27.8*	*0.7*	*28.1*	*0.7*	*27.8*	*0.6*	*26.8*	*0.6*	*25.3*	*0.5*
Social care transfers	*556.1*	*14.1*	*563.5*	*13.4*	*552.5*	*12.6*	*555.1*	*12.1*	*561.4*	*11.9*
Capital budget	*105.9*	*2.7*	*300.2*	*7.1*	*353.3*	*8.0*	*356.3*	*7.8*	*153.9*	*3.3*
Guarantees	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*
Surplus/deficit	*-142.2*	*-3.6*	*-132.0*	*-3.1*	*-68.7*	*-1.6*	*2.9*	*0.1*	*254.1*	*5.4*
Primary surplus/deficit	*-56.5*	*-1.4*	*-32.4*	*-0.8*	*21.0*	*0.5*	*98.7*	*2.2*	*350.0*	*7.4*
Debt repayment	*550.4*	*13.9*	*280.4*	*6.7*	*240.7*	*5.5*	*582.3*	*12.7*	*810.5*	*17.1*
Financing, *of which:*	*-692.6*	*-17.5*	*-412.4*	*-9.8*	*-311.5*	*-7.1*	*-579.4*	*-12.7*	*-556.4*	*-11.8*
Borrowing abroad	*332.0*	*8.4*	*296.4*	*7.1*	*299.9*	*6.8*	*476.6*	*10.4*	*456.5*	*9.7*
Borrowing in the country	*329.2*	*8.3*	*106.0*	*2.5*	*10.0*	*0.2*	*110.0*	*2.4*	*110.0*	*2.3*

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

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

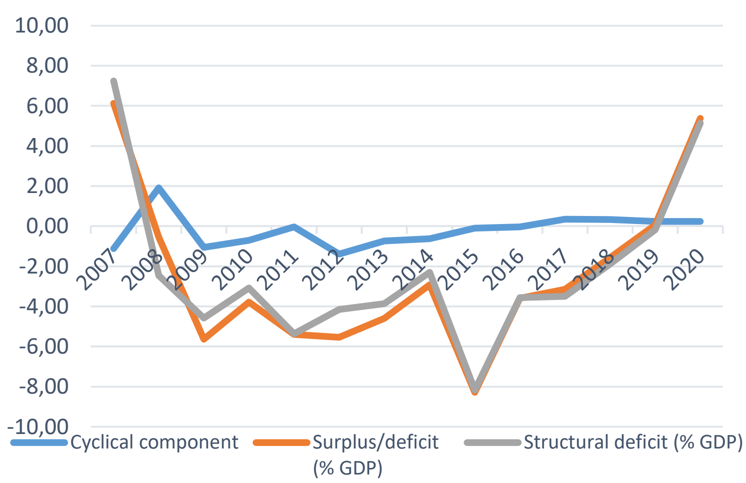
The cyclical component is calculated based on the method used by the European Commission, and it is carried out in two steps, as follows:

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

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

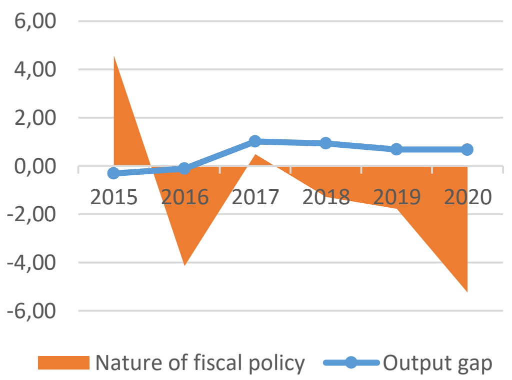
In step 2, the coefficients of elasticity for the following individual revenue categories are estimated: indirect taxes, personal income tax, corporate profit tax and contributions, while for the other revenues the unit coefficient of elasticity is used. Each of the mentioned categories is firstly taken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

Figure 3.4.1: Trend of surplus/deficit, cyclical component and structural deficit



Multiplying the coefficient of elasticity of the mentioned revenue categories by the total share of overall revenues in GDP results in the overall cyclical elasticity of revenues, and at the same time the overall elasticity of public expenditure, because the coefficient of elasticity of expenditure is assumed to be equal to zero. The elasticity of the surplus/deficit in relation to the output gap is estimated to 0.35. The results of the model are limited due to the country specificity, frequent changes of fiscal policy measures, the length of the time series used in assessment of the elasticity, and changes in the methodology, but they reflect the core trends of the structural and cyclical components of the balance of public finances.

Figure 3.4.2: The nature of fiscal policy and the output gap



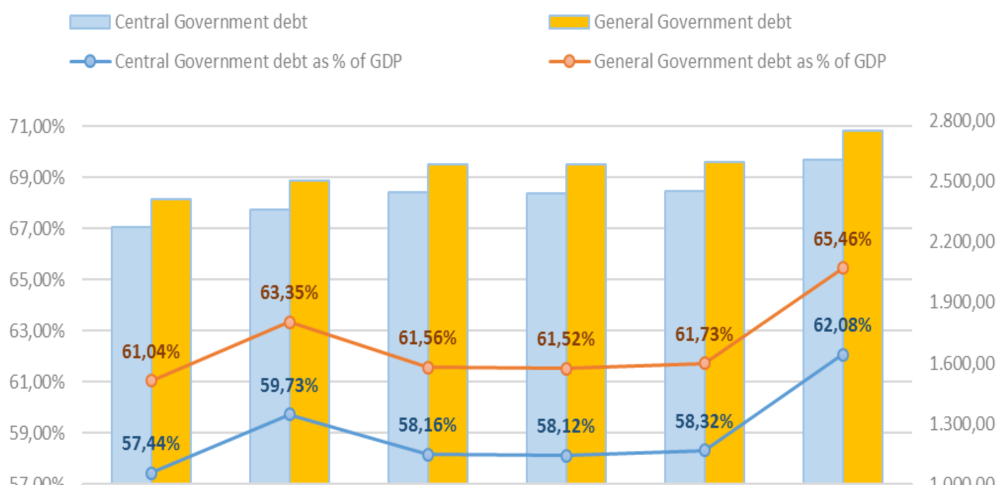
Also, the cyclically-adjusted primary balance (surplus/deficit excluding interest) has been calculated, which is additionally reduced by the one-off collection of revenues (e.g. in 2016 – the collection of a digital dividend) and one-off expenditures (subsidies, repayment of guarantees, redundancy funds and the costs of court proceedings). The sign of the category of the annual change of the cyclically-adjusted primary surplus/deficit indicates the fiscal position and speaks of the nature of fiscal policy in a specific year. Positive values in Figure 3.4.2 represent an expanding fiscal policy, while negative values represent a restrictive fiscal policy. As can be seen, 2015 is characterized by positive values primarily due to higher public expenditure as a result of allocations from the capital budget for the needs of the highway construction and the lower public revenue generated relative to 2014. In 2016, although current expenditure growth is evident, due to the amendments of the legal provisions regarding mandatory spending allocations for the highway were at a significantly lower level, which, along with the record collection of revenues, resulted in a negative value, as is shown in Figure 3.4.2. Also, in 2016 growth was at the level of its potential. In the period 2018–2020, Figure 3.4.2 indicates a restrictive policy nature, with a positive output gap. This situation represents the stabilizing nature of the policy pursued by the Government of Montenegro which is aimed at putting the key fiscal indicators under control by setting fiscal consolidation measures as described in section 3.3 on the medium-term budgetary outlook.

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

3.5.1 Government and public debt in 2017

Montenegro's public debt, as of 31 December 2016, amounted to 2,504.9 million euro or 63.35 percent of GDP, and it included government debt that amounted to 2,361.81 million euro or 59.73 percent of GDP, and local self-government debt that amounted to 143.09 million euro or 3.62 percent of GDP. Total deposits amounted to 77.47 million euro, while the deposits of the Ministry of Finance equalled 47.36 million euro, which also includes 38,477 ounces of gold and local government deposits amounting to 30.11 million euro. Montenegro's net public debt, as of 31 December 2016, including the deposits of the Ministry of Finance and local government, amounted to 2,427.43 million euro or 61.39 percent of GDP.

Figure 3.5.1: Government and public debt of Montenegro in € millions and % GDP[22]



	30.09.2016.	31.12.2016.	31.03.2017.	30.06.2017.	30.09.2017.	31.12.2017.*
Central Government debt	2.271,36	2.361,81	2.443,78	2.442,21	2.450,87	2.608,48
General Government debt	2.413,54	2.504,90	2.586,87	2.585,30	2.593,96	2.750,57

**Debt stock as of 31 December 2017 is according to the latest projections of the Ministry of Finance.*
***The amount of local government debt is according to the projections of the Ministry of Finance, for the reason that the state does not produce quarterly reports on public debt.*
****The debt presented in the figure does not include the deposits of the Ministry of Finance or deposits of local governments.*

[22] The presented overview does not include the railway debt or the outstanding debt for pensions, in order to make the report consistent with the EDP tables submitted to Eurostat.

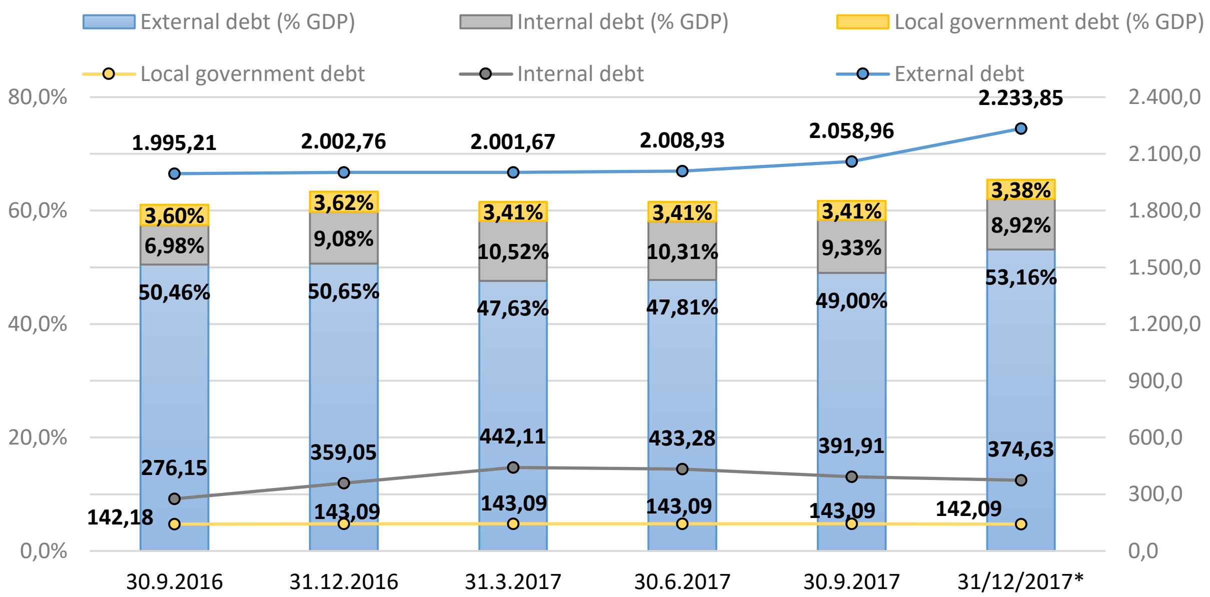
Compared to the data from 2016, public debt is expected to grow by 245.67 million euro, thus implying that public debt at the end of 2017, according to the latest projections of the Ministry of Finance, will amount to 65.5 percent of the estimated GDP.

The Budget Law 2017 envisages that the funds for the needs of budget financing, amounting to around 255 million euro, will be provided based on loan facilities with international or domestic lending institutions. In this regard, the Government of Montenegro – Ministry of Finance by the end of 2017 borrowed a total amount of 254.44 million euro. Of the mentioned amount, 65 million euro is related to new borrowing on the domestic market with commercial banks, while the remaining amount is provided on the international markets.

Compared to the end of 2016, total public debt at the end of the third quarter of 2017 increased by around 89 million euro. In the first three quarters of 2017, external debt went up by around 57 million euro and internal debt by around 33 million euro. The reason for the increased public debt is the loan facilities with Credit Suisse Bank amounting to 78.44 million euro and with Banca Intesa amounting to 30 million euro, concluded for a period of 5 years, and by the end of the year a syndicated loan will be taken out for a period of 5 years, amounting to 81 million euro. In April 2017, the debt in respect of the loan from Credit Suisse was partly refinanced when an old borrowing, amounting to 60 million euro, was repaid, and concurrently the new borrowing amount was specified at 18.44 million euro, which brings the abovementioned facility with Credit Suisse to a total amount of 78.44 million euro.

Also, the increase in debt was affected by long-term borrowing on the domestic market with commercial banks for the purpose of financing the budget and maintaining liquidity, totalling 65 million euro.

Figure 3.5.1-1: Debt trend in € millions and % GDP[23]



[23] The presented overview does not include the railway debt or the outstanding debt for pensions, in order to make the report consistent with the EDP tables submitted to Eurostat.

In 2017, for the needs of constructing the Smokovac–Uvač–Mateševo priority section of the highway, loan funds with the Chinese EXIM Bank were engaged, totalling 149.87[24] million euro (USD 205.49 million). In this regard, the Government of Montenegro provided the remaining 15 percent of funds. [25].

Figure 3.5.1-2: Funds for the highway construction project – Smokovac–Mateševo priority section, in € millions[7]

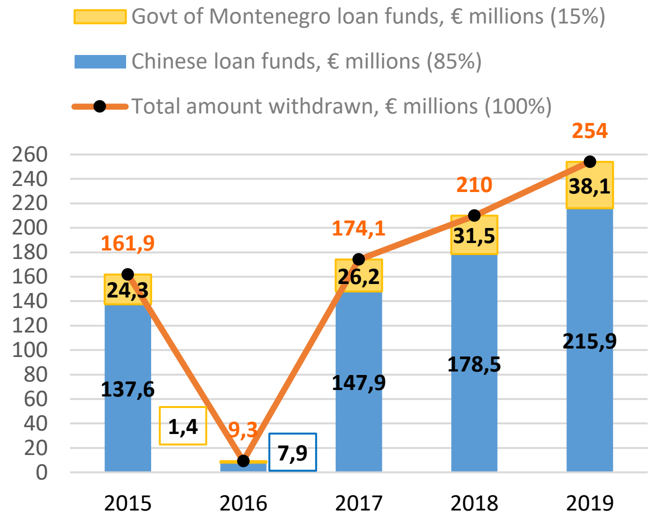


Figure 3.5.1-3: EXIM Bank loan funds for the highway construction project – Smokovac–Mateševo priority section, in USD millions

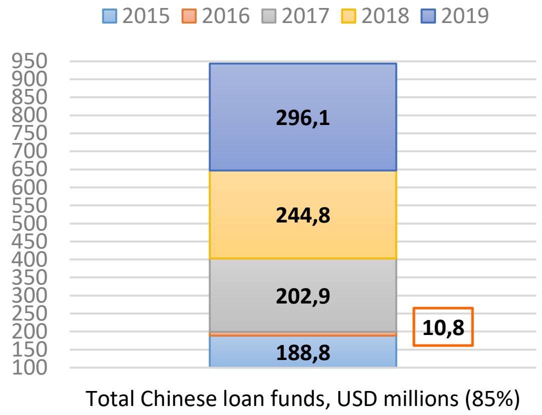
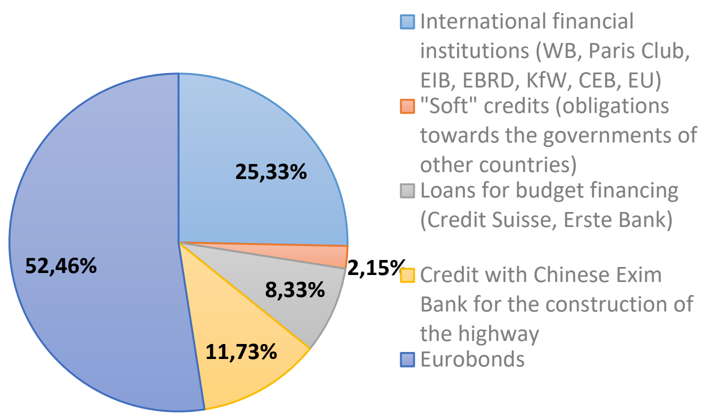


Figure 3.5.1-4: Structure of external debt to creditors as of 30 September 2017



In addition to the mentioned amounts, during the same period of three quarters 2017, loan funds of around 14.2 million euro were withdrawn for the execution of other infrastructure projects, such as World Bank projects for improvement of agriculture, energy efficiency and education; European Bank for Reconstruction and Development (EBRD) projects for construction and restructuring of road infrastructure and wastewater treatment; German Bank for Development (KfW) projects for the needs of constructing the water supply system, drainage and eastewater treatment and energy efficiency; and the Council of Europe Development Bank (CEB) for the Project of Social Housing 1000+.

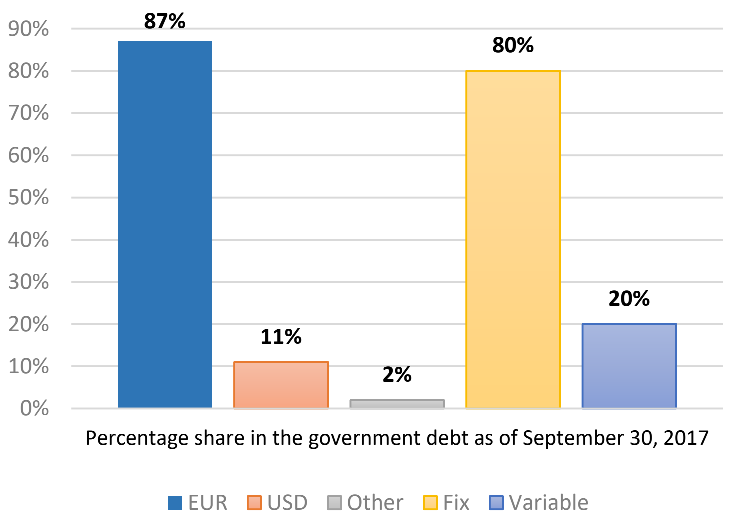
During the same period, government debt repayment amounted to around 333.32 million euro, when treasury bills amounting to 182 million euro were refinanced. Domestic debt has mostly reduced in respect of old FX savings of around 14.18 million euro, domestic bonds with sign GB14 by around 11.31 million euro and Labour Fund bonds amounting to around 1.37 million euro. Also, domestic debt related to restitution reduced by 3.4 million euro and the debt of legal entities and business organisations by around 0.14 million euro. Repayment of foreign debt for the first three quarters of 2017 amounted to around 109.95 million euro.[26]

[24] According to the contracted fixed FX rate EUR/USD of 1.3718.
[25] According to the contracted fixed FX rate EUR/USD of 1.3718.
[26] The presented overview does not include the railway debt or the outstanding debt for pensions, in order to make the report consistent with the EDP tables submitted to Eurostat.

Table 3.5.1: Highest debt liabilities as of 30 September 2017[27]

Debt to residents	Amount in € millions	Debt to non-residents	Amount in € millions
Loans with commercial banks	114	Eurobond	1,080.00
Liabilities in respect of restitution	87.62	Chinese EXIM Bank	241.58
Treasury bills	87.54	International Bank for Reconstruction and Development (IBRD)	204.64
Domestic bonds from 2016	80.41	Credit Suisse	138.44
Old FX savings	15.26	European Investment Bank (EIB)	100.88

Figure 3.5.1-5: Currency and interest structure of government debt as of 30 September 2017[7]



As regards the current public debt stock, around 87 percent of the amount of debt is denominated in the domestic currency, i.e. the euro, so at this point there is no currency risk (Figure 3.5.1-5). As regards the further trend of debt in other currencies, taking into account future disbursement of loan funds for the needs of the highway construction from the Chinese EXIM Bank loan, the funds expressed in dollars are expected to constitute a higher share of the debt stock. Due to the risk that may be attached to the trend of debt, until the beginning of the repayment of liabilities in respect of the loan from the Chinese EXIM Bank, a hedging arrangement will be applied, in order to ensure the best protection against the currency risk. In the overall government debt, the debt with fixed interest rate is the most prevalent, therefore the risk of increased liabilities in this respect is low, and it would not be a significant burden for the budget in case of changes in the borrowing conditions in the market.

For the purpose of analysing the current debt and identifying potential funding sources, the costs and risks of potential borrowings, developing a domestic debt market, as well as determining guidelines for further borrowing and debt management policy in the first quarter of 2018[28], the development of a new Public Debt Management Strategy for the period 2018-2020 is planned. Also, along with the Public Debt Management Strategy the development of a Market Relation Strategy is planned, which would result in greater coverage of credit investors so that better integration and communication can be achieved with interested parties willing to invest in Montenegro. At the same time, this would result in achieving better results in expanding the list of investors, and therefore the possibility for less expensive borrowing on the international markets.

The Public Debt Management Strategy (MTDS) will be based on the macroeconomic and fiscal assumptions set in the documents prepared by the government, based on which the debt trend for a three-year period is also determined. In accordance with this, the MTDS will minimize the borrowing costs based on the mentioned data, and will also take into account the debt portfolio risk indicators, which will direct implementation of the strategy. Accordingly, the MTDS will include data on the debt

[27] According to the exchange rate as of 30 September 2017.

[28] In line with the Work Programme of the Government of Montenegro, the adoption of the Public Debt Management Strategy 2018-2020 is planned for the first quarter of 2018.

trend in line with the existing macroeconomic and fiscal projections, as well as on the debt dynamics in case some of the risks arise that are recognized in the Strategy as some of the initiators that may lead to an increase in debt. In this way, the MTDS will show, in addition to the baseline scenario, what effect the different risk indicators (such as the refinancing risk, interest rate risk and foreign exchange risk) will have on the trend of debt in the medium term. At the same time, the MTDS will also provide a view of the issue of the refinancing of current liabilities, i.e. Eurobonds, which mature during this three-year period. In this regard the government's serious commitment is emphasized to resolving the issue of refinancing and the fact that activities will be most likely undertaken in the coming short-term period to lead to refinancing the mentioned liabilities, thus reducing financial pressure on the budget in view of debt repayment.

3.5.2 Baseline scenario of government debt trend in the period 2018–2020

Pursuant to the Budget Law of 2018, borrowing amounting to 296 million euro is planned. Of the mentioned amount, 106.0 million euro will be required for the financing needs of debt repayment and the capital budget, while around 210.0 million euro will be required for the financing of the highway construction costs, of which 85 percent will be provided from the loan with the Chinese EXIM Bank, while the remaining amount will be provided from the budget.

For 2019, the amount of borrowing required for debt repayment will significantly go up, and will amount to around 573.0 million euro, which is primarily caused by the maturing of Eurobonds from 2014 of 280.0 million euro. Of the mentioned amount, around 178.0 million euro in 2018 and around 215.0 million euro in 2019[29] is related to the funds required for financing the highway construction, and this has already been provided through the concluded loan facility with the Chinese EXIM Bank. According to the repayment schedule, the required amount in 2020 will be around 553.0 million euro. The highest liabilities maturing for debt repayment in 2020 are related to the repayment of Eurobonds from 2015 amounting to 500 million euro. However, despite the maturing of the mentioned repayment for the Eurobonds, taking into account the planned surplus in 2020 of around 207 million euro, as well as the lower level of planned funds for capital budget financing (for the purpose of completing the Smokovac–Mateševo Section of the Highway Construction Project), there will be a shortfall of funds for repayment of only a portion of the debt.

Taking into account the needs of budget financing for 2018, the funds required for debt repayment and payment of liabilities related to the highway construction will be provided through the facility with the Chinese EXIM Bank and through issuing of bonds on the international market, the issuing of domestic bonds or loan facilities with foreign and domestic financial institutions.

In this regard, in order to provide the funds for financing the mentioned liabilities, in November 2017 negotiations were finalized between the Government of Montenegro and the World Bank regarding the granting of Policy-Based Guarantees (PBG) of 80.0 million euro, which was approved to Montenegro in December 2017 and will facilitate government borrowing of 200.0–240.0 million euro under favourable conditions and with a lower interest rate. In this way, the funds for budget financing in 2018 will be provided. In 2018, the possibility will be considered for the mentioned funds to be used for repayment and refinancing of the current debt. At the same time, there is a possibility of the World Bank funds being used for refinancing a portion of the Eurobond liabilities, which will mature in the period 2019–2021. Also, the same facility will also be envisaged in the period 2018–2019, if specific conditions are fulfilled, as determined by the World Bank.

In case the option is selected to settle the Eurobond liabilities maturing in 2019 and 2020 through loan facilities or the issuing of bonds in the years when the Eurobonds mature and to use them to fund the current liabilities, the mentioned borrowing would be long-term, with a grace period that would ensure the avoidance of burdening the budget until 2022.

[29] See Figure 3.5.1-2.

In the period 2018–2020, disbursement of around 186.0 million euro for financing infrastructure and other projects is envisaged, of which around 55.0 million euro is related to borrowing for new infrastructure projects. However, the disbursement of funds for execution of the Bar–Boljare Highway Construction Project will continue to have the greatest impact on the trend of public debt in the period 2018–2019. According to the projection, it is forecasted that loan funds will be engaged at an average level of 60 million euro annually for the implementation needs of infrastructure projects.

Table 3.5.2: Government and public debt trend for the period 2017–2020 – baseline scenario[30]

Year	2017	2018	2019	2020
GDP	4,202.10	4,397.70	4,569.40	4,729.60
Internal debt	373.40	309.71	252.04	144.33
External debt	2,233.85	2,472.03	2,626.22	2,536.02
Debt of state-owned enterprises and business organizations	1.23	1.23	1.23	1.23
Total government debt (€ millions)	**2,608.48**	**2,782.98**	**2,879.49**	**2,681.58**
Total government debt (% GDP)	**62.08%**	**63.28%**	**63.02%**	**56.70%**
Local government debt	142.09	142.09	142.09	142.09
Total public debt (€ millions)	**2,750.57**	**2,925.07**	**3,021.58**	**2,823.67**
Total public debt (% GDP)	**65.46%**	**66.51%**	**66.13%**	**59.70%**

**The amount of local government debt is according to the projections of the Ministry of Finance, for the reason that the state does not produce quarterly reports on public debt.*

***The debt presented in the Figure excludes deposits of the Ministry of Finance and deposits of local government.*

As can be seen in Table at the end of 2017 government debt is expected to amount to 62.1 percent of GDP, while public debt will be at the level of 65.46 percent of GDP.

In 2018, further growth of debt is expected, primarily due to the highway construction costs, therefore it is anticipated that government debt will amount to 63.3 percent of GDP at the end of 2018, while public debt will equal 66.5 percent of GDP. As regards the debt stock for 2019, according to the projections, which also imply high expenditure for the highway construction needs, the government debt will amount to 63.0 percent of GDP, while public debt will amount to 66.1 percent of the estimated GDP. Taking into account that in 2020 there will be no borrowing for the highway project, and that the Eurobonds from 2015 will be repaid in that year, the government debt will be at the level of 56.7 percent of estimated GDP, while public debt will be 59.7 percent of GDP. Also, in addition to the aforementioned, the presented public debt trend dynamic is caused by the following:

- For loans with a variable interest rate, the margins current at the end 2017 were applied, while for loans with a fixed interest rate, the latest interest rates of the financial institutions that extended the loans were applied.
- For loans in non-euro currencies, the exchange rates on 31 October 2017 were applied.
- In the presented period deposits are planned to be maintained at a level of around 10 million euro.
- Borrowing for budget funding in the period 2018–2020 is planned to have a repayment period of 10 years, with a grace period of up to 4 years and an interest rate of up to 4.0 percent.

3.5.3 Low-growth scenario

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

[30] The presented overview does not include the railway debt or the outstanding debt for pensions, in order to make the report consistent with the EDP tables submitted to Eurostat.

Table 3.5.3: Debt trend for the period 2017–2020 – low-growth scenario[31]

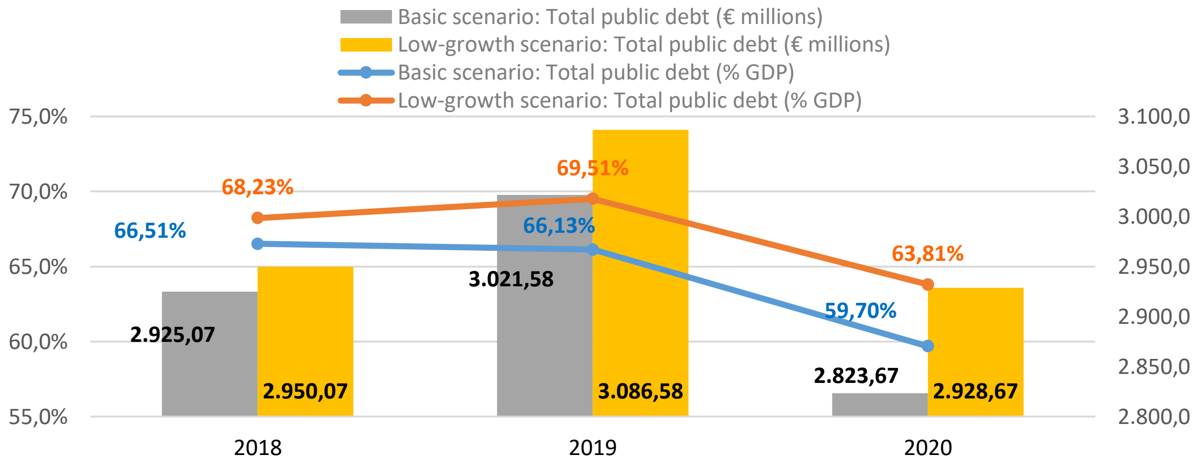
Year	2017	2018	2019	2020
GDP	4,202.10	4,323.60	4,440.30	4,590.00
Internal debt	373.40	309.71	252.04	144.33
External debt	2,233.85	2,497.03	2,691.22	2,641.02
Debt of state-owned enterprises and business organisations	1.23	1.23	1.23	1.23
Total government debt (€ millions)	**2,608.48**	**2,807.98**	**2,944.49**	**2,786.58**
Total government debt (% GDP)	**62.08%**	**64.95%**	**66.31%**	**60.71%**
Local government debt	142.09	142.09	142.09	142.09
Total public debt (€ millions)	**2,750.57**	**2,950.07**	**3,086.58**	**2,928.67**
Total public debt (% GDP)	**65.46%**	**68.23%**	**69.51%**	**63.81%**

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

According to this projection, in the observed period, public debt would reach its peak in 2019 when it would amount to 69.5 percent of GDP, and thereafter it would decrease, which, as in the baseline scenario, would primarily result from the finalization of loans in 2019 for the needs of financing the highway construction project.

Taking into account projections of the debt trend, in the case of revenue reduction and investment stagnation, liabilities for debt repayment in the observed period will not change in relation to the baseline scenario, for the reason that future borrowing is planned with a grace period of up to 4 years, in order to avoid burdening the budget in the period of Eurobond repayment until 2021. However, the borrowing needs will be somewhat higher in the mentioned period, on average around 40 million euro a year, which will affect debt growth by a nominal amount. Taking into account an even lower actual value of GDP, as presented in Table 3.5.3, the public debt stock will make up a larger share of GDP, while it will not reach a level below 60 percent of GDP in 2020, as is planned in the baseline scenario.

Figure 3.5.3: Comparative overview of public debt trend in baseline and low-growth scenarios, € millions and % GDP

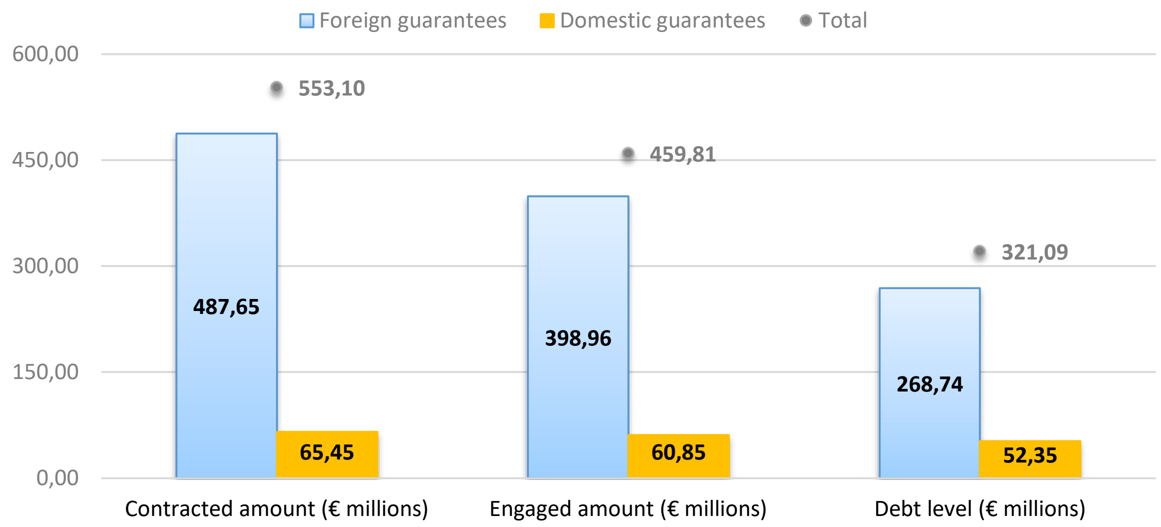


3.5.4 State guarantee stock

Total state guarantees as of 30 September 2017 amounted to 321.09 million euro or 7.63 percent of GDP. Of the mentioned amount, foreign guarantees amounted to around 268.74 million euro (6.39 percent of GDP), while domestic guarantees amounted to 52.35 million euro (1.24 percent of GDP). In 2017, no state guarantees were called upon.

[31] The presented overview does not include the railway debt or the outstanding debt for pensions, in order to make the report consistent with the EDP tables submitted to Eurostat.

Figure 3.5.4: State guarantees as of 30 September 2017



In line with the 2017 Budget Law, the Government of Montenegro issued guarantees totalling 13.7 million euro, of which 7.0 million euro was contracted for a loan facility of 20.0 million euro between Railway Infrastructure (Željeznička Infrastruktura) and the European Investment Bank (EIB) for projects related to the reconstruction and improvement of the railway infrastructure, and for a loan facility between Regional Water Supply for Montenegrin Coast (*Regionalni Vodovod Crnogorsko Primorje*)" and Erste Bank of 7.0 million euro for the purpose of replacing the current guarantee issued to the Abu Dhabi Fund for the loan facility between Regional Water Supply for Montenegrin Coast (*Regionalni Vodovod Crnogorsko Primorje*) and the Abu Dhabi Fund.

In the second quarter of 2017 the abovementioned domestic guarantee for the Public Enterprise Regional Water Supply for Montenegrin Coast (*Regionalni Vodovod Crnogorsko Primorje*) based in Budva was issued for the needs of refinancing the loan from the Abu Dhabi Development Fund amounting to 6.7 million euro. Guarantees issued for the local government for implementation of recovery plans constitute the lion's share of domestic guarantees. The debt stock in respect of guarantees issued for local government at the end of the third quarter of 2017 amounts to 36.11 million euro. In comparison to the end of 2016, the debt stock of total issued domestic guarantees at the end of the third quarter of 2017 went up by around 1.37 million euro.

Although the 2017 Budget Law planned the issuing of guarantees for a loan facility between Montenegrin Electricity Transmission System (*Crnogorski Elektronskoprenosni Sistem* - CGES) and the German Bank for Development (KfW) for a project of energy infrastructure construction on the Luštica Peninsula amounting to 20.0 million euro, the mentioned facility has not been implemented yet. However, the mentioned facility was expected to be signed by the end of 2017. Also, given the risk that it might fail to be signed in 2017, it is also planned for in the 2018 Budget Law.

Also, the 2018 Budget Law envisages the issuing of guarantees of up to 7.0 million euro for a loan facility made in March 2017 between Railway Infrastructure of Montenegro (Željeznička Infrastruktura Crne Gore) and the European Investment Bank for the projects related to the reconstruction and improvement of the railway infrastructure totalling 20.0 million euro.

3.6 Sensitivity analysis and comparison with the previous programme

3.6.1 Sensitivity of public finance projections to alternative risk scenarios

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

Table 3.6: Overview of fiscal risks in the medium term

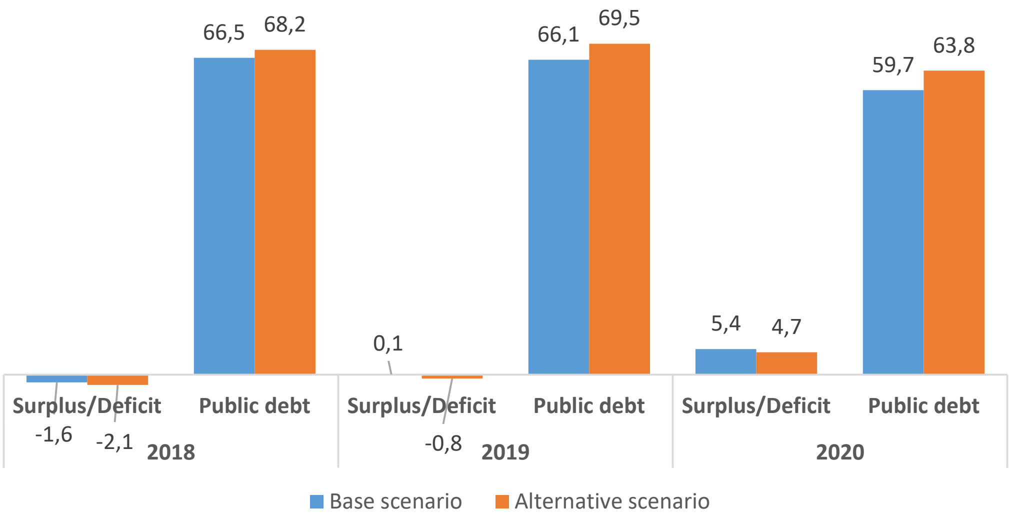
	Positive	Negative
Political	- NATO membership will increase the confidence of investors and tourists, which will have a positive impact on all the economic parameters of the domestic economy and will provide better access to funding sources; - Progress in the EU accession process entails increasing investor confidence, a more stable business environment and access to EU funds;	- Political instability in South East Europe can have a negative impact on Montenegro's economy, especially in the tourism sector;
Economic	- Implementation of fiscal consolidation measures has a positive impact on the stability and sustainability of public finances; - Reducing the level of public debt in the medium term will restore the confidence of financial markets and enable borrowing under more favourable conditions; - Spending and reforms in the budgeting process will increase fiscal discipline, which will have a positive impact on the main fiscal indicators; - The higher multiplier effects of the construction of the highway and the realization of the announced investments will positively reflect on revenue projections; - Intensifying activities to reduce the grey economy and achieving results in this field will increase the tax base, hence increasing the budget revenues; - The rescheduling of the tax debt of municipalities and the obligation to pay earnings at the gross amount will have a positive effect on budget revenues;	- Changing the dynamics in the implementation of investment projects could jeopardize the projected macroeconomic framework, and thus fiscal projections for the medium term; - The failure to implement fiscal consolidation measures in the planned scope may exacerbate the projected amounts of the budget deficit and public debt; - Increasing healthcare liabilities may have an impact on the projected amount of spending; - The cost of building the highway could increase by potentially up to 10%; - The level of government debt exerts a negative economic pressure on the realization of projections, and the increase in government debt affects borrowing conditions on the international market; - Implementation of the ESA2010 methodology will expand the existing institutional coverage of budget accounting to public companies which, according to ESA2010's qualitative and quantitative criteria, should be presented in the General Government sector. Consequently, there is a potential for an increase in the deficit and debt of the mentioned sector in the medium term.

The alternative fiscal scenario is based on the macroeconomic low-growth scenario, which is based on the assumption that medium-term investment will remain high at the 2017 level, and that in 2018 and 2019, due to possible bad weather conditions or geopolitical risks, tourist revenues may fall by 2 percent in both years, as explained in Chapter 2. If these risks were to materialize, budget revenue would not be realized in the scope planned by the baseline scenario and expenditure would remain at the same level, resulting in a higher public finance deficit in the medium term and, therefore, a greater need to finance public spending.

Fiscal elasticity ratios show that, in the fiscal scenario the revenue side is subject to macroeconomic impacts, while macroeconomic trends have little impact on the expenditure side of the budget, especially in Montenegrin conditions where budget spending is of a predominantly mandatory character.

In view of the above, in case of the realization of the macroeconomic low-growth scenario, revenue would decrease annually by about 1.7 percent on average, compared to the baseline scenario. At the same time, there would be an adjustment of the deficit so that in the low-economic-growth scenario the public finance deficit would amount to around 2.1 percent of GDP in 2018 and 0.8 percent of GDP in 2019, while in 2020 a surplus of 4.7 percent of GDP would be achieved. Also, public debt would be at a higher level than in the baseline scenario, as shown in Section 3.5.

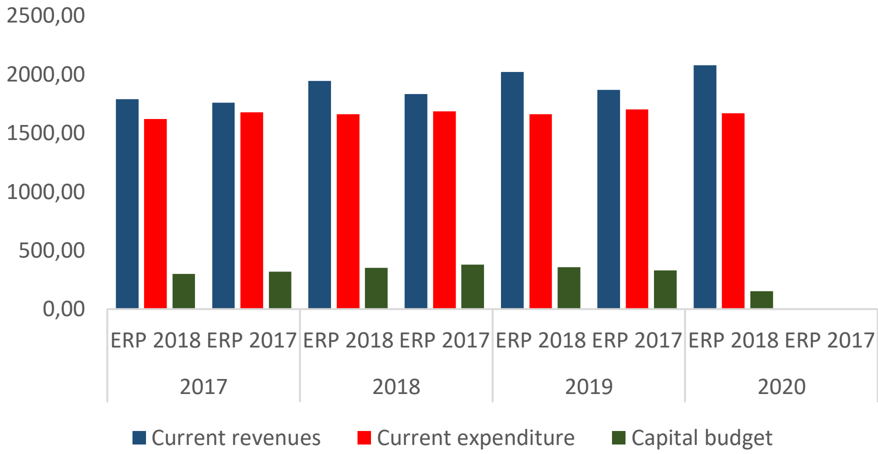
Chart 3.6.1: Comparison of the baseline and low-growth scenarios (in % of GDP)



3.6.2 Comparison with the previous programme

Compared to the revenue projection in last year's programme, the estimated public revenues in 2017 are above the planned 17.9 million euro, which is largely the result of the implemented fiscal consolidation measures but, parallel to that, also the result of a growth in economic activity.

Chart 3.6.2: Sensitivity analysis and comparison with the previous programme



As can be seen on Chart 3.6.2, in all the years shown the source public revenues were achieved at higher amounts than projected, indicating the effect of new measures. The expenditure projections are lower than in the previous Programme in all the projected years due to the effects of the fiscal consolidation measures implemented. As for the capital budget, the projected funds are smaller compared to the previous Programme, due to the decrease in funds in the other projects, as well as the changed dynamics of the withdrawal of funds for the highway requirements, in relation to the assumptions of the previous Programme.

A comparison of debt trends in the 2017-2019 ERP and 2018-2020 ERP

In line with the additional medium-term fiscal consolidation measures contained in the Fiscal Strategy adopted in July 2017 to reduce the deficit and public debt, the need for additional funding for the budget has been reduced, contributing to a slowdown in the growth of public debt.

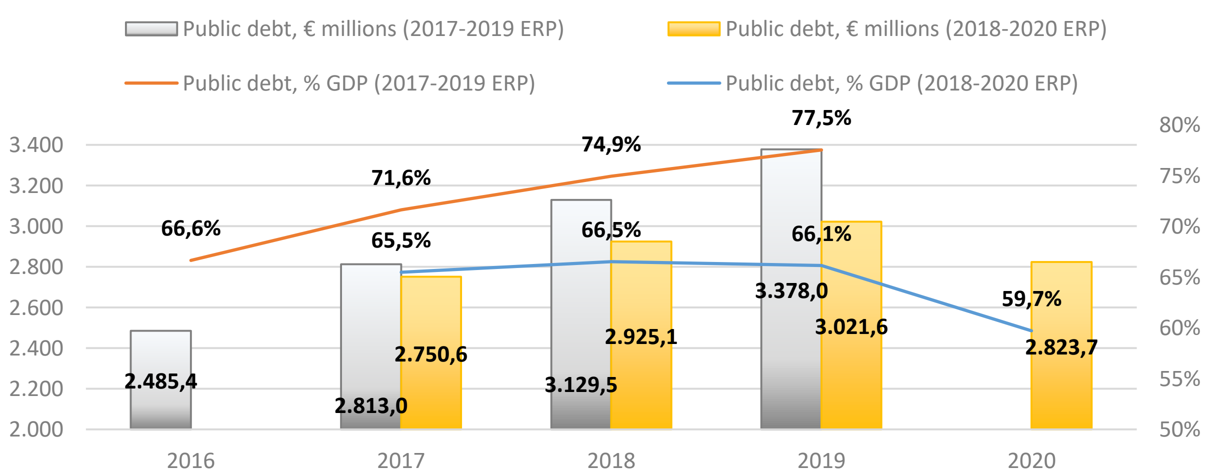
Compared to the projections of public debt trends given in the 2017–2019 ERP, this year's projections differ significantly, primarily due to a different initial state at the moment when they were prepared. New projections have been made taking into account that GDP is expected to grow faster in the period 2018–2020, and that the deficit and the amount of missing funds in the budget, i.e. the need for borrowing, have been reduced.

The presented projections for the period 2018–2020 imply a package of medium-term fiscal consolidation measures covered by the Fiscal Strategy of the Government of Montenegro, while these measures were contained in the ERP for 2017–2019. The mentioned measures contributed to the reduction of the Central Budget deficit in 2017 in relation to the figures from the ERP for 2017–2019, and accordingly, the medium-term projections of budget revenues and expenditures for the period 2018–2020 entail a faster reduction of the budget deficit, thus reducing the need for additional funds to finance the budget.

As seen in the attached tables, the amount of missing funds has been reduced by about 120 million euro in 2018 and about 147 million euro in 2019, compared to the projections in the ERP for 2017–2019, which has affected the level of debt, and resulted in a reduction of the debt for the following years. Also, in the projections for the period 2018–2020, GDP is nominally higher by about 274 million euro in 2017, about 220 million euro in 2018 and about 213 million euro in 2019, compared to the previous ERP projections.

Also, new projections for the period 2018–2020 imply the withdrawal of loan funds for financing infrastructure projects to a lesser extent compared to the previous projections for the period 2017–2019, which is primarily due to the slower withdrawal of loan funds in previous years. Accordingly, in the projections for the period 2018–2020, the amount of loan funds for the financing of infrastructure projects is planned at around 60 million euro per year, while in the previous ERP for 2017–2019 this amount was projected at a level of 100 million euro per year.

Chart 3.6.3: Public debt trend projections in € millions and % GDP, compared to projection given in the 2017–2019 ERP [32]



[32]The presented overview does not include the railway debt or the outstanding debt for pensions, in order to make the report consistent with the EDP tables submitted to Eurostat.

3.7 Fiscal governance and the budget framework

In order for the defined fiscal consolidation programme to have its full impact in the medium term, it is necessary to work in parallel on strengthening the regulatory framework in the field of public finance management, in order to further enhance the credibility of the fiscal policy.

To strengthen the public finance management, through amendments to the Law on Budget and Fiscal Responsibility in 2017, the budget system has formally introduced three-year budgeting, which will become an integral part of the Law on the Budget for 2019, with the first year being mandatory and the next two indicative. This novelty in the budget process allows for significantly higher predictability and transparency of budget spending in the medium term, considering that the expenditure of spending units will be presented for a period of three years, unlike current practice, which involves the presentation of revenue and expenditure in the medium term exclusively at an aggregate level.

The medium-term budget framework will also be improved through strengthening the mechanism for the coordination of strategic government policies and their better linkage to budget programmes and goals. To this end, the Ministry of European Affairs has started activities on: establishing and developing a system of coordinating and monitoring the alignment of strategic documents that define public policies, as well as performance evaluation systems and monitoring of the degree of implementation of the strategic documents that define public policies. Activities to follow in the forthcoming period will be directed towards the achievement of three objectives: enhancing the quality of strategic documents; establishing a system of coordination of strategic documents and establishing medium-term strategic planning with a coordinated inter-ministerial approach.

Along with this process, efforts will be made to introduce programme budgeting, which, according to the PFM reforms, is to be fully implemented by the end of 2020. In order to create the prerequisites for the programme-based budget implementation, the Government of Montenegro has adopted a Decision on the method of preparation and content of the programme-based budget of spending units, as the basis for starting this process. According to the established time schedule, the main elements of the programme-based budget will be phased in, in order to develop indicators for measuring programme performance at the final stage. With the full implementation of the programme-based budget, conditions will be created for the budget to be more transparent and thus more comprehensible to citizens.

As for the budgeting of capital projects, efforts will be made to strengthen the definition of priorities, and the selection, assessment and evaluation of capital investments in order to improve planning of the capital budget, and also to increase the extent of its execution during the year.

All activities related to the process of improving the medium-term budget framework and the implementation of programme budgeting will be financed from the resources provided for these purposes in EU funds. At the same time, software solutions used in the planning and execution of the budget, as well as payroll calculations, will be improved in order to create the conditions to perform the payroll calculation at the central level for all public administration employees. In this way, the payroll calculation process will become more efficient and will ensure a greater degree of control and reporting, and more efficient payroll expenditure management.

In view of the identified needs for further development in the field of fiscal reporting, the new Public Accounting Law will be adopted during 2018. Adoption of this law is the first step in the introduction of accrual accounting and convergence with international accounting standards for the public sector, as well as with financial reporting standards. This is particularly important because, at present, there is no single normative framework defining the basic accounting principles since accounting principles are defined through a series of laws and enabling regulations.

Regarding implementation of the ESA 2010 methodology in the government’s financial statistics, the established working group has been working intensively on the implementation of the mentioned methodology through a project funded through IPA 2013. The project was completed in July 2017 and significant results have been achieved. Regarding the Fiscal Notifications, i.e. the Excessive Deficit

Procedure, the data is sent in accordance with national legislation and methodology, and after full implementation of ESA 2010 and the Manual on Government Deficit and Debt, the other data will be revised as well.

3.8 Sustainability of public finances

Fiscal stability is one of the main prerequisites for maintaining overall macroeconomic stability, and the reforms implemented in the pension, healthcare and social protection system largely determine the level of stability of the overall public finance system of a country.

Fiscal risks that threaten to undermine the stability of public finances are largely reduced by the measures detailed in the previous section of this chapter, but in order to ensure long-term stability of public finances, it is necessary to continue with reforms particularly in the areas that have the greatest impact on the main categories of revenue and expenditure.

In order to reduce the proportion of the wage bill out of total public spending, the focus will be placed on reducing the public administration through optimizing the number of employees, in line with the Public Administration Reform Strategy for the period 2016–2020. Therefore, during 2018 the methodology and plan for optimizing the number of employees in the public administration is expected to be adopted, to define the optimum number of public administration employees. Activities aimed at reforming the public administration to ensure the quality of public services will be funded from the IPA II Pre-Accession Programme through direct budget support of 15.00 million euro.

In order to improve the fiscal sustainability of the social protection system, whose financing makes up a significant part of public spending, and also to increase the social security of the population, significant reforms have been made in this area. Amendments to the Social and Child Protection Law have redefined the basic social protection package so that the distribution of social funds is fairer and directed towards the most vulnerable categories of society. The Montenegrin Constitutional Court has declared the benefits for mothers of three or more children unconstitutional, after which the Law on Implementation of the Constitutional Court's Decision was adopted. Practice has shown that the goal of introducing these benefits has not been achieved with respect to the promotion of birth rates considering the average age of benefit recipients. In addition to significant fiscal pressure, this measure has also had the effect of deteriorating the labour market indicators, as this measure has disincentivized formal employment among the recipients.

In order to offset the negative effects of these measures on the income of the population, the existing social and child protection system has been strengthened by: increasing the amount of child benefit by 20 percent for children from families that use family cash benefits, for children with disabilities and for children without parental care, as well as by increasing the one-time benefit for newborn babies. Also, compensatory remuneration for women who have left their jobs has been introduced following the abolition of the benefits for mothers by the Constitutional Court of Montenegro, and programmes have been designed under the Active Employment Policy for the recipients of benefits who were formerly on the unemployed register, in order to further stimulate them to participate actively in the labour market. In line with the goals in this area, the "Social Card – Social Welfare Information System" project will be continued in order to further improve the database on benefit recipients in the social welfare system and thus better target the budget funds allocated for these purposes.

The healthcare system reforms will be continued with the aim of raising the level and quality of healthcare and ensuring the sustainability of the Health Insurance Fund. In order to stop the trend of the accumulation of unpaid liabilities generated by the health system, especially for the costs of medicines, the Decision on establishing a medication list, containing a list of core medications that are fully reimbursed by the Health Insurance Fund and a complementary list of medications that require partial payment, was revised in 2017. In addition, the revised list will include provisions for managed-entry agreements for expensive medicines as a policy instrument for cost containment, i.e. for keeping the budget for pharmaceutical products under control. These reforms should enable a significant reduction in the cost of medicines in the coming period, which will also result in the reduction of the total overdue liabilities of the healthcare system.

The existing pension system has a significant impact on the sustainability of public finances, taking into account the permanent deficit of the Pension and Disability Insurance Fund which requires budget allocations to ensure the regular payment of benefits related to pension and disability insurance. The reform has been in place since 2011, the retirement age has gradually shifted to 67 years, and the pension adjustment formula has changed. The results of this reform will not be visible in the short term, given the long period of the gradual raising of the age limit for the acquisition of the right to old-age pension, but also because the positive effects of this reform were partly neutralized by introducing special conditions for early retirement, resulting in an increase in the total number of pensioners. In this respect, reform activities in the forthcoming period will be aimed at preventing the possibility of adopting regulations that would allow for ad-hoc early retirement, as well as redefining the conditions for obtaining reduced benefits for years of service for certain job categories.

In line with the projected medium-term budget framework, pensions will be adjusted according to the current and projected macroeconomic indicators, which have an impact on the level of pensions.

In order to improve the efficiency of the public procurement system in 2017, preconditions have been created for the implementation of centralized public procurement through the adoption of the Decree on the consolidation of public procurement of goods and services. Pursuant to the Decree, a central body will be established to implement consolidated public contracting for standardized goods and services for the needs of state administration bodies. The expected effects of this reform should be lower prices due to economies of scale, which will reduce budget allocations for public contracts, but also speed up tendering procedures. There will also be a strong focus on the introduction of electronic public procurement, which is described in more detail in Chapter 4.

The state and trends of local self-government finances make up an important segment of the overall fiscal system. The Law on Spatial Planning and Construction will bring about a positive effect on the revenue collected by local governments, based on the legalization of illegal buildings. Bearing in mind the intended use of these revenues, an increase in capital expenditure of local governments is planned in the forthcoming period.

4. STRUCTURAL REFORMS IN THE PERIOD 2018–2020

4.1 Identifying the key constraints to competitiveness and inclusive growth

Chapter 4 of the Economic Reform Programme for 2018–2020 contains an overview of the priority reform measures in Montenegro, which are closely related to the overall macroeconomic and fiscal policy priorities contained in Chapters 1, 2 and 3 and which, inter alia, have an impact on the overall fiscal and macroeconomic framework specified in those chapters. More specifically, as described in the introductory part of the ERP for 2018, Montenegro has defined its strategic objectives in the field of economic development for the medium term in Montenegro Development Directions 2018–2021 (MDD)[33], a government document aimed at sustainable economic growth that would ultimately result in an improved quality of life for its citizens. In addition to the MDD, another important development document is the South East Europe 2020 Strategy, aimed at generating high and sustainable economic development, and thus stimulating stronger economic growth in the region, greater prosperity and job creation, all through the strengthening of regional cooperation and links with the EU. Also, Montenegro's development vision is defined by the Sustainable Development Strategy to 2030, according to which "the socioeconomic development of the country is based on a harmonious relationship between people and nature and the efficient management of human, social, natural and economic resources". In addition to the mentioned strategic development documents, there are a number of sector-based strategies and policies, such as the Industrial Policy of Montenegro to 2020, which are complementary to their structure.

The Economic Reform Programmes (ERPs) for 2015, 2016,2017 and 2018 provide a thorough diagnosis of the obstacles to competitiveness and further economic growth and development. In view of the structural nature of the mentioned reforms, overcoming these obstacles is a long-term issue.

The text below presents the key obstacles that prevent the improvement of competitiveness and achievement of the country's development goals. They include: an insufficiently developed (transport, municipal utility, energy, etc.) infrastructure; a low level of added value in production and a low degree of diversification of exports; limited access to finance for small and medium-sized enterprises, as well as insufficient advisory support to the SME sector; company registration; slow growth in bank credit as an important factor for increased activity in the real sector, which is, among other things, a consequence of the still-high share of non-performing loans (NPLs) in banks' loan portfolios; the relatively large size of the informal economy; insufficient harmonization of the education system with the needs of the labour market; inflexibility and high costs in the labour market; an insufficiently efficient state administration; the need for further improvement of the rule of law; a low level of innovation; the work of cadastral offices; the issuing of building permits, and tax payment; insufficient predictability of tax policies, etc.

In order to contribute to the elimination or reduction of these obstacles, Sections 4.2 and 4.3 of the 2018 ERP present the reform processes in each of the nine reform areas in line with the EC's Guidance Notes, also offering basic information on each of the selected 20 priority reform measures. Details of the measures are presented in Table 10 of the Annex. In the selection of "priority reform measures", the following criteria were used, i.e. answers were sought for several questions. *First*, the measure had to be broad enough to have an impact on the competitiveness of the country and, on the other hand, sufficiently "concrete" that its impact can be quantified. *Second*, whether and in what way the measure contributes to the realization of priorities in the context of the preparation of ERP 2018. *Third*, how the measure contributes to the implementation of the recommendations given to Montenegro at the Ministerial Meeting in May 2017. *Fourth*, the measure should respond to some of the key obstacles for greater competitiveness and faster economic growth of Montenegro; and *fifth*, whether the measure was ready, in essence.

[33] Document represents is an upgrade of Montenegro Development Directions 2015-2018

As far as the EU's recommendations are concerned, within the Joint Conclusions of the Ministerial Meeting held in May 2017, of the six recommendations mentioned, the first two relate to strengthening the macro-fiscal position of the country, as explained in detail in Chapter 3; Recommendation No. 3 relates to Chapter 2 and Chapter 4 of the ERP 2018–2020; and the remaining three recommendations of the Ministerial Meeting (Recommendations Nos. 4, 5 and 6) relate to certain parts of structural reforms and are addressed in Chapter 4. This refers to the following recommendations whereby Montenegro needs to:

- Harmonize its national rules with Directive No. 2014/61 on cost-reduction measures for the development of high-speed electronic communications networks; ensure effective, efficient and independent rail regulatory and safety authorities to implement the full opening up of the rail market.
- Continue to strengthen financial and non-financial support services for SMEs; adopt legislation to ensure the operational independence of the state-aid authority.
- Reform the law on social protection to ensure cost-effectiveness, better targeting of assistance and the reduction of disincentives for women to work. Carry out a review of active labour market policies with a view to improving their coverage and targeting the long-term unemployed, women and youth. Improve school-to-work transitions through work-based learning and promoting the appeal of vocational professions.

In addition, relevant international organizations such as the World Economic Forum (WEF) and the World Bank (WB) are also concerned with the competitiveness of the Montenegrin economy and the obstacles to its development. On WEF competitiveness list for 2017/2018, Montenegro has risen five places and occupies 77th position among the 137 ranked countries. Accordingly, the greatest progress was achieved with respect to institutions (14 places), the efficiency of the commodity market (9 places) and the efficiency of the labour market (9 places), which speaks favourably about the government's commitment to reforming the economic system.

Also, in the World Bank's new Doing Business Report, Montenegro ranks 42nd out of the 190 ranked countries, which is an improvement of nine places.. The most significant progress has been made in the indicators that are of great importance for investors: getting electricity, dealing with construction permits, registering property and resolving insolvency.

4.2 A brief overview of the reform measures

This chapter of the ERP summarizes the priority reform measures that are defined on the basis of the conducted diagnosis and in response to the identified obstacles to competitiveness and growth, through all nine areas, in accordance with the EC's Guidance notes. Nearly half of the priority reform measures are measures from previous years. They are of a multiannual character and are continued in ERP 2018. The above-mentioned multiannual measures are mostly being implemented within the planned timeframes (as detailed in Table 11 of the Annex), while some, such as Priority Reform Measure 1, are characterized by a slight delay. Also, some measures, such as major investment projects, which date from last year's ERP, are not covered by the 2018 ERP, although most of them are being successfully implemented for sake of consistency with the EC's Guidance Notes.

Below is Table 4.1 with an overview of the priority reform measures contained in the 2018 ERP, prepared according to the ERP implementation monitoring framework developed by the OECD. The table shows in an integral way the significance of the proposed measures according to their estimated impact on economic competitiveness/growth, employment and fiscal sustainability. It shows the link between the individual measures and the recommendations given to Montenegro at the Ministerial Meeting in May 2017, and also indicates the institutions responsible for implementation of the measures.

Table 4.1: Presentation of Montenegro's priority reform measures in the Economic Reform Programme for 2018–2020 and their reference to the recommendations for Montenegro from the May 2017 Ministerial Meeting

#	Priority reform measure	Impact score (weighting)*	Impact on competitiveness	Impact on employment	Impact on fiscal sustainability	Reference to recommendations o the May 2017 Ministerial Dialogue (No.)	Implementing ministry
Public finance management							
1.	Introducing an e-procurement system	10	Large	Indirect	Positive	/	Ministry of Finance
Energy market and transportation market reform							
2.	Improving the legislative/regulatory and institutional framework for integration into the regional electricity market	9	Large	Indirect	Neutral	/	Ministry of Economy
3.	Adopting secondary legislation on a single window for formalities in maritime transport	13	Substantial	Indirect	Positive	/	Ministry of Transport and Maritime Affairs
4.	Creating an efficient and independent rail transport regulatory and safety authority	4	Small	Indirect	Neutral	4	Ministry of Transport and Maritime Affairs
Sector development							
5.	Fostering investment in industrial sector	10	Large	Direct	Negative	5	Ministry of Economy
6.	Supporting development and modernization of the industrial sector	4	Medium	Small	Negative	5	Ministry of Economy
7.	Supporting investments in the food production sector in order to reach EU standards	11	Large	Direct	Neutral	5	Ministry of Agriculture and Rural Development
8.	Diversifying tourist products	15	Substantial	Direct	Positive	5	Ministry of Sustainable Development and Tourism
9.	Encouraging NPL resolution by enhancing the framework for prudential supervision and solvency of banks	9	Large	Small	Positive	3	CBM
Business environment and reduction of the grey economy							
10.	Introducing e-services into the work of cadastral offices	11	Large	Direct	Neutral	/	Ministry of Finance
11.	Adopting the Law on Issuing Electronic Fiscal Invoices and implementing the electronic fiscal invoices system	4	Small	Small	Positive	2	Ministry of Finance
12.	Improving financial support for the small and medium-sized enterprise sector	12	Large	Direct	Positive	5	Ministry of Economy
13.	Improving non-financial support for the small and medium-sized enterprise sector	10	Large	Indirect	Positive	5	Ministry of Economy
14.	Introducing a single information system for spatial planning and building construction	7	Medium	Indirect	Positive	/	Ministry of Sustainable Development and Tourism
Research, development and innovation (RDI) and the digital economy							

15.	Establishing a science and technology park in Podgorica	12	Large	Direct	Positive	5	Ministry of Science
16.	Improving the legislative and regulatory framework with aim to reduce the costs of deploying high-speed electronic communications networks	6	Medium	Indirect	Neutral	4	Ministry of Economy
Trade-related reforms							
17.	Implementing CEFTA Additional Protocol 5 and adopting CEFTA Additional Protocol 6	9	Medium	Direct	Positive	/	Ministry of Economy
Education and skills							
18.	Developing qualifications in line with the labour market needs	6	Medium	Indirect	Neutral	6	Ministry of Education
19.	Carrying out apprenticeships with employers	6	Medium	Indirect	Neutral	6	Ministry of Education
Employment and labour market							
20.	Implementing legal provisions in the field of the labour market with focus on active employment policy	12	Substantial	Indirect	Neutral	6	Ministry of Labour and Social Welfare
Social inclusion, poverty reduction and equal opportunities							

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

4.3 Analysis by areas and structural reform measures

4.3.1 Public Financial Management

Analysis of the main obstacles: Fiscal stability, as an important pillar of Montenegro's economic development, includes, among other things, reform of public finance management. This chapter includes some brief information on the state of affairs in public procurement and internal and external audits, with the strengthening of managerial accountability. Progress in reforms in other areas of the Public Finance Management Reform Programme is presented in Chapter 3 under the section titled "Fiscal Management and Budget Framework".

In the area of public procurement, further reforms are needed in relation to: the harmonization of the legal framework for public procurement with the EU acquis, in particular in the area of concessions and public–private partnerships; achieving greater efficiency while reducing the length of procedures and reducing the costs of public procurement procedures; establishing adequate administrative and institutional capacities at all levels; and raising public awareness of the importance of establishing an effective public procurement system.

The legislative framework for the establishment of an internal financial control system in the public sector is not being implemented according to the planned timeframes, largely due to insufficient understanding of its importance by the management structures. By continuously monitoring the development of the system through a review of the quality of the financial management and control system and of internal auditing, as well as through training, it has been discovered that managerial accountability is a key horizontal issue for the reform of public finance management and internal financial control. The unclearly defined legal framework regulating managerial accountability and the lack of understanding of its importance for effective governance are the main problems and obstacles to the development of this area.

The State Audit Institution is faced with the problem of insufficient auditing staff and has a need to improve the professional skills of its personnel for the implementation of different types of audits.

In order to strengthen the public finance management, the priority reform measure in the field of introducing the electronic public procurement system is presented below, while the introduction of internal financial controls, which is important for this reform area, is a measure continued from 2017, and the significance of that reform is presented in Chapter 3 of this Programme.

Report on implementation of the policy guidance from May 2017: There were not specific recommendations for this are from the Ministerial meeting of May 2017.

Priority Reform Measure 1: Introducing an e-procurement system

Description of the measure: By introducing a system of electronic public procurement, efficiency will be increased, along with a shortening of the length of procedures and a reduction in the costs of procurement procedures, which is in accordance with the Strategy for Development of the Public Procurement System in Montenegro and the Action Plan for its implementation for the period 2016–2020 and the Public Finance Management Reform Programme 2016–2020. There were no EC recommendations for this area.

Timetable for implementation of the measure: Since this is a measure that continues over from previous years, the activities on its implementation undertaken so far are shown in Table 11 of the Annex. The activities on the implementation of the measure starting from 2018 are presented below.

- Activities planned in 2018: The tender procedure that was started in 2017 will be completed and the contract with the selected bidder for the implementation of the e-procurement system introduction project will be signed. A new Law on Public Procurement will be adopted.
- Activities planned in 2019: It is expected to put into operation a pilot project of the system and eliminate the possible shortcomings, as well as to conduct training for employees in the Public Procurement Administration. The Training Plan and materials for training of the system users (contracting authorities and tenderers) will be prepared.
- Activities planned in 2020: Use of the system will start and the system users will be trained.

The implementing institution for this measure is the Public Procurement Administration.

Expected impact of the measure on competitiveness: As the state is directly entering the market through the public procurement procedure, the public procurement system has a major impact on the overall social and economic activity. Significant funds are spent through the public procurement system. The share of the value of public contracts out of gross domestic product in the last five years amounted to about 10.2 percent on an average. The implementation of this measure will increase the transparency of public procurement, and thus, with different measures in all public procurement phases, will contribute to the reduction of irregularities and corruption in this area and to a significant increase in quality of institutions. This will also lead to the increased participation of SMEs that sell goods, provide services or perform works in the public sector. Better monitoring of contract execution will lead to more rational spending of budgetary funds and also to an improvement in the confidence of potential investors.

Estimated cost of the measure/activity and the budgetary impact: The value of the project is 1.65 million euro. The project will be financed from IPA 2014 with an amount of 1.5 million euro, and from Montenegro's annual budgets with an amount of 150,000 euro (co-financing). Of this amount 50,000 euro will be provided from the Budget of Montenegro for 2018. The impact of the electronic public procurement system on budget expenditure will be measurable when fully functional. According to estimates by the EC and other relevant international organizations, this is expected to be around 5 percent per year.

Expected impact on employment and gender equality: The use of public procurement as an instrument for promoting sustainable development, while respecting high-level social and environmental criteria, will increase the accessibility of the public procurement processes, especially for SMEs. In this way, the development of entrepreneurship will be encouraged as one of the models for increasing employment and social inclusion.

Potential risks: Uncertain completion of the tender procedure for choosing the best bidder as well as o "quantifying" the bidders' interest and the quality of bids.

4.3.2 Energy market and transport market reform

Analysis of the main obstacles: The development of Montenegro's energy sector implies the establishment of a competitive and transparent electricity market at the national level and its regional integration. While the activities aimed at removing physical barriers to achieving the stated goal are in progress (connecting with neighbouring power systems by constructing interconnectors), it is necessary to further adjust the legislative and regulatory frameworks and work intensively on their implementation.

In order to achieve the development of self-sustaining transportation and the appropriate standards faster, as regulated in the Trans-European Transport Network, one of the important aspects is liberalization of the transportation market. Given that this is an iterative process that requires time, the reform measures in this document are focused on facilitating the opening up of the rail and maritime transport markets. To have a fully transparent rail market, it is necessary to have independent regulatory bodies, and in order to increase the competitiveness of our ports, it is necessary to establish an information system, the so-called National Maritime Single Window, an electronic system that will accelerate the transport clearance processes for ships and the goods being transported.

Report on the implementation of the May 2017 policy guidance: The report on the implementation of the EC recommendations of May 2017 states: "Montenegro is invited to ensure an effective, efficient and independent rail regulatory and safety authority to implement the full opening up of the rail market." Drafting of the Law Amending the Law on the Railways is underway and it is planned to reorganize the work carried out by the Railway Directorate in such a way that the regulatory and safety functions will be part of the Railway Directorate as an independent government administration body, with clear reference to the functions of one body or the other. Other activities would be implemented during 2018, in order to fully implement this reform measure from 2019.

In relation to the above, two priority reform measures have been proposed for the improvement of the transportation market and one for the energy market.

Priority Reform Measure 2: Improving the legislative/regulatory and institutional framework for integration into the regional electricity market

Description of the measure: In the conclusions of the Ministerial Meeting of May 2017, there were no recommendations related to the field of energy. This reform measure encompasses activities on improving the legislative/regulatory and institutional framework, and aims to develop a competitive and transparent electricity market in Montenegro and integrate it with the regional electricity market. The measure is in line with the Energy Policy of Montenegro to 2030, the Energy Development Strategy of Montenegro to 2030 and the Action Plan for the Implementation of the Energy Development Strategy of Montenegro to 2030, for the period 2016–2020. This measure is also foreseen by the Annex of the Conclusions of the Summit of the West Balkan Six in Vienna, of 27 August 2015, in which national and regional activities for removing barriers to the development of the regional electricity market were indicated as so-called "soft measures". The "soft measures" will be implemented with the support of the Energy Community Secretariat. The key activities relate to the creation of conditions for the efficient functioning of a transparent short-term electricity market at the national and regional levels, active participation in the regional balancing market and the improvement of cross-border electricity exchange.

Timetable for implementation of the measure:

- Activities planned in 2018: Transposition into Montenegrin legislation of Regulation (EU) 347/2013 on guidelines for trans-European energy infrastructure, Regulation (EU) 2015/1222 establishing a guideline on capacity allocation and congestion management and Regulation (EU) 2016/1719 on establishing a guideline on forward capacity allocation and their implementation; creation of a model of national connectivity with neighbouring electricity markets; establishment of an efficient electricity market balancing at the regional level; certification of electricity transmission system operators; selection of the strategic partner for Montenegrin Electrical Power Exchange Ltd
- Activities planned in 2019: Transposition into Montenegrin legislation and implementation of Regulation (EU) 1227/2011 on wholesale energy market integrity and transparency; continuation of activities for connecting the national market with the neighbouring electricity markets.
- Activities planned in 2020: Continuation of activities towards improving the operation of the regional electricity market.

The implementing institutions for this measure are: the Ministry of Economy, the Montenegrin Electricity Transmission System (CGES), the Energy Regulatory Agency, Montenegrin Electricity Market Operator Ltd, and Montenegrin Electrical Power Exchange Ltd.

Expected impact of the measure on competitiveness: This measure has a significant direct impact on increasing the efficiency of the operation and competitiveness of electrical power companies. By creating more favourable conditions for the exporting of electricity, this measure will, along with the construction of additional generation facilities envisaged by the Montenegro Energy Development Strategy, have a positive impact on the exporting of electricity. Furthermore, the measure will ensure the creation of reliable price signals in the functional electricity market, reflecting the impartial and competitive interaction between supply and demand. The price of electricity generated under these conditions will contribute to the creation of a more favourable business environment in Montenegro.

Estimated cost of the measure/activity and the budgetary impact: As technical support for the implementation of the measure is provided through the EU pre-accession programmes, it is estimated that it will not require any additional budgetary resources.

Expected impact on employment and gender equality: A positive impact on employment in the electricity sector and other sectors is expected indirectly, as a result of creating a more favourable overall business environment.

Potential risks: Due to the high level of complexity and the regional dimension of the measure, as well as the large number of participants in its implementation, there is a potential risk of delaying the implementation timeframes for individual activities within this measure.

Priority Reform Measure 3: Adopting secondary legislation on a single window for formalities in maritime transport

Description of the measure: This secondary legislation incorporates into national legislation EU Directive 2010/65, which regulates the introduction of a single electronic system which would be used to announce the arrival and departure of ships in Montenegrin ports and to issue approvals for ships entering and leaving ports. This measure will be implemented by the Ministry of Transport and Maritime Affairs and the Maritime Safety Administration, together with other state authorities responsible for granting approval for the free movement of ships.

Timetable for implementation of the measure: The precondition for implementation of the secondary legislation is the establishment of an information system, i.e. the National Maritime Single Window (NMSW), while funds for its implementation have been requested from IPA II and are expected to be approved in 2018. The planned studies will provide a detailed plan of implementation of this measure.

- Activities planned in 2018: Approval of IPA II funds for implementation of the NMSW. Preparation of the Study on the NMSW will begin once funds are approved.

- Activities planned in 2019: In accordance with the Study on the NMSW, activities will be launched to create the necessary conditions for drawing up secondary legislation, while preparations for launching the tender process for implementation of the NMSW will begin as well.
- Activities planned in 2020: Launching the tender process and contracting for developing the NMSW. Drawing up and adopting secondary legislation.

Since this is a complex IT project, it is expected that its implementation, the training of users and putting it into operation will be finalized by the end of 2023.

The institution responsible for implementing the measure is the Ministry of Transport and Maritime Affairs, in cooperation with state administration authorities.

Expected impact of the measure on competitiveness: The NMSW will shorten the waiting time for receiving approval for ships to enter and leave Montenegrin ports, thus increasing the competitiveness of our ports. Also, the current procedure for the exchanging of documents once a ship enters a port will be replaced by an electronic one which will shorten the time of stay of ships in the port and cut the administrative costs related to ships entering and leaving ports, thus increasing the competitiveness of our ports.

Estimated cost of the measure/activity and the budgetary impact: Implementation of the NMSW is planned within IPA II. The expected implementation costs are 700,000 euro, of which the national contribution accounts for 15 percent.

Expected impact on employment and gender equality: This measure creates conditions for the greater competitiveness of our ports and thus for a more extensive transhipment of cargo, an increase in the number of ships to enter our ports and an increase in the number of transported passengers, which contributes to the more extensive engagement of our capacities in the transport chain leading to job creation. This measure has no impact on gender equality.

Potential risks: In addition to the involvement of the Ministry of Transport and Maritime Affairs and the Maritime Safety Administration, implementation of this measure also requires the engagement of other state administration authorities responsible for ships entering and leaving Montenegrin ports, such as: the Ministry of the Interior (Police Directorate), the Ministry of Finance (Customs Administration) and the Administration for Inspection Affairs. In order to ensure the full commitment of the competent authorities to implementing this measure, thus reducing the risks posed to implementation of the measure and the likelihood of their occurrence, a legal basis needs to be created for setting up an interdepartmental working group which will address this issue.

Priority Reform Measure 4: Creating an efficient and independent rail transport regulatory and safety authority

Description of the measure: The Amendments to the Law on the Railways set out the reorganization of the activities performed by the Railway Directorate by placing regulatory and safety affairs within the purview of the Railway Directorate as an autonomous administrative authority within the Government of Montenegro, with clear specification of the functions of both authorities, in accordance with Directive 2012/34 which specifies the requirements for the functioning of the Single European Rail Area. Moreover, implementation and the models for addressing this legislative measure are specified in the Railway Development Strategy 2017–2027 adopted by the government in Q1 2017. The measure is aligned with Conclusion 4 reached at the Ministerial Meeting which reads as follows:Montenegro is invited "to ensure effective, efficient and independent rail regulatory and safety authorities to implement the full opening of the rail market".

Timetable for implementation of the measure:

- Activities planned in 2018: Changes to the job classification of jobs and the organization of the Railway Directorate, the adoption of amendments to the Law on the Railways.
- Activities planned in 2019: The beginning of operation of the independent regulatory body for rail transport in accordance with EU regulations, strengthening and training administrative capacities; the training will focus on the technical tasks of employees at the Railway Directorate related to safety and regulation in rail transport (issuing of certificates, putting infrastructural subsystems into operation, issuing of permits for vehicles, licensing infrastructure operators and carriers, monitoring of parameters specified in the Network Statement, actions to be taken in the event of discriminatory practices in licencing train routes etc.), which are specified in the 4th Railway Package of EU directives and can be organized through the assistance of consultants or visits to the institutions which already perform these activities independently in the EU or in the region; training courses are needed for at least six employees at the Railway Directorate (four in charge of safety + two in charge of regulatory activities).
- Activities planned in 2020: Strengthening administrative capacities through the continuation of activities that started in 2019.

The institution responsible for implementing activities is the Ministry of Transport and Maritime Affairs.

Expected impact of the measure on competitiveness: Under the conditions of a liberalized rail market, clearly defined legislation in this area and the strong role of an independent regulator may be an incentive to involve new operators in the market, which would improve competitiveness and the quality of services and lead to cost-cutting as a result of an increased market competition. Under these conditions, it is expected that new, more efficient operators will appear which would contribute to an increase in the number of employed, as well as to an improvement in productivity.

Estimated costs of the measure/activity and the budgetary impact: Funds for operation of the Railway Directorate, as the administrative authority functioning under the auspices of the government, are planned in the annual government budget, and for 2018 they amounted to 315,000 euro. New funds for implementation of the measure are not needed since the Railway Directorate already exists, albeit with a lower level of independence.

Expected impact on employment and gender equality: The emergence of new operators is expected to increase the number of people employed, though we are expecting to see firms which will be much more efficient compared to the ones active today and which will have a lower number of employees, but ones that are highly productive.

Potential risks: One risk refers to a not so fast pace of compentencies transformation of employees needed to implement the measures.

4.3.3 Sector development

Analysis of the main obstacles: The key development sectors in Montenegro are industry, agriculture and services, primarily those in tourism. In that regard, the reform measures within the sectors are presented in the 2018 ERP for the areas of industry, agriculture, tourism and financial services, and diagnostics of these areas is outlined below.

Industry: Despite the evident progress made towards targeted industrial development and a more efficient allocation of state aid through various programmes for improving competitiveness and attracting investments, this is still not sufficient to achieve positive trends in this industry sector which is very important for the competitiveness of our economy. Industrial production, is still burdened with structural weaknesses that are accompanied by insufficient diversification of products and products with low value added, accounted for 10.3 percent of GDP in 2016. Additional factors contributing to the currently insufficient level of processing are insufficient investments in modernization (a share of investments in fixed assets within the processing industry, recorded a 1.5 percent decline in 2016), low productivity, a low level of innovative activities in the economy and a weak connection between industrial, educational and research and development policies (investment in research and development in 2015 accounted for 0.38 percent of GDP, the private sector made up 0.11 percent). As for exports, the main subsectors of processing industry are the metal-, food- and wood-processing industries, accounting for over 70 percent, of which the metal industry accounts for 44 percent since it is still the main export potential of the processing industry.

Nevertheless, full implementation of the state-support programmes, combined with the launched investment cycle in the steel and aluminium industries for the purpose of restoring the current capacities and constructing new ones (the announced investments from private sources amount to around 40 million euro) will result in positive trends in the industrial sector and will contribute to an increase in GVA and an expansion of the production base. In addition, various mechanisms for supporting SMEs, particularly innovative ones and the establishment of the Science and Technology Park will increase the share of highly technological industries and the export performance of our economy.

Agriculture: Agriculture is one of strategic development sectors in Montenegro. Its share of GDP accounts for 7.5 percent. Gross value added at current prices in agriculture, forestry and fisheries sectors in 2016 amounted to 295.4 million euro, which is a 0.3 percent rise compared to 2015. The main goal of Montenegro's agricultural policy is to boost the competitiveness of agricultural production and improve living conditions in rural areas. The main obstacles to strengthening the competitiveness of the food production sector in Montenegro are the low productivity per unit of area, an unfavourable age structure in rural areas, a lack of organization of producers into producers' organizations and cooperatives and an underdeveloped rural infrastructure.

In the recent period, significant funds have been made available to Montenegrin producers from the World Bank-funded project MIDAS and pre-accession funds for rural development, as well as from the national budget, the aim of which has been to strengthen the food production sector. In 2017, 17 million euro was invested in strengthening the agricultural sector, of which the support from IPA funds amounted to 3.2 million euro (total investments amounted to 6.3 million euro), whereas 11 million euro was allocated through the measures of the agriculture budget and these included direct support measures (subsidies) and measures which aim to support investments in rural areas, such as support for cultivating new plantations, purchase of livestock and the diversification of economic activities.

With the investments made in food processing facilities and by reaching EU food safety standards, Montenegro fulfilled the recommendations made by the EC for this area. At the moment, Montenegro has export facilities approved by the EC and these are: two slaughterhouses, three facilities for meat processing, three facilities for egg production, three facilities for fishery products and four facilities for the exporting of animal by-products (leather and wool). The assignment of export codes will contribute to a growth in exports of agricultural and food products.

Tourism: The main obstacles to faster development of tourism in Montenegro are an insufficient number of accommodation capacities such as hotels and similar facilities, an uneven regional tourist offer and the pronounced seasonality of the tourist industry.

In fact, analysis reveals that 90–95 percent of the accommodation capacities and tourist trade (number of tourists, overnights and revenue) are located and operated in the coastal region, and that 65–70 percent of such trade takes place during the three summer months (June, July and August).

The consequences of this condition and of tourist developments are the following:

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

Banking services: The banking sector consists of 15 banks, of which nine hold majority foreign capital, and it makes up a dominant share of Montenegro's financial sector. The aggregate balance sheet sum of the banks totalled 4,095 million euro at the end of September 2017, which is 97.5 percent of the estimated GDP for the 2017.[34] During that same period, loans totalled 2,699.8 million euro, or 64.2 percent of the estimated GDP. The banking sector in Montenegro faced numerous challenges in the post-crisis period, while credit activity has still not reached the critical level which used to be a driver of economic growth. The consequences of economic boom and bust have had a strong impact on the quality of banks' credit portfolios, and the subsequent financial crisis additionally prolonged the cleaning up of the banks' balance sheets. The above-mentioned factors resulted in a several-year-long credit crunch and slowed down growth. Banks' lending policies still show extreme cautiousness, as a result of which their contribution to the resolution of problems with insufficient liquidity in the real sector and to the acceleration of economic growth is smaller than expected. Data on the first nine months of 2017 suggest an evident 13.3 percent rise in the loans and receivables of banks at the aggregate level, which is a sign of a recovery in lending activity. The impact of the crisis on the economy, and particularly on the construction sector, real-estate trade and the retail banking sector, resulted in a rise in non-performing loans within the total credit portfolio. Thus, the share of non-performing loans in mid-2011 reached its maximum level of almost 26 percent, which was followed by a rise in loan–loss provisions and capital write-offs. The statutory solvency standards and risk profiles of some of the banks required the recapitalization of a large number of banks from private sources, which preserved the stability of the system. The government, the Central Bank and commercial banks focused on resolution of the large number of NPLs and their high proportion of total loans, as a result of which their level reduced significantly. Therefore, at the end of September 2017 NPLs amounted to 199.8 million euro, or 7.4 percent of total loans.

Report on Implementation of Policy Guidelines of May 2017:

Ministerial meeting of May 2017 has not issued specific recommendations to Montenegro for sectoral policies, but the reform measures being implemented at the sectoral level are aimed to contribute to implementation of the 5th and 6th recommendations of the Ministerial meeting. Their objective, amongst other things, is to support development of the small and medium-sized enterprises in sectors of industry, agriculture and tourism, as well as to support employment, in particular number of women and youth. Given that financial services are covered by the sectoral reforms, therefore this reform area included policy guidance from May, precisely the recommendation No 3 to Montenegro to in such manner that in order to further reduce NPLs amendments to the Law on Voluntary Financial Restructuring of Debts towards Financial Institutions were adopted in 2017, creating a possibility for the out-of-court settlement of NPLs, in the interest of both the debtors and creditors. These loans continue to be subject of permanent and increased supervisory oversight.

Based on the above mentioned, 5 priority reform measures have been envisaged in the reform area entitled Sectoral Development: two for the industry sector, one for agriculture, one in tourism and one in financial services.

Priority Reform Measure 5: Fostering investments in the industrial sector

Description of the measure: This measure is being implemented continuously in accordance with the Decree on Fostering Direct Investment and represents a continuation of the reforms in the area of industrial sector development set out in the ERP for 2016–2018 and the ERP for 2017–2019. It prescribes financial incentives for new investments in the sectors of manufacturing and services, as well as for the expansion or diversification of current production capacities. Funds for fostering investments are allocated based on an open call for participation in the procedure for the allocation of funds for fostering direct investments. In the capital city and in the coastal region, financial incentives are possible for investment projects whose minimum investment value is 500,000 euro and which create jobs for at

[34] Source: Ministry of Finance, estimated GDP in 2017 at 4,202.1 million euro.

least 20 new employees under open-ended contracts, within three years of the day of signing the contract on the use of funds with the government. Investments for the northern and central regions (excluding the capital city) amount to 250,000 euro, subject to the requirement to employ at least 10 new employees under open-ended contracts. The Decree also sets out support for capital investments whose value is at least 10 million euro and which entail the employment of 50 people under open-ended contracts.

The amount of funds for fostering investment ranges between 3,000 euro and 10,000 euro per new employee and is determined based on the criteria laid down in the Decree, which include the investor's references, the value of the investment project, the effect on research and development, human resources and the environment, the economic effects and the effects on regional development, the scope of international trade, etc.

The measure is implemented in accordance with the Industrial Policy of Montenegro to 2020, the Regional Development Strategy to 2020, Montenegro Development Directions 2018–2021 and the South East Europe 2020 Strategy. This is a multiannual measure which is also contained in the 2017 ERP, while an overview of its implementation during the previous year is given in Table 11 in the Annex.

Timetable for implementation of the measure:

- Activities planned in 2018: Monitoring implementation of investment projects in accordance with the contracts entered into in 2016; Continued implementation of the activities from the third call; publishing an open call for participation in the procedure for allocation of funds for fostering direct investment, evaluation of the formal accuracy of applications and analysis of their compliance with planning documents and Montenegro's development plans; Valuation of formally correct applications (investment projects) by the Commission for Valuation of Investment Projects; Adoption of the Decision by the Government of Montenegro regarding the allocation of funds for fostering direct investments and signing a contract on the use of funds; monitoring the implementation of investment projects which are implemented in line with the contracts signed in 2018.
- Activities planned in 2019: Continuation of the activities that started in 2018 and publication of a new open call.
- Activities planned in 2020: Continuation of the activities launched in 2019 and publication of a new open call.

The institution responsible for the implementation of the measure is the Ministry of Economy as well as the Secretariat for Development Porojects.

Expected impact of the measure on competitiveness: Subsidies for investments enable development of new production capacities and improvement of the existing ones which will, in addition to job growth, also lead to a strengthening of economic activities, an increase in production and export potentials, a reduction in the trade deficit, etc. The value of the currently implemented investment projects totals approximately 7.2 million euro, which will enable a gradual expansion of industrial capacities in the timber, food and pharmaceutical industries, tourism and services, while the specific effects will be quantifiable at the end of the investment cycle (in accordance with the contracts that were entered into, a deadline of up to three years is set for investors to finalize investments).

Estimated costs of the measure/activity and the budgetary impact: An amount of 1.25 million euro is allocated in the 2018 budget for fostering direct investment and will be used for the payments to be made based on the call in 2018, as well as for the payment of instalments due based on the open calls published during earlier periods. As for the fiscal effects of the employment of 253 employees under the projects whose implementation commenced in 2016it is estimated around 536,000 euro of taxes and contributions will be generated from the projected average net salary of 264 euro. One should also bear in mind a decrease in expenditure on social benefits, since the majority of those people were unemployed prior to being engaged in these projects. The amount of 1.30 million euro is planned for 2019 for implementation of the measure, and 1.30 million euro is also planned for 2020 as well.

Expected impact on employment and gender equality: The Decree sets out the financing of investment projects which will generate new employment of people under open-ended contracts in those jobs in which the investment projects are being implemented, while the focus is placed on underdeveloped areas and balanced regional development of the country. More than 250 new jobs will be created as a result of the projects whose implementation commenced in 2016 (see Table in the Annex), while the beneficiaries of funds will be obliged to maintain the number of new employees continuously for at least three/five years after finalization of the investment project, depending on whether it is a small and medium-sized or a large enterprise, pursuant to the Article 9 of the Decree.

Potential risks: Despite increased interest among investors to participate in the tender, the quality of the submitted applications and of the required documents, and the risk of default pose the main risks for efficient implementation of the measure.

Priority Reform Measure 6: Supporting the development and modernization of the industrial sector

Description of measure: This measure, which aims to foster investments in technical and technological equipment, is a multiannual reform measure which has been implemented since 2016. A more detailed overview of its implementation in the previous period is given in Table 11 in the Annex. This is one of the core activities in the implementation of the Industrial Policy of Montenegro to 2020 and is harmonized with Montenegro's other strategic development documents, such as Montenegro Development Directions, South East Europe 2020 Strategy and Regional Development Strategy to 2020. This measure for industrial development is implemented through the Programme for Supporting the Development of the Manufacturing Industry and envisages co-financing of up to 20 percent of the eligible costs of procurement of equipment (depending on the enterprise size), while the remaining part of the investment is to be obtained through a credit arrangement with the Investment and Development Fund of Montenegro (IDF). This applies to the businesses that operate at a profit[35] in the area of manufacturing, and is intended for the procurement of either new or used manufacturing equipment and new parts/specialized tools that are needed to put unused machines into operation. During implementation of the pilot programme in 2016, one company operating in the wood processing industry received a grant of 9,500 euro in order to purchase cutting machinery which cost 47,500 euro.

Timetable for implementation of the measure:

- Activities planned in 2018: The plan is to publish an open call for the award of grants in the framework of the Programme for Supporting Modernization of the Processing Industry. In accordance with the rules of the Programme, the submission of applications is followed by evaluation of the documentation and a decision on the awarding of loan funds and grants by the IDF and the Commission of the Ministry of Economy responsible for the awarding of funds.
- Activities planned in 2019: Activities aimed towards implementation of the Programme, as in the previous year (2018).
- Activities planned in 2020: Activities aimed towards implementation of the Programme, as in the previous year (2019).

The institution responsible for implementation of the measure is the Ministry of Economy as well as Investment Development Fund of Montenegro.

Expected impact on competitiveness: This form of support, which entails the adoption of new technologies, primarily aims to ensure greater flexibility, productivity and profitability of Montenegrin enterprises, which boosts the competitiveness of enterprises and enables their integration into global value chains, while optimally using the available resources. All in all, investing in the technical equipment

[35] Enterprises which have operated at profit for at least two years.

of enterprises will lead to an increase in the quality, quantity and output of production and consequently to export growth and positive trends in the trading of goods.

Estimated costs of the measure/activity and the budgetary impact: This measure includes a subsidy, which ranges from 5,000 euro to 20,000 euro, for procurement of the equipment worth between 25,000 and 100,000 euro.[36] The planned budgetary funds for its implementation in 2018 amount to 150,000 euro, while projections suggest that the IDF should allocate at least 800,000 euro for this purpose. The government's budgetary funds planned for 2019 and 2020 amount to 200,000 euro, while the IDF's budget is projected at 1 million euro.

The IDF's loans are extended under conditions that are more favourable than those offered by commercial banks: an interest rate of 3.50 percent (per annum)[37] and a repayment period of 12 months with a four-year grace period. In accordance with the procedure set out in the Programme, grants awarded by the Government of Montenegro are subject to the acceptance of the projects by the IDF, which further ensures the quality of investments and efficiency in spending government funds.

Expected impact on employment and gender equality: The investment in equipment through this assistance will help the development of enterprises in the manufacturing industry, particularly those in underdeveloped areas (since it predominantly includes enterprises engaged in food production and the wood-processing industry, mainly located in the northern region of Montenegro). Moreover, growth and development of enterprises, observed in the long-run, will increase the number of employed.

Potential risks: Insufficient interest among domestic businesses could pose a potential risk to the implementation of this measure, even though the Government of Montenegro is taking all the necessary measures to constantly promote this and other measures which seek to support Montenegrin businesses.

Priority Reform Measure 7: Supporting investments in the food production sector in order to reach EU standards

Description of the measure: This measure supports the cultivation of new plantations of agricultural crops, construction/reconstruction of primary production facilities, expansion of the livestock population, procurement of processing equipment, and the construction and reconstruction of facilities for processing agricultural and fish products, with the aim of improving food safety standards, animal and plant health and welfare through gradual harmonization with EU food quality and food safety standards, while also ensuring competitiveness in the EU market. This measure is being implemented in accordance with the Strategy for the Development of Agriculture and Rural Areas 2015–2020 and Programme for the Development of Agriculture and Rural Areas 2016–2020 (IPARD).

Timetable for implementation of the measure: The measure will be implemented in 2018, 2019 and 2020. It is split into two activities: "Investment in the physical capital of agricultural holdings" and "Investment in physical capital in relation to the processing of agricultural and fish products" which will be implemented through IPARD-like, IPARD and the national budget.

The IPARD-like project is in its final stage, while assistance from the IPARD programme is expected to be received in early 2018.

The institution responsible for implementation of the measure is the Ministry of Agriculture and Rural Development.

Expected impact on competitiveness: The measure will contribute to the expansion of production in the primary sector, which will enable the continuous supplying of the processing sector with domestic raw materials, thus contributing to an increase in the value added of production, a reduction in import

[36] The total cost of procurement of the equipment might exceed 100,000 euro, where the difference up to the total investment is financed by raising the amount of the requested loan from the IDF or by increasing its share of total investment.

[37] The interest rate for enterprises implementing projects in municipalities in the northern region and in municipalities that are below the average level of development in Montenegro is 3.00 percent.

dependency and the greater competitiveness of domestic products. An increase in the exporting of dried and smoked meat, wine, cheese, medicinal and aromatic herbs and essential oils has been recorded in the past three years. A decline in the importing of certain products has been recorded as well, for example imports of eggs have dropped by 25 percent.

Estimated costs of the measure/activity and the budgetary impact: The planned total amount of support in 2018 amounts to 20.7 million euro, of which IPA funds account for 9.7 million euro, private sources and national contributions account for 2.8 million euro and the national in-kind contribution is 1.8 million euro, while the agriculture budget's funds amount to 11 million euro. The planned assistance for 2019 totals 31 million euro, of which IPA funds account for 20 million euro, private sources 6 million euro, national contributions 3.4 million euro and the agriculture budget funds are 11 million euro. The planned assistance for 2020 totals 31.5 million euro, of which IPA funds account for 20 million euro, private sources 6 million euro, national contributions 3.4 million euro, and the funds from the agriculture budget total 11.5 million euro.

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

Potential risks: Implementation of the proposed measure depends on the availability of loan support to producers, since investments are 100 percent pre-financed by producers who are refunded 50–60 percent of the investment value upon finalization of the investment. These rules are statutory and harmonized with the relevant EU rules. Access to financing will be facilitated through legislative amendments which will enable the recognition of land in rural areas as collateral and the establishment of an electronic property register. Furthermore, the IDF has developed a special line which addresses the issue of farmers not having access to loan funds. Besides this, a guarantee fund will be set up in 2018 at the IDF, which will be at the disposal of farmers in order for them to be able to secure collateral. Farmers and manufacturers may use various sources of funding (banks, microcredit institutions, etc.) to finance investments.

Priority Reform Measure 8: Diversifying the tourist product

Description of the measure: Diversification of the tourist product is a measure which aims to support the development of Montenegro as a high-end tourist destination with a year-round tourist offer. The measure is being implemented through the development of nature-oriented tourism, cultural, rural, health, nautical, sports tourism and other forms of tourism, the development of tourist products for selected, targeted groups of tourists, the creation of unique products and the promotion of authentic tourist attractions, thus continuously raising the level of quality of services.

In implementing the activities within the measure, emphasis was placed on improving the tourist product in the north of Montenegro and its merging with the offer of the coast into a single product. The activities within the measure are fully aligned with the principle of sustainability (correlation with the National Sustainable Development Strategy), while its implementation creates the preconditions for a balanced tourist offer from a regional perspective (correlation with the Regional Development Strategy). Some of the results of an improvement in the offer in the northern region are: an increase in the number of new jobs, an increase in tourist trade (numbers of tourists, overnight stays and revenue from tourism), reduced migration from the northern to the southern region, and a higher standard of living of the population (in correlation with the Millennium Development Goals). Activities within the measure will be implemented primarily by small and medium-sized enterprises in which the conditions will be created to employ a significant number of women and young people (in correlation with Recommendations Nos. 5 and 6 given by the EC).

Timetable for implementation of the measure:

- Activities planned in 2018: Hiking and biking, panoramic routes of Montenegro, snowshoeing, Tourism Incentive Programme, etc.; adoption of strategies for rural and cultural tourism.
- Activities planned in 2019: Hiking and biking, panoramic routes of Montenegro, snowshoeing, Tourism Incentive Programme, etc.; implementation of action plans set out in strategies for rural and cultural tourism; adoption of strategies for health and nautical tourism.
- Activities planned in 2020: Hiking and biking, panoramic routes of Montenegro, snowshoeing, Tourism Incentive Programme, etc.; implementation of action plans for rural, cultural, health and nautical tourism.

The institution responsible for implementation of this measure is the Ministry of Sustainable Development and Tourism.

Expected impact on competitiveness: Tourism is one of Montenegro's priority economic sectors, particularly given its export component, i.e. the fact that around 90 percent of the trade comes from abroad. Implementation of the measure will extend the peak tourist season, which will further increase the occupancy of accommodation capacities and the opening up of new jobs. The measure will also contribute to raising awareness about sustainable development of the environment, as well as through capitalizing on the potential of nature and the cultural and historical heritage for the purpose of tourism. Continuous improvement of the tourist product is expected to further expand the export component of tourist services and produce multiplier effects on other sectors of the economy: transport, agriculture and trade. A growth trend in respect of the number of tourists, overnight stays and receipts generated from spending by tourists is expected to continue, while an increase in the total (direct and indirect) share of tourism within GDP at an average rate of approximately 6 percent is also expected in the coming 10-year period (based on the report produced by the World Travel and Tourism Council).

Estimated cost of the measure/activity and the budgetary impact: The amount of 879,335 euro is allocated in the budget for implementation of the activities envisaged for 2018, along with the funds to be provided, depending on the type of activity, by the private sector, i.e. the tourist industry, as the ultimate service provider. It is expected that implementation of measures will request the same amount of funds in 2019 and 2020.

Expected impact on employment and gender equality: Since tourism is a labour-intensive activity, it is expected that it will a make a greater contribution to the total number of employed people (among whom women account for a significant share), which also contributes to the economic empowering of women (in correlation with the Strategy of Development of Women's Entrepreneurship and activities aimed at achieving gender equality). According to the forecasts, the total number of employed is expected to increase until 2027 at an average annual rate of 3.6 percent, while a significant number of new jobs are expected to be created in underdeveloped areas.

Potential risks: Risks to the implementation of the measure primarily refer to the execution of plans within the set deadlines, bearing in mind the statutory tender procedures, which may ultimately lead to funds not being spent for the purposes for which they were earmarked. Mitigation measures of negative effects will be implemented by establishing public–private partnerships and more efficient use of EU funds.

Priority Reform Measure 9: Encouraging resolution of NPL by enhancing the framework for prudential supervision and solvency of banks

Description of the measure: In recent years, Montenegro has launched a number of legal and institutional reforms with the aim of improving the framework for the enforced collection of claims, and thus also claims arising from loans. As a result of all the measures, the banking system has recorded a constant decline in non-performing loans, from 26 percent in mid-2011 to 7.1 percent at the end of October 2017. Such a decline has not been recorded in other countries facing a similar problem. A multidimensional approach has been taken because individual measures could not produce results in this case. One part of the non-performing loans was collected, one part was written off, while another part was sold to factoring companies, but restructuring of the NPLs and improvement to the regulatory framework to ensure more efficient collection were also important. Measures directed towards fixing this vulnerability included an increase in the efficiency of both in-court and out-of-court resolutions. Since 2008, the Central Bank of Montenegro (CBM) has been continuously investing efforts to resolve the issue of non-performing loans, at which time the Credit Registry was also set up for the purpose of better identifying and registering credit risk. The core activities performed by the CBM were focused on implementation of the 2015 Law on the Consensual Restructuring of Debts to Financial Institutions.

Another measure aimed at the further reduction of NPLs included the adoption of an amendment to the Law on the Consensual Restructuring of Debts to Financial Institutions in 2017, which created the possibility of out-of-court resolution of NPLs to serve the interests of both the debtors and creditors. An amount of 10.5 million euro was restructured in the first five months of implementation, while a total of 16 million euro was announced. In order to strengthen the framework for the prudential supervision and solvency of banks and thus to foster financial stability, significant reforms to the regulatory framework for banking operations will be conducted in the process of harmonizing legislation with the EU acquis in the area of financial services, in compliance with the timetable set out in the Programme of Accession of Montenegro to the EU 2018–2020. This is in line with Recommendation No. 3 given in the Joint Conclusions from the Ministerial Meeting of the EU and Western Balkan countries that took place in May 2017.

Timetable for implementation of the measure:

- Activities planned in 2018: Consideration of the possibility of extending the deadline for implementation of the Law on Consensual Restructuring of Debts to Financial Institutions by one more year; adoption of the Law on Bank Resolution and the Law Amending the Law on Banks which will implement Directive 2014/59 EU establishing a framework for the recovery and resolution of credit institutions and investment firms (the so-called BRRD Directive); adoption of the new Law on Banks which will implement Directive 2013/36 EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, and Regulation (EU) No. 575/2013 on the prudential requirements for credit institutions and investment firms; the Central Bank of Montenegro will continue its activities aimed at reducing NPLs through an active supervision process and continuous communication with each bank in the system individually. To that end, the Central Bank of Montenegro will continue to exercise increased supervision to check whether banks are fulfilling their obligations stemming from amendments to the Decision on minimum standards for credit risk management in banks, and these refer to monitoring the implementation of the established strategies and objectives for the resolution of NPLs, which should make an additional contribution to a further reduction of the level of NPLs in banks.
- Activities planned in 2019: Adoption of a set of secondary legislation for implementation of the Law on Financial Leasing, Factoring, Purchase of Receivables, Microcredit and Credit Guarantee Operations; adoption of a set of secondary legislation for implementation of the Law on Bank Resolution; adoption of a set of secondary legislation for implementation of the Law on Banks; adoption of the Law Amending the Law on Bankruptcy and Liquidation of Banks for the purpose of achieving full compliance with Directive 2001/24/EC on the reorganization and winding up of credit institutions; adoption of the Law on the Supplementary Supervision of Financial Conglomerates which will implement Directive 2002/87/EC on supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate.
- Activities planned in 2020: Adoption of a set of secondary legislation for implementation of the Law on the Supplementary Supervision of Financial Conglomerates.

The institution responsible for implementation of the activities mentioned above is the Central Bank of Montenegro, while the supplementary supervision of financial conglomerates falls within the competence of the Central Bank, but also within the competence of the Securities Commission and the Insurance Supervision Agency.

Expected impact on competitiveness/rationale of the measure: Due to its direct impact on the reduction of the scope of NPLs in the coming period, this measure will contribute to an increase in competitiveness in the banking sector and the competitiveness of legal entities and business organizations participating in debt restructuring, which will result in the expected expansion of overall lending activity under more favourable conditions and the development of new products and services. Ultimately, this measure will contribute to strengthening financial stability and to creating a more conducive business environment in Montenegro.

Estimated cost of the measure/activity and the budgetary impact: No funds from the Budget of Montenegro are needed for the implementation of this measure.

Expected impact on employment and gender: There is no direct impact on employment, but there may be a positive indirect impact on employment in the banking and real sectors as a result of the establishment of a more stable and conducive business environment.

Potential risks: Given the fact that a multidimensional approach has been taken in recent years to the resolution and collection of non-performing receivables, and since the credit risk in the banking sector, measured as the share of NPLs within total loans, as an indicator, has constantly declined since 2011, we can conclude that potential risks to the implementation of the measure are reduced to a minimum.

4.3.4 Business environment and reduction of the informal economy

Analysis of main obstacles: Seeking to boost investment competitiveness, the Government of Montenegro has placed strong emphasis on improving the efficiency of the state administration, cutting the costs of administrative procedures and shortening their duration. Therefore, these aspects of creating a favourable climate were at the centre of the measures which were implemented to enhance the business environment. In that regard, at its session held on 1 June 2017, the Government of Montenegro passed the Decision on setting up the Competitiveness Council tasked with coordinating activities related to implementation of the priority reform measures set out in strategic documents, which aim to eliminate key obstacles to Montenegro's greater competitiveness and faster economic growth.

Reform activities which focused on improving the business environment resulted in progress for Montenegro which was recorded in the last 2018 Doing Business (DB) report, in which Montenegro was ranked 42^{nd} out of 190 countries, thus moving up nine places compared to the previous year revised Report (2017). According to DB2018, Montenegro carried out a reform in the framework of the "Getting electricity" indicator. With this reform, Montenegro reduced last year's price of electricity (% of income per capita) from 440.5 to 425.6, while the value of the index of reliability of electricity supply and transparency of tariffs recorded an increase from 0 to 5. Due to this, the country made progress by moving up 40 places compared to DB2017 and ranking 127th at the global level. Progress was also made in the following areas: "Dealing with construction permits", "Registering property" and "Resolving insolvency". As for "Dealing with construction permits", Montenegro made progress by moving up 15 places compared to DB2017 and ranks 78th at the global level. As for "Registering property", Montenegro made progress by moving up 2 places and ranks 76th. In terms of the indicator "Resolving insolvency", Montenegro made progress by moving from 40th to 37th position.

The main obstacles to further improvement of the business environment specified in the Doing Business Report are: "Starting a business", "Work of cadastral offices", "Issuing of construction permits" and "Paying taxes" and these will be the focus of further reform measures.

In the World Economic Forum's Global Competitiveness Report 2017–2018, Montenegro ranked 77th out of 137 countries and thus made progress by moving up five places compared to last year's report.

In its Global Competitiveness Report, the World Economic Forum gives the most comprehensive picture of the economy of a country, since it evaluates institutions, macroeconomic stability, infrastructure, access to healthcare services and education per capita, the efficiency of the labour market and the efficiency of the goods market, the financial market, technological readiness and innovation.

The main challenges to the implementation of reforms in the area of the business environment are:

- Improving the technical preconditions and IT solutions in state institutions, for the purpose of simplifying procedures and increasing the efficiency of state services; and
- A high level of non-transparent procedures, with the steps needed to be taken to carry out a task being unclear in advance, and the need to obtain some form of state consent.
- high number of parafiscal charges, in particular at the local level, which was especially pointed out by representatives of the Chamber of Economy of Montenegro and the Union of Employers at the round table which took place during the consultation process for drafting the 2018 ERP.
- In order to further improve the SME sector, access to funding for SMEs should be improved by resolving issues faced by certain categories of start-ups and SMEs, and these most often include a lack of means to secure loans (collaterals). There are also constraints in respect of financial literacy and investors' readiness to invest funds, which need to be eliminated by means of the proposed measures, while efforts should be intensified to enter new markets, use services of business support, invest in innovation, etc.

One of challenges in 2018 is related to the potencal increase of informal economy at the cigarettes market, due to the excise on cigarettes as one of fiscal consolidation measures, and this will be in focus of the responsible government bodies in order to reduce grey economy and unfair competion.

Report on Implementation of the Policy Guidelines of May 2017: Recommendation No. 5 given to Montenegro at the Ministerial Meeting that took place in May 2017 is to continue to strengthen financial and non-financial support services for the SME sector. The following two measures will be implemented within the framework of activities aimed at supporting SMEs in their access to finances and activities which aim to improve the competitiveness of the sector through a package of non-financial support: "Improving financial support to the SME sector" and "Improving non-financial support to the SME sector". The recommendation No 5 of the Ministerial meeting in Brussels in May 2017 recommends to Montenegro "to adopt legislation to ensure the operational independence of the state aid authority". This was done through drafting and adoption of the new Law on the State Aid Control, which enables for the Commission for the State Aid Control to be transferred under the jurisdiction of the Competition Protection Agency, and by doing so the independence of the Commission is provided, being the authority for state aid control.

The Privatisation Plan for 2018 will be adopted, which represents a base for an accelerated privatisation process in the next period and for inflow of new investments in the country important for increase of revenues, economic growth and employment.

Priority Reform Measure 10: Introducing e-services into the work of cadastral offices

Description of the measure: The measure is multiannual (see the report on its implementation in the previous year in Table 11 in the Annex) and linked to implementation of Montenegro Development Directions, implementation of provisions of the Law on State Surveying and Immovable Property Cadastre and legislation in the area of e-government; provisions of the Law on Infrastructure of Spatial Data (implementation starting from 1-Jan-2019), which was used to transpose the INSPIRE Directive – 2007/2/EC (establishing an Infrastructure for Spatial Information in the European Community) and includes: metadata, spatial topics, services of spatial data, network services and technologies, agreements on data exchange and sharing services, access and use, coordination and monitoring of mechanisms, processes and procedures, and consents).

The measure refers to:

1. Implementation of e-services – use of data from cadastral offices – ownership structure. Therefore, the following is now possible: gaining access to the data contained in the cadastral records (inquiries based on ID, number of the Ownership Certificate (OC)/Title Deed (TD) or number of the cadastral parcel; access to active applications relating to a specific immovable property in order to make sure that the property transactions are secure; tracking the resolution status of applications based on the code assigned at the moment of filing the application. The data serves for information purposes and is updated on-line in real time for the territory of Montenegro. The plan is to test the e-service, which includes taking over electronically signed OCs and TDs by the end of 2017, not only for notaries public, but also for all users in accordance with the legislation.
   http://www.nekretnine.co.me/me/Katastarski_podaci.asp
   http://ekatastar.me/ekatastar-web/action/elogin
2. Implementation of e-services – use of data contained in cadastral records – overview of spatial data. To that end, the GeoPortal of the Real Estate Administration was set up and gives an overview of all the data available in the immovable property cadastre (around 75 percent of the territory of Montenegro – 99 percent of urban areas). Orthophotos are available from different surveying periods for the territory of Montenegro (2004–2011). The data serves for information purposes and is not updated online in real time. The plan is to implement the digital cadastral plan continuously by the end of 2017 and orthophoto surveying in 2017. http://www.geoportal.co.me/

Timetable for implementation of the measure:

- Activities planned in 2018: Continuation of activities which aim to improve the existing e-services related to the availability of cadastral records, through improvement to and upgrading of the regulatory and technical procedures for all users; implementation of the system for using e-services which enables the acceptance of electronically signed documents as official documents; the preparation and testing of e-services for electronic filing of applications by notaries public; improving the quality of data in the digital cadastral plan by providing new updated data; preparatory activities related to implementation of the Law on Spatial Data Infrastructure – harmonization of the spatial data that falls within the competence of the Real Estate Administration and provision of e-services.
- Activities planned in 2019: Continuation of activities which aim to improve the data and the existing e-services, and implementation of the new ones, in accordance with requirements; implementation of the system for using e-services for the electronic filing of applications by notaries public; improving the quality of the digital cadastral plan by providing new updated data; implementation of the Law on Spatial Data Infrastructure – harmonization of the spatial data that falls within the competence of the Real Estate Administration and provision of e-services and metadata for data and services.
- Activities planned in 2020: Implementation of new e-services related to the new registers which use cadastral records as their basis (e.g. the address register and the utility line cadastre); implementation of the Law on Spatial Data Infrastructure that falls within the competence of the Real Estate Administration – establishment of e-services in accordance with the Law.

The institution responsible for implementation of the measure is the Ministry of Finance.

Expected impact of the measure on competitiveness: It will expedite procedures for the registration of immovable property which will lead to an improvement in the quality of records, and increase the efficiency and transparency in using data and services, thus meeting the needs of notaries public, lawyers, banks and the private and public sectors. It has a direct impact on a reduction of the scope of administrative procedures and of the burden on citizens and companies in the procedure for issuing and accepting electronically signed documents, which strengthens the business environment, improves

Montenegro's competitiveness and has a positive impact on reporting on the implemented activities, the Global Competitiveness Report and the Doing Business Report. A positive impact of this measure is also detailed in the 2016 report on implementation of the Land Administration Project (LAMP) financed from a World Bank loan, which deals with expediting the registration of immovable property, reducing the number of open cases, implementation of projects involving establishment of an immovable property cadastral register and modernization of the information system.

Estimated cost of the measure/activity and the budgetary impact: Implementation of this measure is funded exclusively from the budget of Montenegro. The total costs of maintenance and establishment of e-services are estimated at around 300,000 euro and include the costs of licensing and establishing e-services for new registers (e.g. the address register) which, together with cadastral data, has a considerable positive impact on the business environment. An Activity Plan has been prepared, along with a work assignment for the planned activities.

Expected impact on employment and gender equality: The maintenance of current e-services and development of new ones may have an impact on the employment of new staff. Use of e-services has a positive impact on respect for gender equality as a result of having access to the data relevant for transactions, taking out loans, registration of mortgages and other data, which increases the security of operations and creates equal conditions for all interested parties.

Potential risks: A lack of funding and staff, but given its relevance, the expectations are positive. Positive effects from this measure will lead to good results provided that there is an obligation to use e-services in order for electronically signed OCs/TDs to be aacepted by notaries public and public institutions.

Priority Reform Measure 11: Adopting the Law on Issuing Electronic Fiscal Invoices and implementing electronic fiscal invoices system

Description of the measure: Implementation of this measure began in 2017, but the majority of activities were extended until 2018 (see Table 11 in the Annex). The issuing of electronic fiscal invoices is a new business model in which the invoice issuing procedure is based on the electronic submission of data on the issued invoice to the tax authority in real time, while the tax authority also sends a reply and submits a certificate on the received data in real time. A database on all the transactions involving the trade in goods and services has been created and is able to cover all cash and non-cash transactions with minimal costs. In that regard, the Law on Issuing Electronic Fiscal Invoices is planned to be prepared and adopted in 2018, along with amendments to the other laws which would result from the adoption of this law. Data would be exchanged between a taxpayer and the Tax Administration based on an electronic signature assigned to the taxpayer by the Tax Administration, which makes it possible to resolve issues of safekeeping and archiving documents. The project of issuing electronic fiscal invoices requires the adoption of and amendments to the legislation and an IT solution for data transfer and processing.

Timetable for implementation of the measure:

- Activities planned in 2018: Drafting of the Law on Issuing Electronic Fiscal Invoices will be open for public consultation and its adoption can realistically be expected in 2018. Launching the tender process and procurement of the necessary hardware for implementation of the system, development of the necessary software.
- Activities planned in 2019: Procurement of the necessary hardware for implementation of the system, development of the necessary software. Testing the system for issuing electronic fiscal invoices and its gradual putting into operation, as well as the introduction of the data submission process by sectors.
- Activities planned in 2020: Full implementation of the system for issuing electronic fiscal invoices and use of this system by all sectors.

The institution responsible for implementation of the measure is the Ministry of Finance.

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

Estimated cost of the measure/activity and the budgetary impact: The estimated total cost of implementation of the system for issuing electronic fiscal invoices is: 1 million euro for the procurement of the required hardware and 1 million euro for development of the necessary software and consulting services. The project is to be financed from budgetary funds. Based on the comparative experience of the Republic of Croatia, a budgetary inflow of over 30 million euro is expected following the partial operationalization of the system (after 2019), and revenue is expected to rise further once the system becomes fully operational.

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

Potential risks: The slow speed of the tender processes and of system testing are potential risks of implementation of the measure. Apart of that, the implementation risk is also disagreement of businesses owners to implement the measure what will be solved trough the appropriate promotion and inspection surveillance.

Priority Reform Measure 12: Improving financial support for the sector of small and medium-sized enterprises

Description of the measure: Support to allow SMEs to access finances is a measure specified in the national strategic documents (Development Directions 2018–2021, the Strategic Guidelines for SME Development 2018–2021), and in the Small Business Act (SBA) recommendations. This measure is in response to Recommendation No. 5 (to continue the strengthening of financial and non-financial support services to small and medium-sized enterprises), given at the Ministerial Meeting held in May 2017. Recommendation regarded the necessity of Improving financial and non-financial support for the sector of small and medium-sized enterprises was also given by representatives of Federation of Trade Unions of Montenegro aiming at providing preconditions for greater employment (see Annex).

Despite the fact that access to loans from one year to the next has been facilitated, there are still barriers for specific categories like young people, women, technological surplus, people who have been laid off, people on the register of the Employment Office and farmers. In this regard, in the coming period the IDF[38] will intensify activities that will additionally encourage entrepreneurship, and improve the current financial instruments and introduce new ones so that the absorption of financial resources might satisfy different categories of beneficiaries. The financial offer will continue to strive to provide benefits with regard to zero-interest lending for special target groups, as well as favourable interest rates in view of further improvement for SME sector operations, and also to implement entrepreneurship education programmes aimed at easier access to financial support. Especially for 2018, activities are planned to establish a Guarantee Fund and microcredit within the IDF in line with the Law Amending the Law on the IDF. The activities will be undertaken with a view to facilitate interaction between SMEs and financial institutions, through the issuing of loan guarantees for the purpose of overcoming the key problem that SMEs are faced with, i.e. difficulty in mobilizing the collateral required by financial institutions.

The Loan Guarantee Facility financial instrument within COSME will continue, while activities will intensify on promoting the instrument of investing in equity for innovative enterprises within the WB EDIF programme[39] – ENIF Fund (Enterprise Innovation Fund)[40]. The grant model of support for clusters will be implemented on a larger scale in comparison to the previous period due to the increased interest from the clusters themselves and benefits they have based on associating (in 2017, support was

[38] The Investment Development Fund of Montenegro AD-IRFCG, a financial institution under the majority ownership of the state, established with the aim of encouraging and accelerating Montenegro's economic development.
[39] Western Balkans Enterprise Development and Innovation Facility.
[40] The IDF accessed the ENIF – Enterprise Innovation Fund in the capacity of a partner and investor in April 2016.

contracted for 7 clusters amounting to 0,098 million euro, of which 60 percent is related to the clusters from the north, where 5 clusters have carried out planned project and received payment of 0.0647 million euro). With the aim of harmonising with the international business standards a grant support was planned (contracted support for 42 SMEs in the amount of 0.070 million euro in 2017 and subsidy was implemented in the amount of 0.0554 million euro for 34 business entities who have carried out planned activities). Grant support is planned for improving SMEs innovations.

Timetable for implementation of the measure:

- Activities planned in 2018: Adjustment of the financial offer to different target groups in terms of creating special financial instruments and procedures that facilitate lending (establishment of a Guarantee Fund), implementation of a factoring facility; grant support for the establishment of new clusters and improvement of the operations of clusters; and for harmonization with international SME business standards and improving innovation; full implementation of the Loan Guarantee Facility for SMEs through COSME; promotion of the financial instrument – equity investments through the WB EDIF–ENIF Fund – Enterprise Innovation Fund.
- Activities planned in 2019: Improvement of the financial offer through the instruments of loans, factoring, guarantees, microloans and grants; signing new agreements for the COSME guarantee facility by new financial intermediaries; use of equity instruments within the WB EDIF–ENIF Fund.
- Activities planned in 2020: Continuation of the implementation of financial instruments from 2019 and creation of new ones.

The institutions responsible for the implementation of the measure: Ministry of Economy, Investment Development Fund, OTP CKB Bank.

Expected impact on the measure on competitiveness: Ensuring favourable lending conditions and greater scale of support (439 projects supported in the amount of 175.6 million euro in 2017 by IDF) will contribute to the establishment of new enterprises and growth of employment, (8,469 jobs opened/preserved in 2017) and more dynamic and balanced regional development. Establishment of new enterprises and higher productivity of existing SMEs will contribute to the participation in gross value added (GVA), export and global value chains. This measure will ensure a better ranking as regards the Ease of Access to Loans indicator (WEF indicators) and the Getting Credit indicator (Doing Business).

Estimated cost of the measure/activity and the budgetary impact: For implementation of the measure, a total of 140,350,000 million euro will be provided, out of which 140,000,000 million euro will be provided from the loan funds from international sources, loan repayment and fees for loan placements, while 350,000 euro will be provided from the government budget for grants for 2018. A minimum of the same amount of funds is planned for the period 2019–2020.

Expected impact on employment and gender equality: The measure has a direct impact on employment and the preservation of jobs, with special emphasis on the employment of young people and women in business, and stimulating measures for the north and underdeveloped municipalities.

Potential risks: Insufficient demand and insufficient willingness to take start-up business risks, a demanding procedure for taking loans, lack of collateral, insufficient willingness of financial intermediaries to withdraw funds from the EU programmes, an insufficient level of information required for implementation of the financial equity investments instruments.

Priority Reform Measure 13: Improving non-financial support to the sector of small and medium-sized enterprises

Description of the measure: The improvement of non-financial support for the sector of small and medium-sized entrepreneurs comes through the implementation of the measures and activities specified in the strategic documents of the Government of Montenegro (Montenegro Development Directions 2018-2021 and Strategic Guidelines for SME Development 2018–2021) and the EU Small

Business Act recommendations. The implementation of measures in the subject reform area is directly related to Recommendation No. 5 given to Montenegro at the Ministerial Meeting held in May 2017 (to continue strengthening of financial and non-financial support services to small and medium-sized enterprises). In the sector of small and medium-sized enterprises, especially for beginners in business, problems are evident with regard to insufficient capacities for the establishment of enterprises and financial literacy, as well as the potential for enterprises to expand their operations to foreign markets and establish business connections. Taking into account the aforementioned, the non-financial support system improves the readiness for financing and investing in SMEs, with special emphasis on potential entrepreneurs, as well as the conditions for export, internationalization and participation in broader business networks.

Timetable for implementation of the measure:

- Activities planned in 2018: Implementation of the Financial Literacy and Investment Readiness and Mentoring Programmes; updating of the online database of business counselling service providers (consulting services); implementation of activities in the area of SME internationalization and provision of services within the EEN (business counselling services, organizing business meetings and trainings); strengthening cluster capacities, their managerial capabilities and marketing activities.
- Activities planned in 2019: Implementation of the Financial Literacy and Investment Readiness and Mentoring Programmes; continuous implementation of activities in the area of SME internationalization; continuous support for the improvement of cluster operations and establishment of new ones.
- Activities planned in 2020: Implementation of the Financial Literacy and Investment Readiness and Mentoring Programmes, as well as the creation of new support programmes; continuous implementation of activities in the area of SME internationalization; continuous support for the improvement of cluster operations and establishment of new ones.

The institutions responsible for implementation of the measure are the Ministry of Economy.

Expected impact of the measure on competitiveness: This measure will contribute to the opening up of new business entities, an increased survival rate of newly established enterprises, the development and improvement of SME productivity, strengthening innovative activities, the improvement in the export performance of enterprises, which will be reflected in a growth in exports and participation in global value chains.

Estimated cost of the measure/activity and the budgetary impact: In 2018, 176,309.85 euro will be provided from the budget for improvement of non-financial support to the SME sector. Additional funds will be provided from EU sources in the amount of 139,642.75 euro. At least the same amount of funds is planned for the period 2019-2020.

Expected impact on employment and gender equality: An improvement of non-financial support will lead to the establishment of new enterprises/entrepreneurs, which will directly cause a rise in the number of SMEs, the scope of production and services, employment and improvement of the SME sector. Implementation of support in the development of business plans, training and mentoring will improve the readiness of young people and women for self-employment in all regions.

Potential risks: For the purpose of potential risks related to insufficient interest in training and support services, the intensive promoting activities and the evaluation of realized programmes will be undertaken and its' improvement.

Priority Reform Measure 14: Introducing a single information system in the area of planning and building construction

Description of the measure: Improvement of the process of spatial planning and construction of buildings will be achieved through the introduction of a single IT system that will integrate all spatial information (the IT system will link all the authorities at the central government and local government levels and the institutions that are involved in the process of spatial planning and building construction) The establishment of a spatial database will facilitate spatial investments, as well as the construction of utility, energy, transport and other infrastructure. This system should eliminate the paper drafting of planning and engineering documentation, which is huge and voluminous. This is directly related to cost savings, the improvement of efficiency and the enhancement of procedures. All the envisaged activities are in line with the government's plans for establishment of e-governance, i.e. electronic business in day-to-day communication. The implementation of this measure increases transparency, improves the quality of living, increases economic growth, improves interaction between differentstakeholders in society (at the central government and local levels), increases the productivity and efficiency of the central government and local government authorities, institutions and agencies, improves the accessibility of public services, for all the participants in the process of spatial planning and construction of buildings.

Envisaged timetable for implementation of the measure:

- Activities planned in 2018: Description of existing IT systems, proposed design of the future IT system and implementation of tender procedures.
- Activities planned in 2019: Continuation of the activities not completed in 2018.
- Activities planned in 2020: Phase of full implementation of the system.

The institution responsible for implementation of the measure is the Ministry of Sustainable Development and Tourism.

Expected impact on competitiveness of the measure: This IT system will improve the procedures for the issuing of building permits (building permit indicator) in line with the procedures of the World Bank and lead to a better ranking in the Doing Business list. The system will facilitate greater participation of the public through greater transparency in the procedures related to spatial planning and construction, greater efficiency of institutions through faster exchange of information and a better business environment for investors through the reduction of the number of procedures, the time taken to issue the required documentation, and the like.

Estimated cost of the measure/activity and the budgetary impact: The funds required for the mentioned measure have been requested from the Budget, amounting to 450,000 euro for 2018. For the continuation of the activities on upgrading of the IT system and its maintenance in 2019 and 2020, the amounts planned from the budget are 200,000 euro for each year. These funds will be used to finance software procurement, development of IT system components and the training of users.

Expected impact on employment and gender equality: This measure improves the conditions for the development of entrepreneurship and thus contributes to the creation of new jobs. Its implementation leads to increased competitiveness, increases productivity, efficiency and improves the accessibility of public services to citizens.

Potential risks: One of potential risks is a potential delay in implementation of the mentioned IT system due to the large number of users.

4.3.5 Research, development and innovations (RDI) and the digital economy

Analysis of main obstacles: The development of broadband services today significantly affects the development of many economy sectors and of society as a whole. The building of an adequate infrastructure for fast and safe internet is a prerequisite of a digital era in which economic growth can be counted on only by countries that have ensured an infrastructure for the fast transferral of data via the internet.

On the other hand, there are a relatively small number of enterprises whose activities are based on innovation, knowledge and modern technology. Cooperation with enterprises with scientific research (SR) institutions should be intensified, demand increased for consulting services, the innovativeness of goods and services, and business procedures, while the organization and marketing should be improved.

The incentive-giving measures of fiscal and customs policy are also insufficient for the sector of research and development (R&D). Based on the latest official statistical data for the area of R&D for 2015, the total national consumption amounted to 0.38 percent of GDP. Nearly half of the R&D activities (47 percent) were carried out in the sector of higher education, then 30 percent in the business sector, therefore it is necessary to focus on giving incentives to R&D investment, particularly by the private sector.

Report on Implementation of Policy Guidelines of May 2017: The recommendation given at the Ministerial Meeting held in May 2017 related to the area of the digital economy is linked to the harmonization of the national regulation with Directive 2014/61 on measures to reduce the cost of deploying high-speed electronic communications networks. Also, the recommendation from the Ministerial Meeting held in May 2017 regarding this reform area relates to the strengthening of financial and non-financial services for SME support. Therefore, the establishment of a Science Technology Park (STP) in Podgorica which will have space for 40–50 micro, small and medium-sized enterprises from the area of high technology is particularly significant. The STP will provide conditions for easier cooperation of SR institutions and enterprises, as well as the potential for financial and other support for SMEs, especially support for start-ups. The Strategy for Innovation Activity with the Action Plan (2016–2020) prioritizes this measure in the context of the strategic objective "Increase in capacities for innovations and technological development", while other key documents for implementation of this measure are: the 2011 Feasibility Study for Establishment of an STP in Montenegro (2012–2018) and the 2012 Strategic Plan for Establishment of an STP in Montenegro (2013–2018). The specific measures as a response to the obstacles in this area are given below.

Priority Reform Measure 15: Establishing a Science and Technology Park (STP) in Podgorica

Description of the measure: The measure has been carried forward from the previous year, but the activities for 2017 were not undertaken according to the envisaged timetable, due to problems that arose with regard to provision of the previously planned facility for the STP's location, so in the middle of the year another facility was provided. The development of the Terms of Reference for the Conceptual Design is on-going and after its finalization a Tender for Conceptual Design will be published.

The basic objective of the STP is to integrate entrepreneurship, innovative, scientific and economic capacities and establish a strong connection with local and regional business centres, incubators and clusters. Its establishment is envisaged in the following documents in the area of science and innovations: the 2011 Feasibility Study for Establishment of an STP in Montenegro (2012–2018), the 2012 Strategic Plan for Establishment of an STP in Montenegro (2013–2018), and the Innovation Business Activities Strategy (2016–2020). The recommendation from the EC Report from May 2017 regarding this reform measure relates to the strengthening of financial and non-financial services for SME support. The measure is also related to the proposed reform measures in this document regarding financial and non-financial SME support. In this context, the establishing of this form of infrastructure that will have space for 40–50 micro and SMEs from the area of high technology with a focus on ICT, energy, agriculture and medicine, which will be located on the campus of the University of Montenegro (UMNE), represents a significant step. In addition to SMEs, the foreseen users of STP services would be all Montenegrin universities, scientific research (SR) institutions and higher education (HE) institutions.

Envisaged timetable for implementation of the measure:

- Activities planned in 2018: Selection of the Conceptual Design for reconstruction and adaptation of the STP facility (March 2018); the tender for development of the Detailed Design will be published in April 2018; approval of the IPA 2018 Action Document for the Sector of Competitiveness and Innovations, for which the Ministry of Science has proposed the procurement of equipment and training of STP staff, is anticipated.
- Activities planned in 2019: Implementation of the tender for the selection of the most favourable bidder for the performance of works for the reconstruction and adaptation of

the STP facility; signing a contract with the most favourable bidder; and the commencement of works.

- Activities planned in 2020: Carrying out the works.

The institutions responsible for implementation of the measure are the Ministry of Science and the Directorate of Public Works.

Expected impact on competitiveness of the measure: In the Podgorica STP opportunities will be created for: implementation of development research; the commercialization and placement in the market of final goods or services; increase in employment and the competitiveness of the economy; and dynamic development of the state of Montenegro. Taking into account that in the mentioned period 2018–2020 the establishment of infrastructure is planned, the impact on competitiveness will become clear in the long term, i.e. after this infrastructure commences operating at full capacity. In this sense, in the period after 2020, the relevant indicator will be related to the WB's Doing Business survey and the positioning of the country based on the Innovation Index (WIPO).

Estimated cost of the measure/activity and the budgetary impact: In 2018, the Ministry of Science will allocate 20,000 euro for the development of the Conceptual Design, which will be finalized in March. The funds for financing the development of the Detailed Design are provided from the World Bank loan of 130,000 euro. As regards construction and reconstruction of the facility in 2019 and 2020, the funds for these purposes will be provided from the Capital Budget, amounting to 6 million euro. The completion of works on the construction is expected in 2021, and the required funds will also be provided from the Capital Budget (2.2 million euro). The programming process for the IPA 2018 Action Document for the Sector of Competitiveness and Innovations, for which the Ministry of Science has proposed the procurement of equipment and training of STP staff, is on-going, so at this point it is not possible to specify the amount of funds that will be approved for these purposes.

Expected impact on employment and gender equality: Implementation of the measure will have a positive impact whereby 15 people will be employed in the STP in the period 2019–2020, while the STP's activities will additionally lead to the creation of new SMEs that will increase the level of employment, particularly of young people, through the establishment of start-ups.

Potential risks: A delay to the tender procedures for selection of the most favourable bidder for performance of works for reconstruction and adaptation of the STP facility (due to the time taken for proceedings in respect of potential appeals) and a delay to construction works on the STP facility.

Priority Reform Measure 16: Improvement of the legislative and regulatory framework with aim to reduce the costs of deploying high-speed electronic communications networks

Description of the measure: Development of broadband access is a precondition for the development of the digital economy's potential in Montenegro. In the conclusions from the Ministerial Meeting held in May 2017 a recommendation was given to harmonize national regulations with EU Directive 2014/61 on measures to reduce the cost of deploying high-speed electronic communications networks. The Law on Access to and Deployment of High-Speed Communication Networks, based on EU Directive 2014/61, is in the process of development. The objective of adoption of this law is the joint use of infrastructure, coordinated construction work, a reduction of costs, facilitating and encouraging high-speed electronic communication networks for potential investors, for the purpose of increasing competitiveness in the market of electronic communications, in order to accelerate the achievement of the goals set in the 2020 Information Society Development Strategy and the Digital Agenda for Europe to 2020.

The adoption of this law will facilitate the deployment of high-speed networks on the entire territory of Montenegro, it will reduce the building costs for the deployment of high-speed networks through integrated and coordinated access.

Also, it is expected that use of the existing physical infrastructure of network operators will significantly improve, while the spatial information system will ensure good coordination and the efficient performance of building works on the existing physical infrastructure.

This law should reduce the cost and environmental impact, increase transparency, competitiveness and the quality of services in the electronic communications market. In addition, it should support the digitalization of the public sector and provision of more efficient digital services to citizens. Therefore, measures are required to encourage, speed up, facilitate and reduce the cost of deploying high-speed electronic communications networks. For the purpose of encouraging the building of networks for broadband access in regions where commercial interest for investments is absent, it is necessary to carry out a detailed analysis of the broadband access market and the existing regulatory framework, in order to assess the potential of the market to eliminate the existing gap in the infrastructure, identify areas without broadband access availability, i.e. the zone of potentially unsuccessful market operation, map the infrastructure that is under private and public ownership, consider potential action by the state through incentive-giving measures or the use of other tools of government intervention.

Envisaged timetable for implementation of the measure:

- Activities planned in 2018: Work on harmonizing the Law on Access to and Deployment High-Speed Electronic Communications Networks with the new Law on Spatial Planning and Building Construction.
- Activities planned in 2019: Development of an analysis of the market for broadband access and the existing regulatory framework.
- Activities planned in 2020: Establishing the proposed law by the Government of Montenegro.

The institution responsible for implementation of the measure is the Ministry of Economy.

Note: The beginning of application of this law is envisaged for 1 January 2021, for the reason that the Law on Spatial Planning and Building Construction stipulates that the contents and method of maintaining the documentation database and information system, and the indicators for monitoring implementation of the planning documentation are to be prescribed by the Government of Montenegro. The Government of Montenegro adopted the *Decree on the contents and method of maintaining the documentation database and information system and indicators for monitoring of planning documentation implementation*, which envisages that the documentation base and information system will be established within three years of this Decree entering into force. Thus, this law cannot be applied until the information system has been established, for the reason that the spatial information system is the basis for its implementation.

Expected impact of the measure on competitiveness: Development of competition in this area is an important factor in raising the level of coverage and quality of broadband access to the internet, given that broadband development represents a precondition for further development of a digital economy in Montenegro. Broadband access opens the way to the development of entirely new industries and also improvement of the existing ones, then to attracting foreign investors, as well as the creation of new jobs. A reduction of the digital gap and an increase in competitiveness in the electronic communications market are some of the key tasks in this area.

Estimated cost of the measure/activity and the budgetary impact: Implementation of the measure does not directly affect the budget of Montenegro.

Expected impact on employment and gender equality: The Brookings Institution has identified a positive link between the use of broadband access and employment in several different industries. Broadband access opens the way to the development of entirely new industries and also the improvement of existing ones, then to attracting foreign investors, as well as the creation of new jobs. In addition, broadband access reduces the digital gap and facilitates flexible work engagements like working from home, which can particularly be supportive of the participation of women in the labour market. An increase in broadband access indirectly leads to an increase in the number of employees.

Potential risks: This measure depends on the application of the Law on Spatial Planning and Building Construction and establishment of the spatial information system, given that the spatial information system will be established only in 2021.

4.3.6 Trade-related reforms

Analysis of main obstacles: In spite of the significant potentials for fostering exports and reducing the external economic imbalance, Montenegro is characterized by the existence of a narrow export base, i.e. a low level of export diversification, as well as a low level of value-added manufacturing. The structure of Montenegrin exports in the last 10 years has substantially changed in favour of exports of services, which increased to over 70 percent of total exports in 2016. In that sense, in addition to strengthening the competitiveness of the exporting of services as the largest export category, it is very important for Montenegro to diversify the exporting of goods and increase export-oriented value-added manufacturing. Export of raw materials and semi-finished products instead of finished products has been identified as an obstacle to increasing competitiveness also by trade union representatives during the consultative process of drafting ERP (see annex). Representatives of trade union recommend intensification of activities related to branding domestic products and services from Montenegro.

It would, at the same time, contribute to a greater coverage of import by exporting goods and a reduction in the foreign trade deficit in goods.

The total foreign trade of Montenegro for the period January–November 2017, according to MONSTAT's preliminary data amounted to 2,407.3 million euro, which indicates a growth of 10.3 percent in comparison to the same period last year. Goods exports totalled 334.8 million euro, and imports were 2,072.5 million euro. In relation to the same period in the previous year, export wes 14percent higher, and import 9.7 percent higher. The coverage of imports by exports amounted to 16.2 percent and this is higher than during the same period in the previous year (15.6 percent). The largest foreign trade partners in exports were: Serbia, Bosnia and Herzegovina and Hong Kong, while the largest foreign trade partners in imports were: Serbia, China and Germany. The greatest foreign trade was achieved with CEFTA signatories and the European Union.

As a member of the World Trade Organization, Montenegro forms its trade policy in line with the rules of the international trading system, defined at the level of the World Trade Organization. The World Trade Organization's concept of trade facilitation was introduced by the multilateral Trade Facilitation Agreement that entered into force on 22 February 2017. The Agreement contains a set of measures focused on speeding up the movement, release and customs clearance of goods, including goods in transit. It envisages provisions for efficient cooperation between customs and other the authorities responsible for the cross-border movement of goods, as well as the provisions for technical assistance and capacity building for its full application. Montenegro submitted the ratification instrument to the World Trade Organization on 10th May 2016 and thus bound itself to full application of the Agreement in line with the notified schedule.

Taking into account the inter-sector nature of the Agreement, the pace of its implementation will depend on the level of availability of international donor support for the establishment of electronically tied complex systems (single-window systems), as well as a systemic, coordinated approach in monitoring and implementing the concept of trade facilitation at the national level. Also, Montenegro, as a member of the CEFTA 2006 determines its trade policy within the CEFTA legal framework aimed at eliminating obstacles to trade within the region of seven CEFTA signatory countries, as well as new areas not dealt with by bilateral agreements on free trade, such as trade in services, investments, public procurement, protection of intellectual property rights and arbitrage in case of disputes.

In line with the Multiannual Action Plan for a Regional Economic Area between the Western Balkans Six (MAP REA) which emphasizes the importance of promoting further trade integration for the countries of the region, Montenegro has defined planned priorities and activities in the area of trade policy, including further activities within CEFTA's Additional Protocol 5 which refers to trade facilitation.

Implementation of the mentioned activities is based on rules harmonized with the EU integration process, with the aim of facilitating the free flow of goods, services and high-qualified labour force, making the region more attractive for investments and trade, EU integration process and prosperity for all citizens.

The regional economic area is not an alternative to the EU accession process of Montenegro. Rather, the establishment of the regional economic area for the countries of the region is deemed a process complementary to EU membership. An above mentioned Action Plan implementation should accelerate the EU accession process of all economies in the region and support the national efforts ont the alignment and harmonisation with the EU rules and standards.

So, with a view to eliminating obstacles to international trade, Montenegro is implementing a range of prioritized reform measures as a member of the World Trade Organization and as a signatory to CEFTA.

In this regard, in 2018, as important reform measures Montenegro will adopt the Trade Facilitation Strategy and the Action Plan for its implementation for the purpose of ensuring full implementation of the World Trade Organization's Agreement on Trade Facilitation. Full implementation of the Agreement will contribute to decreasing trading costs, reducing clearance times at the border and improving the coordination and efficiency of state authorities responsible for the cross-border movement of goods. Also, an important component of this Agreement relates to the improvement and simplification of procedures for exporting and overcoming bottlenecks on the export side. Its implementation will assist developing countries and the least developed countries to diversify their exports, increase the competitiveness of small and medium-sized enterprises, further enhance the environment for attracting foreign direct investments, reduce the possibilities for corruption at borders and accordingly improve the system of revenue collection.

In addition to the reform measures directed at full application of the WTO Agreement on Trade Facilitation, in 2018 Montenegro will focus on implementation of the Law on the Ratification of Additional Protocol 5 to CEFTA, which is also aimed at facilitating trade in the CEFTA free-trade zone. Also, in 2018 the accent will be on finalizing negotiations within Additional Protocol 6 and commencement of negotiations concerning CEFTA Additional Protocol 7, which ensures the timely implementation of the activities within the Multiannual Action Plan for a Regional Economic Area in the Western Balkans Six.

Report on Implementation of Policy Guidelines of May 2017: There were not specific recommendations for this are from the Ministerial meeting of May 2017.

Priority Reform Measure 17: Implementing CEFTA Additional Protocol 5 and adopting CEFTA Additional Protocol 6

Description of the measure: In line with the Multiannual Action Plan for a Regional Economic Area in the Western Balkans Six (MAP REA), adopted in Trieste on 12 July 2017, which points out the importance of promoting further trade integration for the countries of the region, Montenegro specified its planned priorities and activities in the area of trade policy. The activities envisaged in the first part of the MAP – Trade – mostly originating from CEFTA Additional Protocol 5 on trade facilitation and CEFTA Additional Protocol 6 on liberalization of the trade in services.

At the CEFTA Ministerial Meeting held on 26 May in Belgrade, CEFTA Additional Protocol 5 was adopted. The primary objective of the Protocol is harmonization and simplification of the export and import procedure, reduction of the time taken for the release of goods at the border, which are some of the key problems identified by the business community. Implementation of the Protocol implies the tying of the customs and inspection services of the countries of the region into a single IT system that will lead to a simplification of border procedures, increased transparency and reduced transaction costs, which will result in the increased competitiveness of Montenegrin enterprises and the national economy as a whole. The Parliament of Montenegro ratified the CEFTA Additional Protocol 5 in December 2017.

Based on the structure of the Montenegrin economy from 2006 to 2014, as well as the projection for the period 2015–2018, it can be concluded that the Montenegrin economy is being restructured to shift to a service economy, which will make up almost 80 percent of the gross value added at the end of the period. Recognizing the significance of the trade in services, Montenegro took part in the negotiations within CEFTA regarding Additional Protocol 6. This protocol involves the mutual opening up of the service market, which will expand the liberalization achieved in the trade in goods to include the services that make up most of the trade in the region. The sector of services is playing an increasing role in the economies and trade of all CEFTA parties, with great potential for intra-regional trade in services.

Montenegro's position is based on the obligations undertaken within the World Trade Organization (WTO), economic interests from the aspect of the structure of the Montenegrin economy and obligations undertaken through the Stabilization and Association Agreement (SAA). Following the analysis of the previous 10-yearimplementation of CEFTA Agreement, one of the flaws of the Agreement is deemed to be inadequate determination of the procedures for settlement of bilateral trade disputes in the CEFTA region. Namely, articles 42 and 43 of the CEFTA Agreement fail to stipulate these procedures in a precise way. In this regard, within the CEFTA structure, it has been agreed that the mechanism for the settlement of bilateral trade disputes in the CEFTA region needs to be enhanced. In this way, trade will be additionally facilitated in the region, which will lead to growth in the regional competitiveness of the Montenegrin economy.

Envisaged timetable for implementation of the measure:

- Activities planned in 2018: After ratification in the Parliament of Montenegro in December 2017, in 2018 Montenegro will be conducting activities in relation to the implementation of the CEFTA Additional Protocol 5; Adoption of CEFTA additional Protocol 6, that has been agreed on tehnical level, is also expected. In addition, intensification of negotiation of the the CEFTA Additional Protocol 7 on dispute settlement is also expected.
- Activities planned in 2019: Ensuring the timely entering into force of the CEFTA Additional Protocol 6; establishment of a point of single contact for services.
- Activities planned in 2020: Adoption of the CEFTA Additional Protocol on Dispute Settlement; ensuring the timely entering into force of the CEFTA Additional Protocol on Dispute Settlement.

The institution responsible for implementation of the measure is the Ministry of Economy.

Expected impact of the measure on competitiveness: Trade facilitation through the CEFTA additional protocols will have a significant impact on eliminating trade barriers, and thus on the increased competitiveness of small and medium-sized enterprises on the international markets, which will lead to growth of the Montenegrin economy.

Estimated cost of the measure/activity and the budgetary impact: Implementation of the mentioned activities will have no impact on the budget. Taking into account the regional nature of activities originating from the CEFTA additional protocols it is expected that international sources of support will be ensured in the first quarter 2018

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

Potential risks: Bearing in mind the regional character of the measure and the fact that more countries are involved in the implementation process of the planned activities, the potential risk could be coordination and timely mobilisation of funds.

4.3.7 Education and skills

Analysis of main obstacles: For the purpose of providing a competitive labour force it is necessary to ensure continuous education from the earliest age. The coverage of preschool education will be expanded through the building of seven new preschool faclities, as described in the 2016 Economic Reform Programme. Also, the harmonization of higher education with the labour market's needs, as planned in the Montenegro Economic Reform Programme for 2017–2019, has been completed. The job-skills training programme for university graduates, which has been implemented for six years in a row, covers 14,252 users, of whom 6,856 (or about 48 percent) have continued with their work engagement.

Currently, the labour market is characterized by a mismatch of supply and demand, which is becoming more distinct with the growth of the number of unemployed university graduates. At the same time, the number of vocational high school students who continue their education is growing, therefore the development of qualifications in line with the needs of the labour market represents the key priority of future reforms. Also, educational curricula need to be modernized. The basis for successful vocational education is high-quality apprenticeships carried out in an actual work environment in cooperation with employers. The key obstacles in this area have been recognised by trade unions during the consultative process as a part of ERP 2018 development and their comments were significantly addressed trough proposed priority reform measures in this area.

Report on Implementation of Policy Guidelines of May 2017: This priority reform area is in response to the European Commission's Recommendation No. 6 related to improvement of the school-to-work transition process through on-the-job learning and promoting the appeal of vocational education. During the 2017/2018 school year, application of 10 modularized curricula commenced, which have been developed based on 29 occupational standards and 26 qualification standards, and 150 teachers have been trained. The activities towards the modernization of the curricula need to be continued, so during the 2020/2021 school year all educational curricula will be reviewed or new ones adopted in line with the established needs. For the purpose of reducing the trend of a decreasing interest in enrolling students in three-year curricula, the Ministry of Education, in cooperation with schools, has organized promotional activities in order to familiarize students and parents with the educational offer of vocational schools that enables faster employability.

Priority Reform Measure 18: Developing qualifications in line with the labour market needs

Description of the measure: One of the priority areas in the Vocational Education Development Strategy (2015–2020) is high-quality and efficient vocational education relevant for the labour market. This measure relies on learning-outcome-based qualification standards, which are developed in cooperation with employers and adjusted to the labour market needs. Therefore it is necessary to implement the modernization of education curricula for all levels of vocational education. Monitoring and external and internal evaluation of the existing curricula will be carried out continuously, including data on the careers of students who have finished vocational education, in order to evaluate their performance. During the 2017/2018 school year, the application of 10 modularized curricula commenced, which were developed based on 29 occupational standards and 26 qualification standards, and 150 teachers have been trained. The activities on modernization of the curricula need to be continued, so during the 2020/2021 school year all educational curricula will be reviewed or new ones adopted in line with the established needs. This measure is in response to the European Commission's Recommendation No. 6 related to the improvement of the school-to-work transition process through on-the-job learning and promoting the appeal of vocational education.

Envisaged timetable for implementation of the measure:

- Activities planned in 2018: Development of 15 educational curricula and a minimum of 250 teachers trained to implement the learning-outcome-based curricula.
- Activities planned in 2019: Development of 20 educational curricula and a minimum of 350 teachers trained for implementation of learning-outcome-based curricula.
- Activities planned in 2020: Completion of the modernization of all vocational education curricula.

The institution responsible for implementation of the measure is the Ministry of Education.

Expected impact of the measure on competitiveness: The qualifications developed, based on detailed analyses of the existing and future labour market needs and learning-outcome-based education curricula, which are implemented in cooperation with employers, will ensure a high-quality and faster response in education to the labour market needs. In this way, education will be better linked to the labour market, and this will contribute to overall increased productivity and greater employability of the labour force.

Estimated cost of the measure/activity and the budgetary impact: In 2018, the planned budget funds for implementation of the mentioned reform measure are 246,080 euro. In 2019 funds will be planned for implementation of the activities from the government budget totalling 270,000 euro and IPA grants of 650,000 euro, which will be spent in 2018 and 2019. In 2020, budget funds of 300,000 euro are planned.

Expected impact on employment and gender equality: A labour force with qualifications developed in cooperation with employers and with the skills demanded in the labour market will be facilitated to transition into work. Education programmes provide qualifications for different target groups (young people, adults and students with special educational needs), implying that the same opportunities are ensured for all.

Potential risks: Given the significant involvement of teachers in strategy development, the risk associated with implementation is limited. Based on the previous practice and experience, risks are not expected in the application.

Priority Reform Measure 19: Carrying out apprenticeships with employers

Description of the measure: The possibility of apprenticeships with employers (dual education) is envisaged by the law. High-quality apprenticeships will be provided in actual work environments. Employers are responsible for the organization and implementation of apprenticeships and verification of the achievements of students. Dual education is implemented in line with the subject curricula. The Ministry of Education, in cooperation with schools, has organized promotional activities with a view to familiarizing students and parents with the educational offer of high schools and the benefits related to employability. For the purpose of giving incentives to employers to become involved in the programme, the funds for fees for first- and second-year students are provided from the Budget (first year: a minimum of 10 percent of the average net wage; second year: a minimum of 15 percent), while the fees in the third year are the obligation of the employers (a minimum of 20 percent of the average net wage). In the coming period, due to the significance of professional informing and counselling, careers guidance will be improved with enhancement of the skills of the school teams responsible for it.

This measure is in response to the European Commission's Recommendation No. 6, related to improvement of the school-to-work transition process through on-the-job learning and promoting the appeal of vocational education.

Envisaged timetable for implementation of the measure:

- Activities planned in 2018: 258 students who signed individual education agreements in the 2017/2018 school year will be apprentices with employers.
- Activities planned in 2019: 250 students who will sign individual education agreements in the 2018/2019 school year will be apprentices with employers.
- Activities planned in 2020: It is estimated that the new generation of enrolled students who will be apprentices with employers in the 2019/2020 school year will number 300 students.

The institution responsible for the implementation of the measure is the Ministry of Education.

Expected impact of the measure on competitiveness: A labour force with qualifications developed in line with the expressed market demands and the skills developed at work guarantees better employability, which will contribute to the growth of employment, productivity and attractiveness to foreign investors.

Estimated cost of the measure/activity and the budgetary impact: Government budget funds of 250,000 euro for 2018, 300,000 euro for 2019 and 350,000 euro for 2020 are envisaged for the implementation of the reform measure.

Expected impact on employment and gender equality: The measure is aimed at facilitating the transition of young people into the labour market, reducing the risk of unemployment through linking theory and practice and facilitating students to build a system of applicable knowledge required for professional and personal development. The programme is available to all students, which ensures equal opportunities.

Potential risks: Maybe some time will be required for students and employers to recognize the full potential of dual education.

4.3.8 Employment and the labour market

Analysis of main obstacles: After the implementation of specific economic policy measures and reforms in the area of social and education policy, the labour market is recording positive shifts. The labour market has been showing signs of recovery in the first three quarters of 2017. The activity rate (56.4 percent) and the employment rate (48.0 percent) have been increasing continuously, while the unemployment rate (14.8 percent) has decreased. However, challenges remain with regard to the low activity rate and the employment rate. The low rate of labour force activity indicates still insufficiently used human potential whose inclusion in the labour market should contribute to economic growth. On the other hand, insufficient activity, mobility and motivation of the labour force are causing the significant employment of foreign labour which, together with informal labour, shows as-yet-insufficient flexibility in the labour market.

Report on Implementation of Recommendations of May 2017: In line with Recommendation No. 6, in the first nine months of 2017 about 2,000 unemployed people were included in the measures of active employment policy implemented by the Employment Office of Montenegro, as well as 700 disabled people through professional rehabilitation measures and activities. Also, 3,274 university graduates were included in the Programme of Job-Skills Training of University Graduates.

Priority Reform Measure 20: Implementing legal provisions in the field of the labour market with focus on active employment policy

Description of the measure: This is an administrative measure from the previous year and it represents the continuation of activities undertaken on the development of the new Labour Law and the Law on Employment Intermediation and Benefits during Unemployment, due to the prolongation of particular activities (for more details, see Table 11 in the Annex). The adoption of a new Labour Law should contribute to greater flexibility in the labour market, through recruiting employees in a fast, simple and efficient way and without a public announcement of vacancies, while for the purpose of achieving a more flexible layoff of employees, the procedure has been simplified for establishing the liability of employees in a much shorter, more efficient and economical procedure. Adoption of the new Law on Employment Intermediation and Benefits during Unemployment will create the conditions for greater flexibility with regard to active measures in the labour market and their adjustment to the current needs of the labour market, strengthening of the role of employment intermediation, as well as protection during periods of unemployment. At the same time, the active employment policy measures will financially help the long-term unemployed, young people and women for the purpose of their greater inclusion in the labour market, with a special focus on women who are the former recipients of benefits for giving birth to three or more children. Activities will be additionally carried out to activate those beneficiaries of social benefits (family cash benefits) who are able to work. In cooperation with the Investment Development Fund (IDF), activities will be focused on implementing the programme for incentivizing employment and entrepreneurship for the purpose of developing small, family businesses and supporting unemployed people to realize their business ideas.

Envisaged timetable for implementation of the measure:

- Activities planned in 2018: The development of enabling regulations will commence after the adoption of the legislative provisions. The measures of active employment policy (job-skills training for independent work, education and training of adults, apprenticeships with employers and public works) will be undertaken. Additionally, measures of professional rehabilitation and the employment of disabled people, as well as the activities to support self-employment will be carried out.
- Activities planned in 2019: Completion of activities on adopting enabling acts for the purpose of the full implementation of legislative provisions, with a special focus on implementing the measures of active employment policy and suppressing informal labour.
- Activities planned in 2020: Full implementation of the legislative provisions.

Expected impact of the measure on competitiveness: Implementation of this measure will have an impact on the competitiveness of the Montenegrin economy through the introduction of additional flexibility into the labour market and enhancement of the business environment. Generally, this reform measure should produce results in the medium term, in terms of contributing to the creation of new jobs that will, in turn, contribute to the growth of employment and entrepreneurship, and the formalization of informal labour.

Estimated cost of the measure/activity and the budgetary impact: It is estimated that the annual impact on the budget will be around 5.8 million euro, through an increase in employment and in revenues from labour-related taxes and contributions.

Expected impact on employment and gender equality: The expected impact of this measure is that on average 2,200 people will be employed annually, and around 3,500-4,000 unemployed people will be engaged in the measures of active employment policy.

Potential risks: Non-adoption of legislative provisions within the envisaged timeframe.

4.3.9 Social inclusion, reduction of poverty and equal opportunities

Analysis of main obstacles: One of the obstacles in the area of social and child care is the fact that services in the system of social and child care are hard to access. Improvements to social and child care are being carried out within the project "Reform of the Social and Child Care System: Improvement of Social Inclusion". Through the adoption of the 2013 Law on Social and Child Care and the introduction of the "IT System – Social Card", the number of recipients of family cash benefits was reduced by 50 percent, from the 14,737 families recorded in July 2013 to 7,374 families in July 2017. After the reforms in the area of social and child care in terms of new amendments in 2017 to the Law on Social and Child Care, particularly taking into account the reform related to the adoption of the Law on the Enforcement of the Decision of the Constitutional Court of Montenegro No. 6/16 of 19 April 2017 (Official Gazette of Montenegro 42/17) which terminates enforcement of the decisions on the right to benefits for giving birth to three or more children and a new right to benefits for former recipients of benefits for giving birth to three or more children depending on their age, implementation of reform activities according to the given recommendations are being continued. In the coming period special attention will be paid to activating the beneficiaries of family cash benefits.

As regards the pension system, its basic goal is to ensure the adequacy and sustainability of pension benefits. The Montenegrin pension system is in transition, due to the reform measures of 2011 which enable the gradual equalization of women and men in terms of the conditions for becoming entitled to pension benefits, including reaching the legally envisaged age limit of 67 (by 2025 for men and by 2041 for women). Although the results of this reform will be visible in the coming years, the results of the reform are partially neutralized due to the introduction of ad-hoc special retirement conditions in the previous years. The proportion of the total pension system financing made up of general revenues is still high and in 2016 general revenues amounted to around 30 percent of the total expenses of the Montenegro Pension and Disability Insurance Fund. Also, after the Constitutional Court pronounced the provisions of the Law on Social and Child Care related to benefits for mothers of three or more children unconstitutional, 4,761 former recipients of the benefits went back to receiving pension benefits. This increased the number of recipients of the pension and disability insurance benefits paid by the Pension Fund to 129,218, of which 123,002 are pension beneficiaries (data for October 2017). The dependency ratio (ratio of those insured to the number of pensioners) is 1.5:1.

Report on Implementation of Policy Guidelines of May 2017: In line with Recommendation No. 6 from the Ministerial Meeting held in Brussels for the purpose of ensuring the equitable distribution of social funds, in January 2017 the Law Amending the Law on Social and Child Care (Official Gazette of Montenegro 1/2017) was adopted, which resulted in a reduction of the benefits for mothers of three or more children, i.e. Priority Reform Measure 20: Implementation of the legal provisions from the social care area contained in the 2017 ERP was implemented.

In order to reduce the public expenditures related to pension benefits, the document Montenegro Fiscal Strategy 2017–2020, adopted by the Parliament in July 2017, envisages a review of the legal conditions that enable early retirement. It should reduce early leaving from the labour market and increase equality in the system. Future reforms in this area will be directed to preventing early leaving from the labour market and early retirement, at the same time ensuring the adequacy of pension benefits.

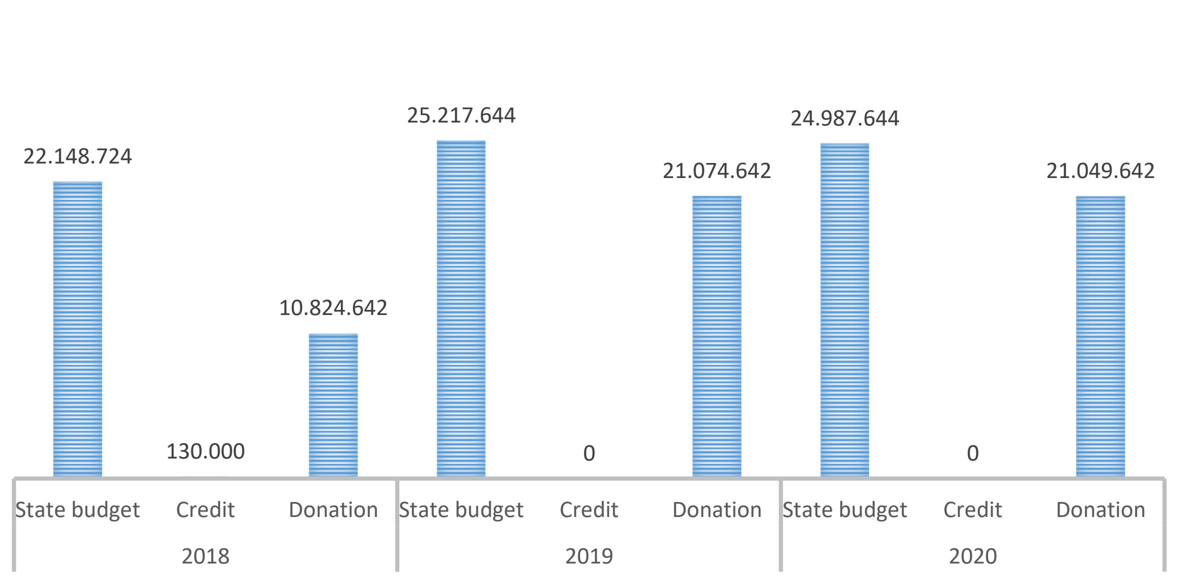
Based on the previously mentioned, there are several priority reform measures in this area. They are related to activities towards the greater social inclusion of disabled people, improvement of the conditions for professional rehabilitation and job-skills training of disabled people. In this direction, the establishment of the Centre for Professional Rehabilitation is expected. Activities will be implemented towards: resolving the housing issues of displaced and internally displaced persons, as well as those related to the constructing and furnishing of multipurpose facilities in the municipalities of Petnjica and Gusinje; adapting and opening a ward for people suffering from dementia within the Senior Citizens' Care Home in Bijelo Polje; the construction, reconstruction, adaptation and furnishing of day-care centres, reception centres, centres for social work, etc. Given that investment measures which in methodological terms cannot be a part of the ERP are dominant, they are not detailed in the document, but they will definitely be implemented in 2018.

5. BUDGETARY IMPLICATIONS OF STRUCTURAL REFORMS

In line with the European Commission's Guidance Notes, this chapter summarizes the direct effects of implementation of the priority structural reforms on the budgetary revenues and expenditures in 2018, as well as giving an indicative estimate of these effects in the implementation of the measures in 2018, 2019 and 2020. An overview of the direct fiscal impact of 20 reform measures is presented in Table 10 in the Annex to this document. Any impact which increases budgetary expenditure is marked with a minus sign (−) for each priority reform measure, and if the priority reform measure leads to an increase in revenues or has positive net effects then it is marked with a plus sign (+). On the basis of Table 10 of the Annex, which contains the direct fiscal implications for each of the 20 priority structural reforms, the following text presents the budgetary implications of the priority reform measures that are part of the 2018 ERP.

The costs of implementing priority reform measures and supporting activities are presented in Figure below.

Figure 5.1: Estimated costs of implementation of the priority reform measures for ERP 2018-2020 (in euros)

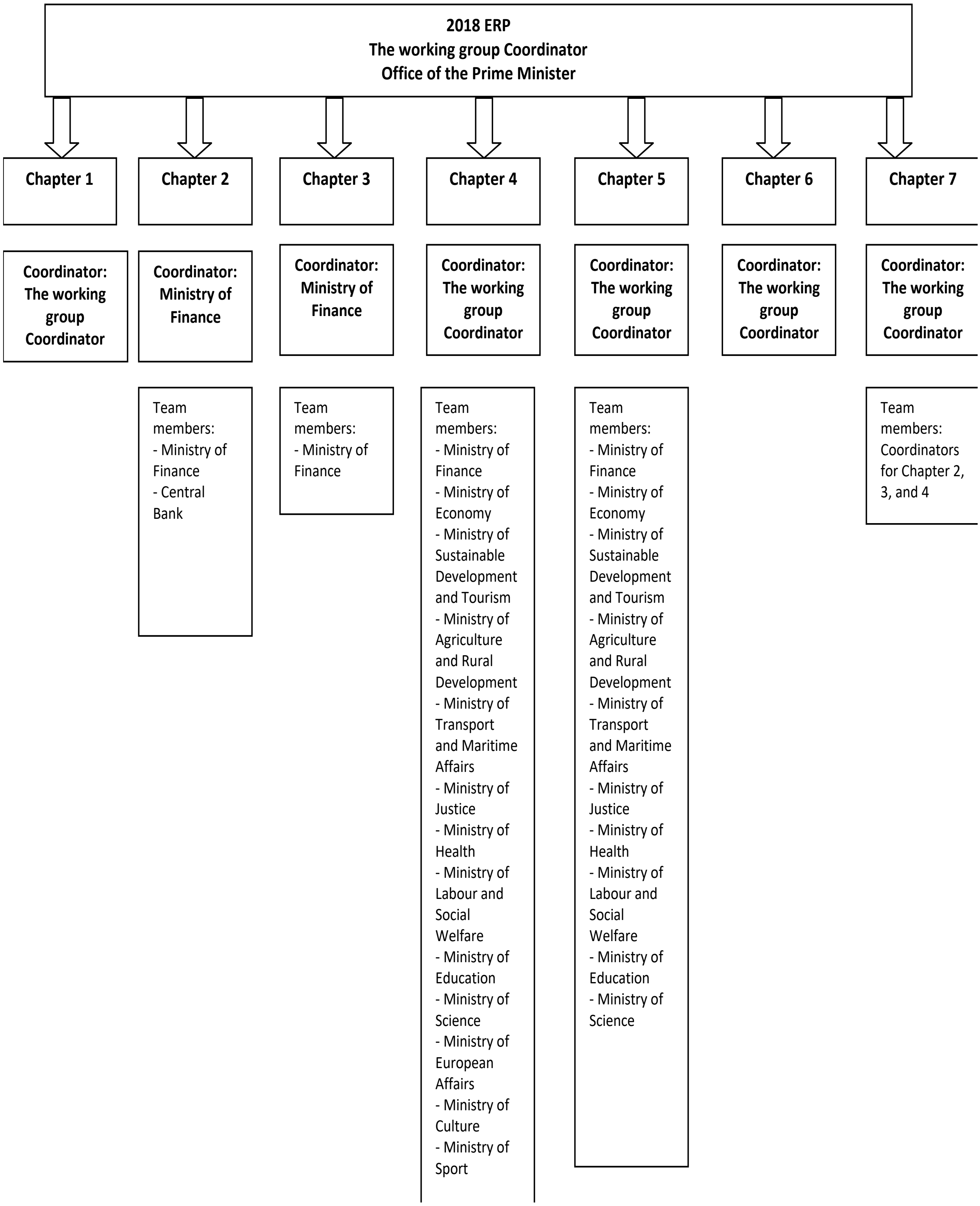


Reform measure No. 11, which pertains to adopting the Law on Issuing Electronic Fiscal Invoices and implementing an electronic fiscal invoice system, will have the most important effect on the revenue side of the budget, which is expected to be fully implemented in 2020. This measure will create the prerequisites for the significant collection of tax revenues by reducing grey-economy businesses (which is reflected in the failure to issue fiscal invoices). In addition to this measure, measure No. 10, introducing e-services into the work of cadastral offices, will also have a positive fiscal impact on the state budget during the entire three-year period of implementation of the measure, as follows: 80,000 euro in 2018, 150,000 euro in 2019 and 250,000 euro in 2020.

Based on all the above-stated, the net direct impact on the budget for implementation of the priority measures in 2018 will be −33,023million euro. Given the abovementioned revenues resulting from implementation of measure No. 11, the net direct effect on the budget of implementation of the priority measures in 2019 will be −46,142 million euro, while the net direct effect on the budget in 2020 will be -15,787 million euro (see Table 10 for more details).

6. INSTITUTIONAL ISSUES AND STAKEHOLDER INVOLVEMENT

The process of preparing Montenegro's Economic Reform Programme commenced with the government's adoption of the Decision on establishing the working group for preparation of the Economic Reform Programme (ERP) for the current year, and so the government adopted the Decision establishing the working group for preparation of the 2018 ERP on 31 August 2017. The diagram below shows the national coordination for the ERP and the coordination of the chapters and institutions that were represented in preparation of the 2018 ERP



Montenegro's Economic Reform Programme for 2018-2020 has been developed in joint consultation with the relevant ministries responsible for implementation of specific reform measures, those parts of the international community whose activities complement the subject programme, and also with the important stakeholders in the society, which were informed about the fact that the drafting process for the Economic Reform Programme was starting and were invited to submit their proposals for reforms that could, in their opinion, be part of the 2018-2020 ERP or which could contribute to the drafting of the 2018 ERP indirectly by taking part in the drafting of specific laws (like the Labour Law) via membership of working groups. Information on the commencement of the 2018 ERP drafting process was sent to representatives of trade unions, representatives of employers, universities, professional associations, and relevant non-governmental organizations. Proposals for the focus of reform measures in the 2018 ERP were received from the Chamber of Commerce of the Montenegro and the Trade Union Federation of Montenegro. Their proposals were focused on furthering incentives for improving the business environment, intensifying cooperation between the real sector and industry, improving the transport infrastructure and strengthening fiscal sustainability, which has all been taken into consideration during the drafting of the 2018 ERP.

In order to improve the text of the draft of Montenegro's Economic Reform Programme for 2018-2020, and in line with the European Commission's Guidance Notes, the Draft Programme was subject to a consultation process with stakeholders from 14 December 2017 to 5 January 2018. During the observed period, the Draft Programme was available to media representatives and broader public on the government's website at: http://www.gov.me/vijesti/179581/Nacrt-Programa-ekonomskih-reformi-za-Crnu-Goru-za-period-2018-2020-godina.html. Newspapers articles which contained comments to the draft document were published in local media outlets, like: ND Vijesti, Pobjeda, Dneven novine, etc; as well as at some web portals (ND Vijesti portal). A round table was also organised as part of the consultation process about the Draft Programme on 27 December 2017, in order to improve the text of the Programme (http://www.gov.me/vijesti/180091/Odrzan-okrugli-sto-o-PER-CG-2018-2020-fokusmakroekonomska-stabilnost-i-unapredenje-konkurentnosti.html); http://www.vijesti.me/vijesti/vukovic-prosjecna-stopa-realnog-rasta-bdp-crne-gore-od-2018-do-2020-iznosice-oko-28-odsto-969467. In addition to representatives of the Government, representatives of employers, non-governmental organisations, representatives of professional associations, representatives of trade unions, representatives of the University, as well as the broader public participated at the round table and provided their proposals for improving the 2018 ERP text. Proposals in writing to improve the draft ERP text were received from the Union of Free Trade Unions of Montenegro, Union of Employers of Montenegro, Montenegro Business Alliance, which are attached to this document.

Furthermore, the document was the subject of a discussion by the Parliamentary Committee on Economy, Finance and Budget, which was held on January 17th, 2018.

After all the proposals and suggestions were received during the consultation process, resulting in improvements to the 2018 ERP text, the document was finalized and submitted for procedural consideration and adoption at a session of the Government of Montenegro on 25 January 2018.

Annex:

7. SUMMARY DATA

Annex 1: Tables to be contained in the Pre-Accession Economic Programmes and their updates

Table 1a: Macroeconomic prospects

	ESA	2016 Level (€) million	2016	2017	2018	2019	2020
			Rate of change				
1. Real GDP at market prices	B1*g	3,762	2.9	4.0	3.0	2.7	2.6
2. GDP at market prices	B1*g	3,954	8.2	6.3	4.7	3.9	3.5
Component of real GDP							
3. Private consumption expenditure	P3	3,048	5.4	5.3	2.9	2.3	1.9
4. Government consumption expenditure	P3	0,707	0.8	2.1	−1.2	−0.5	−0.8
5. Gross fixed capital formation	P51	0,939	27.5	6.6	7.0	0.0	−1.5
6. Changes in inventories and net acquisition of valuables (% GDP)	P52+P53		938.6	−20.7	−0.5	−0.5	−0.5
7. Exports of goods and services	P6	1,634	6.2	7.0	4.0	2.6	3.0
8. Imports of goods and services	P7	2,547	15.0	6.6	3.6	0.1	−0.5
Contribution to real GDP growth							
9. Final domestic demand			10.0	6.0	3.6	1.7	1.0
10. Changes in inventories and net acquisition of valuables	P52+P53		−0.5	−0.6	0.0	0.0	0.0
11. External balance of goods/services	B11		−6.5	−1.3	−0.6	1.1	1.6

Table 1b: Price developments

		2016	2017	2018	2019	2020
1. GDP deflator	%, yoy	5.1	2.1	1.6	1.1	0.9
2. Private consumption deflator	%, yoy	−0.4	1.6	1.9	1.4	1.2
3. HICP	%, yoy	−1.3				
4. National CPI change	%, yoy	−1.1	2.1	0.1	−0.7	−0.4
5. Public consumption deflator	%, yoy	9.6	2.2	1.9	1.4	1.2
6. Investment deflator	%, yoy	−2.4	0.0	0.5	0.5	0.5
7. Export price deflator (goods and services)	% yoy	−2.1	3.4	1.8	1.8	1.9
8. Import price deflator (goods and services)	% yoy	−2.3	1.5	1.8	1.8	1.9

Table 1c: Labour market developments

	ESA	2016	2016	2017	2018	2019	2020
		Level	Rate of change				
1. Population (thousands)			622.4	622.9	623.3	623.8	624.4
2. Population (growth rate in %)			0.0	0.1	0.1	0.1	0.1
3. Working–age population (persons)[41]			267.5	268.3	269.1	269.9	270.7
4. Participation rate			63.8	155.8	155.0	154.1	153.2
5. Employment, persons [42]			219.3	222.6	224.2	225.1	225.8
6. Employment, hours worked[43]							
7. Employment (growth rate in %)			1.1	1.5	0.7	0.4	0.3
8. Public sector employment (persons)							
9. Public sector employment (growth in %)							
10. Unemployment rate [44]			47.7	46.8	46.2	45.9	45.6
11. Labour productivity, persons[45]		17.2	1.9	2.5	2.3	2.3	2.3
12. Labour productivity, hours worked[46]							
13. Compensations of employees	D1	1.8	4.9	4.6	3.0	2.7	2.6

Table 1d: Sector balances

% GDP	ESA	2016	2017	2018	2019	2020
1. Net lending/borrowing vis-à-vis the rest of the world	B.9	−18.1	−18.0	−18.0	−16.5	−14.5
of which:						
- Balance of goods and services		−22.5	−22.0	−22.0	−20.5	−18.5
- Balance of primary incomes and transfers		4.4	3.9	3.9	4.0	4.0
- Capital account		0.0	0.0	0.0	0.0	0.0
2. Net lending/borrowing of the private sector	B.9/ EDP B.9					
3. Net lending/borrowing of the general government		−3.6	−3.1	−1.6	0.1	5.4
4. Statistical discrepancy			optional	optional	optional	optional

Table 1e: GDP, investments and gross value added

	ESA	2016	2017	2018	2019	2020
GDP and investments						
GDP *level at current* market prices (in domestic currency)	B1g	3,625.6	3,729.5	3,928.5	4,176.9	4,357.8
Investment ratio (% GDP)		23.2	23.2	23.9	23.1	22.1
Growth of gross value added, percentage change at constant prices						
1. Agriculture		3.9	4.2	3.0	3.1	3.1
2. Industry (excluding construction)		−2.0	−0.2	5.4	5.4	3.8
3. Construction		32.0	28.1	10.0	3.3	3.1
4. Services		1.2	17.9	2.7	2.3	2.4

[41] Age group 15–64 years.
[42] Employed population, domestic concept of national account definition.
[43] National account definition.
[44] Harmonized definition with EUROSTAT; levels.
[45] Real GDP per person employed.
[46] Real GDP per hour worked.

Table 1f: External sector developments

€ millions, unless otherwise indicated	2016	2017	2018	2019	2020
1. Current account balance (% GDP)	−17.6	−18.5	−18.8	−17.4	−15.7
2. Export of goods	0.3	0.4	0.4	0.4	0.5
3. Import of goods	2.0	2.2	2.3	2.4	2.4
4. Trade balance	−1.7	−1.8	−1.9	−1.9	−2.0
5. Export of services	1.3	1.4	1.5	1.5	1.6
6. Import of services	0.5	0.5	0.5	0.5	0.5
7. Services balance	0.8	0.9	1.0	1.0	1.1
8. Net interest payments from abroad	0.1	0.0	0.0	0.0	0.0
9. Other net factor income from abroad	0.0	0.0	0.0	0.0	0.0
10. Current transfers	0.1	0.1	0.1	0.1	0.1
11. Of which from EU					
12. Current account balance	−0.7	−0.8	−0.8	−0.8	−.0.7
13. Capital and financial account	0.2				
14. Foreign direct investments	0.6				
15. International reserves	−0.1				
16. Foreign debt					
17. Of which: public					
18. Of which: foreign-currency denominated					
19. Of which: repayments due					
20. Exchange rate vis-à-vis euro (end of year)	1.0	1.0	1.0	1.0	1.0
21. Exchange rate vis-à-vis euro (annual average)	1.0	1.0	1.0	1.0	1.0
22. Net foreign savings (lines 21–25: % GDP)					
23. Domestic private saving					
24. Domestic private investment					
25. Domestic public saving					
26. Domestic public investment					

Table 1g: Sustainability indicators

	Dimension	2013	2014	2015	2016	2017
1. Current account balance	% GDP	−18.5	−14.5	−14.1	−17.6	−18.5
2. Net international investment position	% GDP					
3. Export market shares	% YOY					
4. Real effective exchange rate [47]	% YOY					
5. Nominal Unit Labour Costs	% YOY	−8.1	9.8	−8.6	−0.2	3.7
6. Private-sector credit flow	% GDP					
7. Private-sector debt	% GDP					
8. General government debt	% GDP			54.1	54.8	58.1

[47] Please explain the methodology used (deflators, trade weighting, etc).

Table 2a: General government budgetary prospects

	ESA	2016	2016	2017	2018	2019	2020
		Level	% GDP				
Net lending (B9) by subsectors							
1. General government	S13	−0.1	−3.6	−3.1	−1.6	0.1	5.4
2. Central government	S1311	−0.1	−3.4	−4.1	−2.6	−0.9	4.4
3. State government	S1312						
4. Local government	S1313	−0.2	1.0	1.0	1.0	1.0	1.0
5. Social security funds	S1314						
General government (S13)							
6. Total revenue	TR	1.7	42.6	42.6	44.2	44.2	43.9
7. Total expenditure[48]	TE	1.8	46.2	45.7	45.8	44.1	38.6
8. Net borrowing/lending	EDP.B9	−0.1	−3.6	−3.1	−1.6	0.1	5.4
9. Interest expenditure	EDP.D41	0.1	2.2	2.4	2.0	2.1	2.0
10. Primary balance[49]		0.0	−0.7	−0.8	0.5	2.2	7.4
11. One-off and other temporary measures[50]							
Components of revenues							
12. Total taxes (12 = 12a+12b+12c)		0.9	23.4	24.2	25.7	26.1	26.0
12a. Taxes on production and imports	D2	0.7	17.9	18.9	20.2	20.7	20.8
12b. Current taxes on income and wealth	D5	0.2	5.2	5.2	5.1	5.0	4.9
12c. Capital taxes	D91	0.0	0.3	0.4	0.4	0.4	0.3
13. Social contributions	D61	0.5	11.7	11.9	11.6	11.4	11.2
14. Property income	D4	0.1	2.0	2.0	2.1	2.0	2.0
15. Other (15 = 16−(12+13+14))[51]		0.2	5.5	4.7	4.8	4.7	4.7
16 = 6. Total revenue	TR	1.7	42.6	42.6	44.2	44.2	43.9
p.m.: Tax burden (D2+D5+D61+D91−D995)[52]							
Selected components of expenditures							
17. Collective consumption	P32						
18. Total social transfers	D62 + D63	0.6	14.1	13.4	12.6	12.1	11.9
18a. Social transfers in kind	P31 = D63						
18b. Social transfers other than in kind	D62	0.6	14.1	13.4	12.6	12.1	11.9
19 = 9. Interest expenditure	EDP.D41	0.1	2.2	2.4	2.0	2.1	2.0
20. Subsidies	D3	0.0	0.7	0.7	0.6	0.6	0.5
21. Gross fixed capital formation	P51	0.1	2.7	7.1	8.0	7.8	3.3

[48] Adjusted for the next flow of swap-related flows, so TR−TE = EDP.B9.
[49] The primary balance is calculated as (EDP.B9, item 8) plus (EDP D41 + FISIM recorded as intermediate consumption, item 9).
[50] A plus sign denotes deficit-reducing one-off measures
[51] P.11+P.12+P.131+D.39+D.7+D.9 (apart from D.91).
[52] Including those collected by the EU and including an adjustment for uncollected taxes and social contributions (D995), if appropriate.

22. Other (22 = 23−(17+18+19+20+21)[53]		1.0	26.6	22.1	22.6	21.5	20.9
23 = 7. Total expenditures	TE[54]	1.8	46.2	45.7	45.8	44.1	38.6
p.m. Compensation of public-sector employees	D1						

Table 2b: General government budgetary prospects

	ESA	2016	2017	2018	2019	2020
		€ billions				
Net lending (B9) by subsectors						
1. General government	S13	−0.1	−0.1	−0.1	0.0	0.3
2. Central government	S1311	0.1	−0.2	*0.1	0.0	0.2
3. State government	S1312					
4. Local government	S1313	0.0	0.0	0.0	0.0	0.0
5. Social security funds	S1314					
General government (S13)						
6. Total revenue	TR	1.7	1.8	1.9	2.0	2.1
7. Total expenditure[55]	TE	1.8	1.9	2.0	2.0	1.8
8. Net borrowing/lending	EDP.B9	−0.1	−0.1	−0.1	0.0	0.3
9. Interest expenditure	EDP.D41	0.1	0.1	0.1	0.1	0.1
10. Primary balance[56]		0.0	0.0	0.0	0.1	0.4
11. One-off and other temporary measures[57]						
Components of revenues						
12. Total taxes (12 = 12a+12b+12c)		0.9	1.0	1.1	1.2	1.2
12a. Taxes on production and imports	D2	0.7	0.8	0.9	0.9	1.0
12b. Current taxes on income and wealth	D5	0.2	0.2	0.2	0.2	0.2
12c. Capital taxes	D91	0.0	0.0	0.0	0.0	0.0
13. Social contributions	D61	0.5	0.5	0.5	0.5	0.5
14. Property income	D4	0.1	0.1	0.1	0.1	0.1
15. Other (15 = 16−(12+13+14))[58]		0.2	0.2	0.2	0.2	0.2
16 = 6. Total revenue	TR	1.7	1.8	1.9	2.0	2.1
p.m.: Tax burden (D2+D5+D61+D91−D995)[59]						
Selected components of expenditures						
17. Collective consumption	P32					
18. Total social transfers	D62 + D63	0.6	0.6	0.6	0.6	0.6

[53] D.29+D4 (other than D.41)+ D.5+D.7+D.9+P.52+P.53+K.2+D.8.
[54] Adjusted for the next flow of swap−related flows, so TR−TE = EDP.B9.
[55] Adjusted for the next flow of swap−related flows, so TR−TE = EDP.B9.
[56] The primary balance is calculated as (EDP.B9, item 8) plus (EDP D41 + FISIM recorded as intermediate consumption, item 9).
[57] A plus sign denotes deficit−reducing one−off measures
[58] P.11+P.12+P.131+D.39+D.7+D.9 (other than D.91).
[59] Including those collected by the EU and including an adjustment for uncollected taxes and social contributions (D995), if appropriate.

18a. Social transfers in kind	P31 = D63					
18b. Social transfers other than in-kind	D62	0.6	0.6	0.6	0.6	0.6
19 = 9. Interest expenditure	EDP.D41	0.1	0.1	0.1	0.1	0.1
20. Subsidies	D3	0.0	0.0	0.0	0.0	0.0
21. Gross fixed capital formation	P51	0.1	0.3	0.4	0.4	0.2
22. Other (22 = 23−(17+18+19+20+21)[60]		1.0	0.9	1.0	1.0	1.0
23 = 7. Total expenditure	TE[61]	1.8	1.9	2.0	2.0	1.8
p.m. Compensation of public-sector employees	D1					

[60] D.29+D4 (apart from D.41)+ D.5+D.7+D.9+P.52+P.53+K.2+D.8.
[61] Adjusted for the next flow of swap-related flows, so TR−TE = EDP.B9.

Table 3: General government expenditure by function

% GDP	COFOG	2016	2017	2018	2019	2020
1. General public services	1	11.4	10.2	9.7	9.2	9.2
2. Defence	2	1.0	1.1	1.2	1.2	1.3
3. Public order and safety	3	4.0	3.3	3.6	3.4	3.2
4. Economic affairs	4	4.2	7.8	8.7	8.2	3.4
5. Environmental protection	5	0.1	0.1	0.1	0.1	0.1
6. Housing and community	6	0.1	0.1	0.1	0.1	0.1
7. Health	7	6.0	4.7	4.7	4.7	4.6
8. Recreation, culture and religion	8	1.1	1.0	1.1	1.1	1.0
9. Education	9	4.5	4.1	4.0	3.9	3.8
10. Social protection	10	13.8	13.3	12.6	12.2	11.9
11. Total expenditure (item 7 = 23 in Table 2)	TOTAL	46.2	45.7	45.8	44.1	38.6

Table 4: General government debt developments

% GDP	ESA	2016	2017	2018	2019	2020
1. Gross debt [62]		63.3	65.4	66.5	66.1	59.7
2. Change in gross debt ratio		−1.8	2.1	1.1	−0.4	−6.4
Contributions to change in gross debt						
3. Primary balance [63]		0.67	0.4	−0.4	−2.2	−7.4
4. Interest expenditure [64]		2.17	2.4	2.0	2.1	2.0
5. Stock-flow adjustment		−4.7	−0.6	−0.5	−0.3	−1.1
of which:						
- Differences between cash and accruals[65]						
- Net accumulation of financial assets[66]						
of which:						
- Proceeds from privatization						
- Valuation effects and other[67]						
p.m. implicit interest rate on debt[68]		3.6	4.0	3.2	3.2	
Other relevant variables						
6. Liquid financial assets[69]						
7. Net financial debt (7 = 1 − 6)						

[62] As defined in Regulation 3605/93 (not the ESA concept).
[63] Cf. item 10 in Table 2.
[64] Cf. item 9 in Table 2.
[65] The differences concerning interest expenditure, other expenditure and revenue could be distinguished when relevant.
[66] Liquid assets, assets in third countries, government-controlled enterprises and the difference between quoted and non-quoted assets could be distinguished when relevant.
[67] Changes are due to exchange-rate movement, and the operations in the secondary market can be distinguished as needed.
[68] Calculated as interest expenditure divided by the debt level from the previous year.
[69] AF1, AF2, AF3 (consolidated at market value, AF5 (if quoted in stock exchange; including mutual fund shares).

Table 5: Cyclical developments

% GDP	ESA	2016	2017	2018	2019	2020
1. Real GDP growth (%)	B1g	2.9	4.0	3.0	2.7	2.6
2. Net lending of general government	EDP.B.9	−3.6	−3.1	−1.6	0.1	5.4
3. Interest expenditure	EDP.D.41	2.2	2.4	2.0	2.1	2.0
4. One-off and other temporary measures[70]		0.0	0.0	0.0	0.0	0.0
5. Potential GDP growth (%)[71]			2.7	2.7	2.7	2.7
Contributions:						
- Labour						
- Capital						
- Total factor productivity						
6. Output gap		−0.1	1.0	0.9	0.7	0.7
7. Cyclical budgetary component		0.0	0.4	0.3	0.2	0.2
8. Cyclically adjusted balance (2 – 7)		−3.6	−3.5	−1.9	−0.2	5.1
9. Cyclically adjusted primary balance (8 – 3)		−1.4	−0.8	0.1	1.9	7.2
10. Structural balance (8 – 4)		−3.6	−3.1	−1.9	−0.2	5.1

Table 6: Divergence from previous programme

	2016	2017	2018	2019	2020
1. GDP growth (%age points)					
Previous	2.9	3.2	4.4	2.6	
Current	2.9	4.0	3.0	2.7	2.6
Difference	0.0	0.8	−1.4	0.1	
2. Net lending of general government (% GDP)					
Previous	−3.8	−6.1	−5.5	−3.8	
Current	−3.6	−3.1	−1.6	0.1	5.4
Difference	0.2	3.0	3.9	3.9	
3. General government gross debt (% GDP)					
Previous	66.6	71.61	74.92	77.52	
Current	63.3	65.4	66.5	66.1	59.7
Difference	−3.3	−6.2	−8.4	−11.4	

[70] A plus sign denotes deficit-reducing one-off measures.
[71] Until an agreement on the Production Function Method is reached, countries can use their own figures (SP).

Table 7: Long-term stability of public finances

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

Table 7a: Contingent liabilities

% GDP	2017	2018
Government guarantees	7.64	Optional
Of which: linked to the financial sector	0.95	Optional

Table 8: Basic assumptions on the external economic environment underlying the programme framework

This table should preferably be included in the programme itself; if not, these assumptions should be transmitted to the Commission together with the Programme.

	Dimension	2016	2017	2018	2019	2020
Short-term interest rate[72]	Annual average					

[72] If necessary, purely technical assumption.

Long-term interest rate	Annual average					
USD/EUR exchange rate	Annual average	1.1069	1.1295	1.178	1.178	
Nominal effective exchange rate	Annual average					
Exchange rate vis-à-vis euro	Annual average	1.0	1.0	1.0	1.0	
Global GDP growth, excluding EU	Annual average	3.3	3.8	4.0	4.0	
EU GDP growth	Annual average	1.9	2.3	2.1	1.9	
Growth of relevant foreign markets	Annual average					
World import volume, excluding EU	Annual average	1.287129	4.2	4.1	4.1	
Oil prices (Brent, USD/barrel)	Annual average	44.8	53.6	55.7	54.7	

Table 9: Selected employment and social indicators[73]

	Data source[74]	2014	2015	2016	2017	2018
1. Labour market participation rate (%) total (15+ years)	e	52.7	53.7	54.5		
- Male	e	59.5	60.1	61.8		
- Female	e	46.2	47.6	47.6		
2. Employment rate (%) total (15+ years)	e	43.2	44.3	44.9		
- Male	e	48.9	49.4	50.5		
- Female	e	37.8	39.4	39.4		
3. Unemployment rate (%) total (15+ years)	e	18.0	17.5	17.7		
- Male	e	17.8	17.7	18.2		
- Female	e	18.2	17.3	17.1		
4. Long-term unemployment rate (%) total	e	14.0	13.6	13.4		
- Male	e	13.8	13.6	13.8		
- Female	e	14.1	13.3	12.8		
5. Youth unemployment (15–24 years) rate (%) total	e	35.8	37.6	35.9		
- Male	e	(36.0)	(39.9)	36.9		
- Female	e	35.4	34.5	(34.6)		
6. Young people (15–24) not in employment, education or training (NEET) (%)		17.7	19.1	18.4		
7. Early school leavers (%) – EUROSTAT definition		5.1	5.7	5.5		
8. Participation rate in early childhood education and care	e	35.8	37.5	37.7	42.9	
9. GINI coefficient	e	26.2 (2013)	n/a	n/a		
10. Inequality in income distribution S80/S20		4.3 (2013)	n/a	n/a		
11. Social protection expenditure (% GDP)		14.8	13.8	13.5	13.6	
12. Health expenditure (% GDP)	e	1.8	1.7	1.7	1.7	
13. At risk of poverty before social transfers (% of population)	e					
14. Poverty rate (for 2013)	e	8.6 (2013)	n/a	n/a		
15. Poverty gap (Please indicate which data is available for your country)	e	2.4 (2013)	n/a	n/a		

[73] Given the disparate availability of data and variety of definitions used for indicators, countries should use EUROSTAT data when available. In the case of data from national or international sources, a footnote should be added for each indicator indicating how it is defined. In case no data is available for an indicator, please see whether any data would be available for a similar indicator and explain so. It is recommended that year x = 2015. In case no data is available for 2015, the data available for the previous years (2014 and 2013) shall be introduced in the respective columns. For all indicators the values shall be inserted in the table, not the year-over-year change of values as in some other tables.

[74] For the indicators marked “e”, EUROSTAT indicators should be available for all enlargement countries.

Table 10: Matrix of policy commitments

Policy description	2017	2018	2019	2020
	Priority Reform Measure 1: Introducing an e-procurement system			
A. Duration of the reform*	*	*	*	*
B. Net direct budgetary impact (if any) (€)		−50,000	−50,000	−50,000
B.1 Direct impact on budgetary revenue (€)				
B.2 Direct impact on budgetary expenditure (€)		50,000	50,000	50,000
B.3 Possible non-budgetary financing (€)		660,000	525,000	315,000
-B.3.1 Of which committed IPA funding including WBIF funding (€)		660,000	525,000	315,000
	Priority Reform Measure 2: Improving the legislative/regulatory and institutional framework for integration into the regional electricity market			
A. Duration of the reform*	*	*	*	*
B. Net direct budgetary impact (if any) (€)	−12,000	−12,000	− 12,000	− 12,000
B.1 Direct impact on budgetary revenue (€)				
B.2 Direct impact on budgetary expenditure (€)	12,000	12,000	12,000	12,000
B.3 Possible non-budgetary financing (€)				
-B.3.1 Of which committed IPA funding including WBIF funding (€)				
	Priority Reform Measure 3: Adopting the Decree on a single window for reporting maritime transport formalities			
A. Duration of the reform*	*	*	*	*
B. Net direct budgetary impact (if any) (€)			−15,000	−105,000
B.1 Direct impact on budgetary revenue (€)				
B.2 Direct impact on budgetary expenditure (€)			15,000	105,000
B.3 Possible non-budgetary financing (€)			85,000	595,000
-B.3.1 Of which committed IPA funding including WBIF funding (€)				

	Priority Reform Measure 4: Creating an efficient and independent rail transport regulatory and safety authority			
A. Duration of the reform*	*	*	*	*
B. Net direct budgetary impact (if any) (€)	−315,000	−315,000	−315,000	−315,000
B.1 Direct impact on budgetary revenue (€)				
B.2 Direct impact on budgetary expenditure (€)	315,000	315,000	315,000	315,000
B.3 Possible non-budgetary financing (€)				
-B.3.1 Of which committed IPA funding including WBIF funding (€)				
	Priority Reform Measure 5: Fostering investments in the industrial sector			
A. Duration of the reform*	*	*	*	*
B. Net direct budgetary impact (if any) (€)	−1,300,000	−1,250,000	−1,300,000	−1,300,000
B.1 Direct impact on budgetary revenue (€)				
B.2 Direct impact on budgetary expenditure (€)	1,300,000	1,250,000	1,300,000	1,300,000
B.3 Possible non-budgetary financing (€)				
-B.3.1 Of which committed IPA funding including WBIF funding (€)				
	Priority Reform Measure 6: Supporting development and modernization of the industrial sector			
A. Duration of the reform*	*	*	*	*
B. Net direct budgetary impact (if any) (€)	−100,000	−150,000	−200,000	−200,000
B.1 Direct impact on budgetary revenue (€)				
B.2 Direct impact on budgetary expenditure (€)	100,000	150,000	200,000	200,000
B.3 Possible non-budgetary financing (€)				
-B.3.1 Of which committed IPA funding including WBIF funding (€)				

	Priority Reform Measure 7: Supporting investments in the food-production sector in order to reach EU standards			
A. Duration of the reform*	*	*	*	*
B. Net direct budgetary impact (if any) (€)		−11,000,000	−11,000,000	−11,500,000
B.1 Direct impact on budgetary revenue (€)				
B.2 Direct impact on budgetary expenditure (€)		11,000,000	11,000,000	11,500,000
B.3 Possible non-budgetary financing (€)		9,700,000	20,000,000	20,0000,000
-B.3.1 Of which committed IPA funding including WBIF funding (€)				
	Priority Reform Measure 8: Diversifying tourist products			
A. Duration of the reform*		*	*	*
B. Net direct budgetary impact (if any) (€)		−879,335	−879,335*	−879,335*
B.1 Direct impact on budgetary revenue (€)				
B.2 Direct impact on budgetary expenditure (€)		879,335	879,335*	879,335*
B.3 Possible non-budgetary financing (€)				
-B.3.1 Of which committed IPA funding including WBIF funding (€)				
	Priority Reform Measure 9: Encouraging NPL resolution by enhancing the framework for prudential supervision and bank solvency			
A. Duration of the reform*		*	*	*
B. Net direct budgetary impact (if any) (€)		0	0	0
B.1 Direct impact on budgetary revenue (€)				
B.2 Direct impact on budgetary expenditure (€)		0	0	0
B.3 Possible non-budgetary financing (in €)				
-B.3.1 Of which committed IPA funding including WBIF funding (€)				

	Priority Reform Measure 10: Introducing e-services into the work of cadastral offices			
A. Duration of the reform*	*	*	*	*
B. Net direct budgetary impact (if any) (€)		−120,000	−150,000	−50,000
B.1 Direct impact on budgetary revenue (€)	*	80,000*	150,000*	250,000*
B.2 Direct impact on budgetary expenditure (€)	50,000	200,000**	300,000	300,000
B.3 Possible non-budgetary financing (€)				
-B.3.1 Of which committed IPA funding including WBIF funding (€)				
	Priority Reform Measure 11: Adopting the Law on Issuing Electronic Fiscal Invoices and implementing an electronic fiscal invoices system			
A. Duration of the reform*	*	*	*	*
B. Net direct budgetary impact (if any) (€)		−1,000,000	-1,000,000	30,000,000
B.1 Direct impact on budgetary revenue (€)				30,000,000
B.2 Direct impact on budgetary expenditure (€)		1,000,000	1,000,000	
B.3 Possible non-budgetary financing (€)				
-B.3.1 Of which committed IPA funding including WBIF funding (€)				
	Priority Reform Measure 12: Improving financial support for the small and medium-sized enterprise sector			
A. Duration of the reform*	*	*	*	*
B. Net direct budgetary impact (if any) (€)	−120,540	−350,000	−400,000	−500,000
B.1 Direct impact on budgetary revenue (€)				
B.2 Direct impact on budgetary expenditure (€)	120,540	350,000	400,000	500,000
B.3 Possible non-budgetary financing (€)	175,605,447	140,000,000	140,000,000	140,000,000
-B.3.1 Of which committed IPA funding including WBIF funding (€)				

	Priority Reform Measure 13: Improving non-financial support for small and medium-sized enterprises sector			
A. Duration of the reform*	*	*	*	*
B. Net direct budgetary impact (if any) (€)	−150,165.07	−176,309.85	−176,309.85	−176,309.85
B.1 Direct impact on budgetary revenue (€)				
B.2 Direct impact on budgetary expenditure (€)	150,165.07	176,309.85	176,309.85	176,309.85
B.3 Possible non-budgetary financing (€)	29,244.50	139,642.75	139,642.75	139,642.75
-B.3.1 Of which committed IPA funding including WBIF funding (€)				
	Priority Reform Measure 14: Introducing a single information system for spatial planning and building construction			
A. Duration of the reform*		*	*	*
B. Net direct budgetary impact (if any) (€)		−450,000	−200,000	−200,000
B.1 Direct impact on budgetary revenue (€)				
B.2 Direct impact on budgetary expenditure (€)		450,000	200,000	200,000
B.3 Possible non-budgetary financing (€)				
-B.3.1 Of which committed IPA funding including WBIF funding (€)				
	Priority Reform Measure 15: Establishing a science and technology park in Podgorica			
A. Duration of the reform*		*	*	*
B. Net direct budgetary impact (if any) (€)		−20,000	−3,000,000	−3,000,000
B.1 Direct impact on budgetary revenue (€)				
B.2 Direct impact on budgetary expenditure (€)		20,000	3,000,000	3,000,000
B.3 Possible non-budgetary financing (€)				
-B.3.1 Of which committed IPA funding including WBIF funding (€)		World Bank loan: 130,000		

	Priority Reform Measure 16: Improving the legislative and regulatory framework with aim to reduce the costs of deploying high-speed electronic communications networks			
A. Duration of the reform*		*	*	*
B. Net direct budgetary impact (if any) (€)		0	0	0
B.1 Direct impact on budgetary revenue (€)		0	0	0
B.2 Direct impact on budgetary expenditure (€)				
B.3 Possible non-budgetary financing (€)		0	0	0
-B.3.1 Of which committed IPA funding including WBIF funding (€)				
	Priority Reform Measure 17: Implementing CEFTA Additional Protocol 5 and adopting CEFTA Additional Protocol 6			
A. Duration of the reform*	*	*	*	*
B. Net direct budgetary impact (if any) (€)		0	0	0
B.1 Direct impact on budgetary revenue (€)		0	0	0
B.2 Direct impact on budgetary expenditure (€)				
B.3 Possible non-budgetary financing (€)		0	0	0
-B.3.1 Of which committed IPA funding including WBIF funding (€)				
	Priority Reform Measure 18: Developing qualifications in line with labour market needs			
A. Duration of the reform*	*	*	*	*
B. Net direct budgetary impact (if any) (€)	– 184,560	– 246,080	– 270,000	– 300.000
B.1 Direct impact on budgetary revenue (€)				
B.2 Direct impact on budgetary expenditure (€)	184,560	246,080	270,000	300.000
B.3 Possible non-budgetary financing (€)				
–B.3.1 Of which committed IPA funding including WBIF funding (€)		IPA 650,000		

	Priority Reform Measure 19: Carrying out apprenticeships with employers			
A. Duration of the reform*	*	*	*	*
B. Net direct budgetary impact (if any) (€)	− 60,499	− 250,000	− 300,000	− 350,000
B.1 Direct impact on budgetary revenue (€)				
B.2 Direct impact on budgetary expenditure (€)	60,499	250,000	300,000	350,000
B.3 Possible non-budgetary financing (€)				
-B.3.1 Of which committed IPA funding including WBIF funding (€)				
	Priority Reform Measure 20: Implementing legal provisions in the field of the labour market with the focus on active employment policy			
A. Duration of the reform*	*	*	*	*
B. Net direct budgetary impact (if any) (€)		−5,800,000	−5,800,000	−5,800,000
B.1 Direct impact on budgetary revenue (€)				
B.2 Direct impact on budgetary expenditure (€)		5,800,000	5,800,000	5,800,000
B.3 Possible non-budgetary financing (€)				
-B.3.1 Of which committed IPA funding including WBIF funding (€)				

Table 11: Reporting on the implementation of the structural reform measures of the ERP 2016–2018 and the ERP 2017–2019

Priority Reform Measure 1: Introducing an e-procurement system

<table>
<tr><td>Brief description of activities planned for 2017</td><td colspan="2">- During 2017, completion of the tender procedure is planned in order to select the most favourable bidder to implement the project of introducing the electronic public procurement system and to start with development of the electronic public procurement system.</td></tr>
<tr><td>Have the activities planned for 2017 been implemented?</td><td colspan="2"><u>Partially</u></td></tr>
<tr><td>If yes/partially, include:
• Description of steps taken
• Timeline of implemented actions
• Difficulties and delays in implementation
• Whether the reform will continue in 2018

If no, explain why not</td><td colspan="2">The working group has worked to draft the Contract Notice and Terms of Reference and has stated the ex-ante controls for the Contract Notice.

The reform will continue during 2018.

In Q1 of 2018, finalization of the tender procedure and signing of the contract with the selected bidder is expected, while it is expected that implementation of the contract will start during 2018.</td></tr>
<tr><td rowspan="2">Actual cost of implementation and impact on the annual budget</td><td>Actual cost</td><td>Planned cost</td></tr>
<tr><td>0</td><td>€1,650,000</td></tr>
<tr><td>Source of funds</td><td colspan="2">IPA 2014 – €1,500,000
Government budget – €150,000</td></tr>
</table>

Priority Reform Measure 2: Strengthening managerial accountability in the public sector

Brief description of activities planned for 2017	– During 2017, drafting of the methodology for delegated powers and authorizations in the public sector is planned.	
Have the activities planned for 2017 been implemented?	**Partially**	
If yes/partially, include: • Description of steps taken • Timeline of implemented actions • Difficulties and delays in implementation • Whether the reform will continue in 2018 If no, explain why not	An analysis of obstacles to establish managerial accountability was developed, as a base for drafting the methodology for delegated powers and authorizations. Planned deadline for finalizing the methodology is Q3 and Q4 of 2017. The reform will continue during 2018.	
Actual cost of implementation and impact on the annual budget	Actual cost	Planned cost
	n/a	€25,000
Source of funds	Government budget/donation/credit	

Priority Reform Measure 3: Construction of an undersea cable between Montenegro and Italy with transmission infrastructure in the country and interconnection with Serbia

Brief description of activities planned for 2016 Brief description of activities planned for 2017	During 2016, construction of the following transmission infrastructure is planned: • Lastva substation 400/110/35 kV – procurement of equipment and construction (executing construction works and electrical installation works); • 400 kV transmission line Lastva–Čevo–Pljevlja – design, procurement of equipment and construction (construction of foundation and assembly of towers), activities to secure land required for execution of works; • 400 kV transmission line Pljevlja–border with Serbia – develop feasibility study. During 2017, construction of the following transmission infrastructure is planned: • Lastva substation 400/110/35 kV – procurement of equipment and construction (executing construction works and electrical installation works); • 400 kV transmission line Lastva–Čevo–Pljevlja – design, procurement of equipment and construction (construction of foundation, assembly of towers and electrical installation works), activities to secure land required for execution of works; • 400 kV transmission line Pljevlja–border with Serbia – selection of consultant for project implementation.
Have the activities planned for 2016 been implemented? Have the activities planned for 2017 been implemented?	**Partially** **Partially**

<table>
<tr><td rowspan="1">If yes/partially, include:
• Description of steps taken
• Timeline of implemented actions
• Difficulties and delays in implementation
• Whether the reform will continue in 2018

If no, explain why not</td><td colspan="2">All planned activities are being implemented continuously, but of a somewhat lower scope than planned.

Reasons for the slight delay in implementation relate to resolving property-related legal issues on access roads, relocating the transmission line route in some sections, slower design and execution of works.

The reform will continue during 2018.</td></tr>
<tr><td rowspan="2">Actual cost of implementation and impact on the annual budget</td><td>Actual cost – preliminary data</td><td>Planned cost</td></tr>
<tr><td>€18,260,000.00
No impact on the Government budget</td><td>€25,860,000.00</td></tr>
<tr><td>Source of funds</td><td colspan="2">Donation/loan
In 2017 the funds from a loan and CGES’s own funds were spent.</td></tr>
</table>

Priority Reform Measure 4: Construction of Block 2 of the Thermoelectric Power Plant in Pljevlja

<table>
<tr><td>Brief description of activities planned for 2017</td><td colspan="2">For 2017, it was planned to secure financing for implementation of the reform measure, for contract to enter into force, main design development, procurement and delivery of equipment, and commencement of construction works.</td></tr>
<tr><td>Have the activities planned for 2017 been implemented?</td><td colspan="2"><u>No</u></td></tr>
<tr><td>If yes/partially, include:
• Description of steps taken
• Timeline of implemented actions
• Difficulties and delays in implementation
• Whether the reform will continue in 2018

If no, explain why not</td><td colspan="2">Negotiations with the Czech Export Bank and EGAP have not resulted in securing financing for realization of the project.

The project steering committee for construction of the second block of the Thermoelectric Power Plant in Pljevlja reached a decision on 27 December 2017 to end cooperation with Škoda Praha with respect to implementation of the Contract signed on 29 September 2016 in Pljevlja.

In order to find alternative solutions, a detailed analysis of conditions for project implementation will be carried out in the forthcoming period, as well as financing basis and conditions.</td></tr>
<tr><td rowspan="2">Actual cost of implementation and impact on the annual budget</td><td>Actual cost</td><td>Planned cost</td></tr>
<tr><td>€151,345.00
(No impact on the Government budget)</td><td>After financing was to be secured, the advance payment for the contract on development of the main design and contract on execution of works of €49,664,036.00 was planned.</td></tr>
<tr><td>Source of funds</td><td colspan="2">Government budget/donation/credit
– EPCG’s own funds were used for the period until 30 November 2017.</td></tr>
</table>

Priority Reform Measure 5: Construction of the Smokovac–Mateševo priority section of the Bar–Boljare highway

Brief description of activities planned for 2016 Brief description of activities planned for 2017	The Bar–Boljare highway is included in the SEETO Comprehensive Regional Transport network as SEETO road route 4[75], through Annexes (Annex III VOL 30/33 and 31/33) in October 2011 and is a priority of the Government of Montenegro and one of the elements on the country's European Union accession agenda, which will enable better and safer mobility of people, goods and services. Montenegro's Transport Development Strategy envisages integration into the Trans-European Transport Network (TEN–T) to be achieved, among other things, via the Bar–Boljare highway. The Bar–Boljare highway cuts transversally through the entire territory of Montenegro and will be an integrating link within the country, and enable tapping into development resources in the north of Montenegro. Finally, it will be the fastest connection with Serbia and Central Europe. The Bar–Boljare–Belgrade transport corridor has been an integral part of the main Western Balkans Transport Network. It constitutes an extension of the TEN–T Middle East–East Med Corridor. Montenegro's 2014–2020 Regional Development Strategy envisages the implementation of key capital projects, one of the most significant being the Bar–Boljare highway, as one of the instruments to reduce regional disparities in Montenegro and to achieve a more balanced social and economic development of its regions, based on competitiveness, innovation and employment. The importance of the Bar–Boljare highway for transport and economic connectivity and the intensive economic development of Montenegro and the region are also identified in the Strategy on Development and Maintenance of State Roads of Montenegro. As one of important arguments in favour of building the Bar–Boljare highway, this Strategy mentions the

	need to increase road safety and reduce the number of road-traffic accidents, given that it is actually impossible to upgrade the current road through the Platije Canyon to the level of an expressway, since the funding needed would be approximately that of a completely new highway, without fully resolving the issues. The Bar–Boljare highway is on the Consolidated List of Priority Infrastructure Projects that was approved by the Government in July 2017. Having put in place the statutory and contractual requirements, 11 May 2015 was set as the commencement date for works on the Smokovac–Uvač–Mateševo priority section of the Bar–Boljare highway, with a contractual term of 48 months for completion of the project. During 2016, the contractor for works worked on: execution of preparatory works, designing and part of permanent works. Total amount of €9,291,185.30 (€1,393,677.80 from the State Budget and €7,897,507.51 from China EXIM bank in US$[76]) was paid to the contractor for works. During 2017, the contractor for works worked on: execution of preparatory works, designing and part of permanent works. Total amount of €176,316,260.17 (€26,447,439.04 from the State Budget and €149,868,821.13 from China EXIM bank in US$[77]) was paid to the contractor for works.
Have the activities planned for 2016 been implemented? Have the activities planned for 2017 been implemented?	**Yes** **Yes**
If yes/partially, include: • Description of steps taken • Timeline of implemented actions • Difficulties and delays in implementation	The contractor for works is executing works on the Smokovac–Mateševo priority section of the Bar–Boljare highway in accordance with its programme of works.

[76] Exchange rate €1 = US$1.3718.

[77] Exchange rate €1 = US$1.3718.

<table>
<tr><td>• Whether the reform will continue in 2018

If no, explain why not</td><td colspan="2">The priority section Smokovac–Uvač–Mateševo of the Bar–Boljare Highway, with an approximate length of 41 km, has 20 bridges of total length 5.91km, 16 double-pipe tunnels of total length 17.95 km due to the terrain configuration, while the uncovered road is projected with a total length of approximately 17 km, and works are currently taking place on 15 tunnels, 11 bridges and on the uncovered road.

The subject section is divided into four parts with 19 subsections. So far, 17 building permits have been issued for the execution of the main construction works and nine building permits for execution of works on disposal sites for excess material from excavations.

The measure will continue to be implemented also during 2018.</td></tr>
<tr><td rowspan="2">Actual cost of implementation and impact on the annual budget</td><td>Actual cost</td><td>Planned cost</td></tr>
<tr><td>€176,316,260.17</td><td>€180,460,000</td></tr>
<tr><td>Source of funds</td><td colspan="2">Government budget/donation/credit
<u>Budget of Montenegro:</u>
€26,447,439.04
<u>China EXIM bank:</u>
€149,868,821.13
<u>Budget of Montenegro:</u>
15%
<u>China EXIM bank:</u>
85%</td></tr>
</table>

Priority Reform Measure 6: Modernization of the section of the Bar–Belgrade railway passing through Montenegro (Vrbnica–Bar)

Brief description of activities planned for 2016 Brief description of activities planned for 2017	- During 2016, implementation of the following activities is planned: • Remediation of Trebaljevo Bridge – €3,021,320.60 (EIB) • Remediation of Morača Bridge – €886,713.47 (EIB) • Urgent remediation measures of four steel bridges – €968,435.98 (EIB) During 2017, implementation of the following activities is planned: • Railroad overhaul on the Kolašin–Kos section – €5,898,315.30 (EIB) • Decommissioning of the existing, and procurement and installation of the new Trebješica power substation – €3,140,000.00 (IPA III) • 106 tunnels and development of the main designs for priority remediation – €2,500,000.00 (WBIF) • Remediation of Morača Bridge – €886,713.47 (EIB) • Railroad overhaul on the Virpazar–Sutomore section in Sozina Tunnel – €4,500,000.00 (IPA III) • Remediation of six slopes – €4,500,000.00 (EIB and WBIF (new loan 20+20)) • Replacing the signal safety devices in the Podgorica station – €6,000,000.00 (EIB and WBIF (new loan 20+20)) • Urgent remediation measures of five concrete bridges – €500,000.00 (EIB and WBIF (new loan 20+20))
Have the activities planned for 2016 been implemented? Have the activities planned for 2017 been implemented?	**Yes/Partially** **Yes/Partially**
If yes/partially, include: • Description of steps taken • Timeline of implemented actions • Difficulties and delays in implementation	**For 2016:** • Remediation of Trebaljevo Bridge: Works were completed in 2016 – Timeframe 2015–2016 – Certificate on acceptance of works was signed on 18 October 2016. The reform did not continue in 2017.

• Whether the reform will continue in 2018 If no, explain why not	• Remediation of Morača Bridge: Works took place during 2016. All constructed works were completed. The contractor for works was issued an order to replace all the sleepers on bridges that do not meet criteria due to previous poor quality and installation, according to the report of the Technical Acceptance Commission. Regular speed was introduced on the bridge, and the certificate on acceptance of works will be signed once the shortcomings are fixed. Timeframe 2015–2016. The reform continued in 2017. • Urgent remediation measures on four steel bridges: Works took place during 2016. Due to delays in the procurement of equipment by the contractor for works (joints and sleepers), as well as problems during the execution of works on bridge No. 6 and poor installation works on Ljuboviđa Bridge, there was a delay in implementation of the project. Timeframe 2015–2016. The reform continued in 2017. The works are completed and the certificate on acceptance of works was signed on 29 June 2017, after the contractor for works had fixed all the shortcomings. **For 2017:** • Railroad overhaul on the Kolašin–Kos section: The project was completed and the certificate on acceptance of works was signed on 21 December 2017. Timeframe 2015–2017. The reform will not continue in 2018. • Remediation of three tunnels: The project was completed and the certificate on acceptance of works was signed on 28 December 2017. Timeframe 2015–2017. The reform will not continue in 2018. • Decommissioning of the existing, and procurement and installation of the new Trebješica power substation: The main design was completed and works are in progress. The deadline for completion of works is end of 2017, but due to a delay in developing the main design as well as due to failure to reach an agreement between the competent authorities, the contractor for works and oversight authority with respect to defining obligations in process of

	obtaining certain permits and consents, inadequate access roads construction by the contractor which resulted in rockfalls and landslides, it is questionable whether the deadline will be met. The reform will continue in 2018. The project falls within the competence of the Public Works Directorate as the implementing agency. The Railway Infrastructure of Montenegro (ŽICG) has the status of beneficiary. • Special inspection of 106 tunnels was completed. The terms of reference for the main design was completed and submitted to ŽICG. It is currently being agreed. The reform will continue in 2018. Timeframe 2017−2019. • Inspection of 91 concrete bridges was completed, as planned for 2017. The main design is currently being drafted. The reform will continue in 2018. • Railroad overhaul on the Virpazar–Sutomore section in Sozina Tunnel: The works are completed. The certificate on the acceptance of works is currently being signed. The project falls within the competence of the Public Works Directorate as the implementing. ŽICG has the status of beneficiary. Timeframe 2016–2017. The reform will not continue in 2018. • Remediation of six slopes: The contract was signed. The main design is currently being drafted. The deadline for completing the main design and finalizing works is 20 months. Timeframe 2017–2019. The reform will continue in 2018. • Replacing the signal safety devices in Podgorica station: The contract was signed and the execution of works is currently underway. The deadline for completion of works is 12 months. Timeframe 2017–2018. The reform will continue in 2018. • Urgent remediation measures of five concrete bridges: Review of the main design is currently underway, to follow the issuing of a public call. Timeframe 2017–2018. The reform will continue in 2018. Remediation of drainage pipes and watercourse regulation: The contract on the execution of works was signed and works have commenced, which was planned for 2017. Works were

	interrupted due to increased water levels of the river, resulting in damage to a dam. The deadline for the completion of works is 12 months. Timeframe 2017–2018. The reform will continue in 2018.	
Actual cost of implementation and impact on the annual budget	Actual cost up until 30 July 2017	Planned cost
	€5,400,000	€10,000,000
Source of funds	Remediation of Trebaljevo Bridge – EIB loan Railroad overhaul on the Kolašin–Kos section – EBRD loan Remediation of three tunnels – EBRD loan Decommissioning of the existing, procurement and installation of the new Trebješica power substation – EU donation (IPA III) Inspection of 106 tunnels – WBIF donation Inspection of 91 concrete bridges – WBIF donation Remediation of Morača Bridge – EIB loan Railroad overhaul on the Virpazar–Sutomore section in Sozina Tunnel − EU donation (IPA III) Remediation of six slopes – New loan 20+20 (EIB and WBIF) Replacing the signal safety devices in Podgorica station − New loan 20+20 (EIB and WBIF) Urgent remediation measures for five concrete bridges − New loan 20+20 (EIB and WBIF) Remediation of drainage pipes and watercourse regulation – EBRD loan Contract for new loan 20+20 (EIB+WBIF) was signed during 2017. According to the bank's announcement, the first withdrawal will be on 8 January 2017. Remediation of six slopes – New loan 20+20 (EIB and WBIF) Replacing the signal safety devices in Podgorica station – New loan 20+20 (EIB and WBIF) Urgent remediation measures for five concrete bridges – New loan 20+20 (EIB and WBIF) Remediation of drainage pipes and watercourse regulation – EBRD loan	

Priority Reform Measure 7: Fostering investments in the industry sector, with a focus on the manufacturing industry

Brief description of activities planned for 2016 Brief description of activities planned for 2017	- Publishing an open call for participation in the procedure for the awarding of funds for fostering direct investments and continuation of subsidizing investment projects whose implementation has already begun - Monitoring fulfilment of contractual obligations stemming from the first and second public calls - Publishing at least one open call for participation in the procedure for the awarding of funds for fostering direct investments. Continuation of subsidizing investment projects whose implementation has already begun in accordance with the established timetable for implementation.
Have the activities planned for 2016 been implemented? Have the activities planned for 2017 been implemented?	**Yes** **Partially**
If yes/partially, include: • Description of steps taken • Timeline of implemented actions • Difficulties and delays in implementation • Whether the reform will continue in 2018 If no, explain why not	• Companies that are beneficiaries of the funds for fostering direct investments on the basis of the first open call published in 2015 embarked on implementation of investment projects in 2016. There are three investors (operating in the areas of wood processing, animal feed manufacturing and personal and property insurance), while the value of the investment projects amounts to €2.5 million, including employment of 103 employees over a three-year period, and the total value of funds allocated per new work position is €362,000. • Three contracts for implementation of investment projects were signed following the 2016 open call in the area of food production, the pharmaceutical industry and tourism, with investments totalling €4.7 million and the creation of 150 new jobs in a three-year period; a total amount of subsidies of €1.12 million

	• Visits of investment projects that are being implemented according to signed contracts in 2016, as well as check of realization dynamics • Delivery of audit reports to Secretariate for Development Projects (SDP) by fund users • On 4 March 2017, an open call was published for participation in the procedure for awarding funds for fostering direct investments • On 4 May 2017, a corrigendum to the open call was published • On 29 May 2017, the received applications were opened publicly • Nine applications were received by the deadline for this open call • At the moment, these applications are being evaluated in terms of their formal accuracy, and analysis is also being conducted regarding compliance of investment projects with the planning documents and development plans of Montenegro • The process of analysing the formal accuracy of the applications was characterized by a delay in obtaining the opinions of the Commission for State Aid Control and opinion of the Tax Administration, since these constitute a necessary requirement for the funds being awarded for the purpose of fostering investments specified in provisions of the Decree • Procedure for the awarding of funds for fostering direct investments is expected to be finalized in Q1 2018 • Continuation of the reform is planned in 2018 and the new open call will be published. Effects produced as a result of implementation of the six investment projects: until now, a total of €7,094,511 has been invested, subsidies of €1,031,999 were paid out and 200 work positions were created and filled for open-ended contracts (of which 103 are in the northern region, 97

	in the central region, out of the total 253 persons envisaged in the contract). The amount of funds spent on implementation of the mesure from 2016 State budget was €681,333 while from Secretariat for Development Project allocated funds for 2017 in the amount of €1,3 mil, €350,666 was spent.	
Actual cost of implementation and impact on the annual budget	Actual cost	Planned cost
	€350,666	€1,300,000
Source of funds	**Government budget**	

Priority Reform Measure 8: Supporting the development and modernization of the industrial sector

Brief description of activities planned for 2017	In order to implement the Programme for Supporting the Modernization of the Processing Industry, an open call will be published and grants/subsidies will be awarded for the procurement of equipment, in accordance with rules and criteria set out in the Programme.	
Have the activities planned for 2017 been implemented?	**Partially**	
If yes/partially, include: • Description of steps taken • Timeline of implemented actions • Difficulties and delays in implementation • Whether the reform will continue in 2018 If no, explain why not	A public call for participation in the Programme for Supporting the Modernization of the Manufacturing Industry was published on 1 April and it lasted until 15 December 2017. Five applications were submitted to this open call by businesses operating in the wood industry, furniture manufacturing, glass manufacturing and plastic product manufacturing. As stipulated in the rules set out in the Programme, all the received applications were processed by the IDF and reviewed at sessions of the Commission for the Awarding of Grants. Following receipt of the documentation by the IDF, the Commission of the Ministry of Economy reviewed applications in November and December and decided to accept four applications, but due to a lack of compliance with the rules set out in the Programme rendered a decision rejecting one application for the awarding of grants. There have been no difficulties or delays in the implementation of the measure. Implementation of this reform measure is planned to continue in 2018.	
Actual cost of implementation and impact on the annual budget	Actual cost	Planned cost
	€61,636.32[78]	€100,000
Source of funds	**Government budget**	

[78] One should bear in mind that, in accordance with the Programme's model, the IDF allocated €408,207.10 of loan funds for this purpose, which, together with the budgetary funds, adds up to €469,843.42.

Priority Reform Measure 9: Supporting investments in the food-production sector in order to reach EU standards

Brief description of activities planned for 2016 Brief description of activities planned for 2017	- In 2016, the same measure was implemented as in 2017, and support concerned primary production and processing, construction and reconstruction of the facilities used for processing agricultural and fish products. - This measure supports the cultivation of new plantations of agricultural crops, increase in livestock population, the purchase of equipment for processing, construction and reconstruction of the facilities used for processing agricultural and fish products, all aimed at improving standards for food safety, animal welfare and plant health, through progressive harmonization with EU food quality and safety standards, thus enabling competitiveness in the EU market. This measure is aligned with the Strategy for Development of Agriculture and Rural Areas 2015–2020 and the Programme for Development of Agriculture and Rural Areas 2016–2020 (IPARD).
Have the activities planned for 2016 been implemented? Have the activities planned for 2017 been implemented?	**Yes** **Partially**
If yes/partially, include: • Description of steps taken • Timeline of implemented actions • Difficulties and delays in implementation • Whether the reform will continue in 2018 If no, explain why not	The planned activities were implemented. The measures covered by the agriculture budget were implemented as planned, all premiums were paid out, and all open calls planned in the framework of the agriculture budget were published and paid out. The project IPARD-like 1 was implemented, while implementation of the IPARD-like 2 project will continue in early 2018 as well. Implementation of the project for the measure “Investment in physical capital in relation to processing and marketing of agricultural and fish products – IPARD-like 2” and IPARD-like 2.2 will continue in 2018. A new open call was published under IPARD-like 2.3 in 2017, in the framework of the

	project IPARD-like 2. Implementation of the projects contracted under the framework of this open call is expected in 2018. Moreover, Montenegrin producers of products of animal origin – three operating in the meat industry and two egg producers – were assigned export numbers for the EU market during 2017.	
Actual cost of implementation and impact on the annual budget	Actual cost	Planned cost
	From EU funds to date (until 21 December 2017), €2,312,454.37 was paid out, while €770,818.12 was paid out from the national budget for the purpose of co-financing EU projects, which means that a total of €6 million was invested through the IPARD-like programme and €10 million has been paid out so far for national measures.	The plan is to invest €14 million through the IPARD programme, but due to the delay in accreditation, funding of €5 million planned for 2017 was not available. The national budget is in accordance with what has been planned.
Source of funds	**Government budget/donation**	

Priority Reform Measure 10: Improving the tourist offer in the north of Montenegro through construction of the required infrastructure at ski resorts

Brief description of activities planned for 2016 Brief description of activities planned for 2017	- Investment activities at six sites in six municipalities were planned during 2017: – Kolašin 1600, Cmiljača (Bijelo Polje), Žarski (Mojkovac), Savin Kuk (Žabljak), Vučje (Nikšić), and Hajla (Rožaje). **Cmiljača, Bijelo Polje:** Works on phase I of the Ravna Rijeka–Jasikovac road, selection of the contractor for phase II of works; works on phase I of the Jasikovac−Cmiljača road and selection of the contractor for phase II; launch of the tender for construction of a ski lift; development of the main design for construction of the TS35/10 transformer substation; **Kolašin 1600, Kolašin:** Implementation of phase I: works to construct the road infrastructure with parking, base station (construction of building with supporting facilities), primary electricity network, ski lift, hydro-technical and telecommunication infrastructure, approx. 4 km of ski slopes and the procurement of the required machinery and equipment; **Savin kuk, Žabljak:** Development of the project documentation and works executed for constructing a ski slope 1.5 km in length; development of the project documentation for construction of approx. 21 km of slopes; works on the construction of a road 1.5 km in length to the ski resort; public call and hiring of contractors for works for the water supply project; launch of the public call for procurement of the ski lift, after the planning documentation for 21 km of slopes is completed; **Žarski, Mojkovac:** Design which will be used for execution of works on the Vragodo–Vrioca–Žarski Katun road; **Vučje, Nikšić:** Finalizing works on construction of a reservoir; **Hajla, Rožaje:** Construction of the Rožaje–Štedim road 4.8 km in length;
Have the activities planned for 2016 been implemented?	**Partially**

Have the activities planned for 2017 been implemented?	
If yes/partially, include: • Description of steps taken • Timeline of implemented actions • Difficulties and delays in implementation • Whether the reform will continue in 2018 If no, explain why not	All activities are underway. **Cmiljača, Bijelo Polje:** Works on phase I of the Ravna Rijeka–Jasikovac road are underway. The tender for phase II of works was launched and bids are currently being evaluated. A decision on the most favourable bid for phase I works was taken and the tender for the phase II was launched for construction of the Jasikovac−Cmiljača road 8 km in length. The main design for the construction of the TS35/10 transformer substation for supply of the Cmiljača site is underway. **Kolašin 1600, Kolašin:** Works on installation of the TS35/10 transformer substation were completed and its connection to the power line from HPP Mušovića Rijeka is expected. Works on phases I and II to construct the base station are ongoing. The contractor for works is selected to construct the parking for day skiers. Execution of phases I and II of works to construct the road from the "Kolašin 1450" ski resort to the "Kolašin 1600" ski resort are currently underway. Execution of preparatory works for construction of a K8DC6 six-seater ski lift are ongoing. **Savin kuk, Žabljak:** The project of construction of a ski slope of approx. 1.5 km is being developed as "design and build". The contract was signed in August 2016, and in order for the project documentation to be developed it is required for the Environmental Protection Agency to issue a permit for forest clearing for the proper geodetic surveying of the terrain. Requests were sent to competent institutions and an approval for zone II was received, while activities to obtain permission for zone III are underway. Finalization of the project documentation is planned by end of the 2017. as well as the execution of works. Construction of a road 1.5 km in length to the ski resort site – the contractor for works was selected during the public call, but the

<table>
<tr><td rowspan="1"></td><td colspan="2">procedure was resent for repeated valuation due to a complaint from the State Public Procurement Commission. The municipality has submitted a request to secure €48,000 for land expropriation. A public call for drafting the main design for the construction of the parking lot at the ski resort site was also launched.
Water supply – a study was developed and the municipality has provided its consent. A public call for design and build is planned to be launched for procuring snowmaking systems for slopes.
Žarski, Mojkovac: Vragodo–Vrioca–Žarski Katun road – the tender for developing a conceptual design for Tara Bridge and linking the arterial road with the regional road is currently open.
Vučje, Nikšić: Execution of final works is currently underway for the reservoir.
Hajla, Rožaje: Works on phase II of the Rožaje–Štedim road are currently underway. The tender for phase III of works is ongoing, which will result in the completion of works on the road 4.8 km in length, without asphalt surfacing. Activities of preparing the planning documentation falling within the competence of Rožaje Municipality are currently underway.

Divergence from the planned schedule is mainly caused by the public procurement procedures and administrative procedures.

Yes, the reform will also continue in 2018, since these are multiannual projects, with the expectation of the project of the Vučje reservoir, planned to be completed in the 2017.</td></tr>
<tr><td rowspan="2">Actual cost of implementation and impact on the annual budget</td><td>Actual cost</td><td>Planned cost</td></tr>
<tr><td>€614,734.98</td><td>€10,040,000.00</td></tr>
<tr><td>Source of funds</td><td colspan="2">Government budget/donation</td></tr>
</table>

Priority Reform Measure 11: Introducing e-services into the work of cadastral offices

Brief description of activities planned for 2017	During 2017, implementation of the following activities is planned: • The implementation of data access by means of e-services from the projects involving the establishment of records of the immovable property cadastre in the part of the territory of Montenegro that has not been surveyed was carried out • Improving the process of registration of immovable property by using upgrades to software applications • Creating regulatory and technical preconditions for the establishment of e-services • Modernizing the information system
Have the activities planned for 2017 been implemented?	**Yes**
If yes/partially, include: • Description of steps taken • Timeline of implemented actions • Difficulties and delays in implementation • Whether the reform will continue in 2018 If no, explain why not	• Drawing up proposals for improving legislation (law and decrees) • In the framework of the project involving preparation of the document entitled “Introducing e-services at the Real Estate Administration by drawing up regulations, an action plan and cost analysis”, representatives of the Ministry of Finance and Real Estate Administration have provided support and actively participated in the preparation of the document drawn up by the consultant selected through UNDP assistance. • Implementation of e-services – use of data from cadastral records – ownership structure. To that end, the following is now possible: gaining insight into the data contained in cadastral records (inquiry based on ID, number of Ownership Certificate (OC)/Title Deed (TD) or number of cadastral parcel); insight into active applications related to specific immovable property in order to make sure that property transactions are secure; tracking status of deciding upon applications based on the code assigned

	at the moment of filing application. The data serves for informational purposes and is updated online in real time for the territory of Montenegro. The plan is to test e-services, which includes transfering over electronically signed OCs and TDs by the end of 2017, not only by notaries public, but also by all the users in accordance with the legislation. http://www.nekretnine.co.me/me/Katastarski_podaci.asp; http://ekatastar.me/ekatastar-web/action/elogin Implementation of e-services – use of data contained in cadastral records – overview of spatial data. To that end, the GeoPortal of the Real Estate Administration was set up and it enables overview of all the data available in the digital cadastral plan of the immovable property cadastre records (around 75% of the territory of Montenegro – 99% of urban area). Orthophotos are available from different periods of surveying of the territory of Montenegro (2004–2011). The data serves for informational purposes and is not updated online in real time. The digital cadastral plan is implemented continuously after verification of the database of records of immovable property cadastre. http://www.geoportal.co.me/ • Improving the quality of the cartographic database and developing a data model • Rules and procedures are currently being prepared to meet the new needs and demands of users of services and data • Proposal for the activities aimed at establishing a register of house numbers, streets and squares has been drawn up All activities are implemented continuously, due to constant improvements made to the procedures, business processes and data.

<table>
<tr><td></td><td colspan="2">• Human resource structure and filling vacancies
• Providing larger scope of funding for the purpose of implementing the planned projects.

The reform will certainly continue in order to put in place procedures compliant with European standards for all the activities falling under the competence of the Real Estate Administration and in accordance with the planned activities.</td></tr>
<tr><td rowspan="2">Actual cost of implementation and impact on the annual budget</td><td>Actual cost</td><td>Planned cost</td></tr>
<tr><td>€50,000</td><td>€380,000</td></tr>
<tr><td>Source of funds</td><td colspan="2">Government budget – €50,000 (€50,000 was allocated in the budget for maintenance and licensing needs).</td></tr>
</table>

Priority Reform Measure 12: Introducing electronic fiscal invoicing in order to reduce the size of the informal economy

<table>
<tr><td>Brief description of activities planned for 2016
Brief description of activities planned for 2017</td><td colspan="2">During 2016, implementation of the following activities is planned:
• Develop the project “Introducing electronic fiscal invoicing”
During 2017, implementation of the following activities is planned:
• Develop tender documentation for the procurement of hardware and software
• Adopt legislation in the area of fiscal invoicing
• Sign contract upon completion of the launched public call</td></tr>
<tr><td>Have the activities planned for 2016 been implemented?
Have the activities planned for 2017 been implemented?</td><td colspan="2"><u>Yes</u>
<u>Partially</u></td></tr>
<tr><td>If yes/partially, include:
• Description of steps taken
• Timeline of implemented actions
• Difficulties and delays in implementation
• Whether the reform will continue in 2018

If no, explain why not</td><td colspan="2">• Consultations were carried out concerning the experiences of countries that have introduced fiscal invoicing
• Working draft of the legislation was prepared
• Tender documentation was prepared for procurement of hardware and software
• Additional consultations were required with experts concerning assessment of the quality of the working draft of the legislation
• Adoption of legalization on electronic fiscal invoicing can be expected by the end of 2018</td></tr>
<tr><td rowspan="2">Actual cost of implementation and impact on the annual budget</td><td>Actual cost</td><td>Planned cost</td></tr>
<tr><td>-</td><td>Up to €1,000,000</td></tr>
<tr><td>Source of funds</td><td colspan="2">Government budget</td></tr>
</table>

Priority Reform Measure 13: Improving financial support for the small and medium-sized enterprise sector

Brief description of activities planned for 2016 Brief description of activities planned for 2017	Financial support for the SME sector for 2016 included updating the existing financial instruments and creating new ones (loans, factoring arrangements, grants and equity investment instruments) in order for them to be better used by the SME sector, as well as grant support for cluster development. Financial support segment to the SME sector for 2017 is a continuation of activities from 2016, with a particular focus on: - Improving credit schemes for start-ups and the SME sector by facilitating conditions for access to finance by reducing the interest rate, zero-interest lending, co-financing costs, training for various categories (university graduates, young people, women, laid-off workers, technological surplus, start-up companies, companies planning to access foreign markets, etc.) - Using financial support in the form of grant schemes for creating new clusters and improving the functioning of existing ones as well as harmonization with international business standards - Further implementation of the COSME guarantee facility for SMEs by CKB bank with favourable terms for accessing loans, implementation of financial instrument for equity investments for innovative start-ups and SMEs using the WB EDIF–ENIF Fund
Have the activities planned for 2016 been implemented? Have the activities planned for 2017 been implemented?	**Yes** **Yes**
If yes/partially, include: • Description of steps taken	- In 2016 the IDF placed 457 credit placements with a value of €128.5 million, of which 416 are loans with a value of €71.4 million and 40 are factoring arrangements with a value of €57.1 million for purchased receivables, resulting in opening/preserving 6,711 jobs. - In the period 1 January to 31 December 2017, the IDF approved 439 loans (long-term and short-term) totalling €175,6 million, which is approx. 36% more than 2016. Of this number, 407 loans amounting to €110,9 million were approved, while 32 contracts were realized in the segment of factoring and €64,65 million of receivables were purchased. The placed funds provide support for opening/preserving more

• Timeline of implemented actions • Difficulties and delays in implementation	than 8,469 jobs. The financial offer is being implemented under 33 credit lines which were updated in 2017 to include support for women with employment potential, for technological redundancies, greenfield investments and fostering exports. Incentive measures are reflected in a 0.5% reduction in interest rates compared to 2016, thus they range from 0 to 4.5% with an additional reduction aimed at providing incentives for the northern region and municipalities with below-average development, for those employing 5 or more new personnel, when submitting a bank guarantee as security interest and for business entities on the whitelist of taxpayers. Financing via factoring arrangements is improved by a reduction of the interest rate and fees of 1% compared to 2016 (the level of interest rate and fees ranges from 3.5 to 4.25%); and by offering new financing models (soft, contract and seasonal factoring). In addition to the financial support to the SME sector, in cooperation with line ministries the IDF organized the seminar "Možeš i ti (*You can do it)*" attended by 477 participants. Moreover, 11 presentations were organized during 2017 in cooperation with the Employment Office, as part of the campaign "Šansa za posao (*A chance for a job)*", attended by more than 470 participants. The priority target groups were presented with the possibilities of access to financial and non-financial assistance in order to start their own businesses. - In 2016, financial support in the form of grants was provided for 6 clusters totalling €23,687; in 2017 total 7 contracts for grants were signed in amount of €98,000, of which 5 clusters have completed their projects and were granted the right to financial support totalling €64,700. In order to comply with international business standards, grants for 34 companies who successfully closed the project were disbursed in the amount of €55,400. - As part of the COSME programme, CKB bank placed €11.6 million for 610 enterprises via a credit guarantee instrument (from July 2015 to 30 June 2017), without a need for them to provide a collateral. - Utilization of the new financial instrument for equity investments as part of the WB EDIF (ENIF) for start-up innovative enterprises and enterprises in the development phase engaged

• Whether the reform will continue in 2018 If no, explain why not	in innovative activities is in the starting phase, after signing a contract on accessing ENIF by the IDF in 2016; and activities in 2017 were directed towards promotion and presentation with this type of financing for SMEs. • Financial support for SMEs is being implemented using financial instruments (loans, factoring and grants) continuously in the period 1 January to 31 December 2017. • SME financial support activities (loans, factoring and grants) for 2017 are implemented within defined scope, while the segment concerning introduction of the instrument of equity financing is still in the initial stage. • The reform measures of improving financial support to SME sector will continue with implementation in 2018 as well.	
Actual cost of implementation and impact on the 2017 annual budget	Actual cost	Actual cost of implementation and impact on the 2017 annual budget.
	€175,725,668.00	€120,100,000.00
Source of funds	**Government budget/loan –2017** Government budget – €120,540.00 Loans – €175,605,447.00 (IDF funds from EIB loan, repayment and revenues from interest and fees)	

Priority Reform Measure 14: Improving non-financial support for the small and medium-sized enterprise sector

Brief description of activities planned for 2017	During 2017 implementation of the following activities is planned: • Organising entrepreneurial training for start-ups with a focus on women and young people (education on starting and managing business, development of business plans, the financial and tax system and legislation) • Creating an electronic database on advisory-service providers (consulting) for SMEs • Implementation of the project "Mentoring Services for SMEs" • Providing advisory services as part of the EEN • Organizing B2B events • Organizing training for improving export performances of enterprises • Technical support for preparation of project proposal for applying for foreign sources; support in preparation and implementation of projects for programme of support to clusters in applying for grants.
Have the activities planned for 2017 been implemented?	**Yes**
If yes/partially, include: • Description of steps taken	**Improving financial literacy and investment readiness through training** • In February 2017, the Agreement on Cooperation for the Project of Establishing and Promoting a Mentoring System for Small and Medium-Sized Enterprises in the Western Balkans (Phase II), between the Ministry of Economy – Directorate for SME Development and the Japanese International Cooperation Agency (JICA) was signed. As part of phase II of the project, 6 new mentors were trained. Within the public call for enterprises, new users of mentoring services, 17 new enterprises have applied for new mentoring services scheme, application evaluation is in progress. • The Agreement on Cooperation between the Ministry of Economy – Directorate for SME Development and the Investment and Development Fund of Montenegro JSC was signed for implementation of the "Programme for Support for Entrepreneurship Development" was signed. A public call was launched in the period from 24 September to 13 October 2017, and 12 applications were

	received. After verifying whether the criteria set in the public call had been met, one application was rejected, while the 11 remaining candidates met the requirements for a further implementation phase – attending entrepreneurial cycle of education, which took place in the period 30 October to 6 November 2017 (6 days). The following topics covered by the education were: the legal basis and procedures for registration of business entities; financial management and the tax system in Montenegro; marketing and branding of SMEs; business communication; development of business ideas; and sales channels. A business plan was developed for 9 candidates and project documentation, which was sent to the IDF for the final decision on lending. **Development of the consulting services market** • An electronic database was created containing data on business advisory service providers (consultants) for SMEs **Internationalization of SMEs** • Continuous delivery of advisory services about international markets as part of the Enterprise Europe Network (EEN); information support provided for 80 enterprises • As part of the second annual forum of the EU Strategy for the Adriatic and Ionian Region (EUSAIR), the EEN organized B2B events for eight Montenegrin enterprises • B2B events for four Montenegrin enterprises were organized as part of the Business Forum on Internationalization – Jahorina, Bosnia and Herzegovina • As part of the first conference on women's entrepreneurship in the Republika Srpska, Banja Luka, B2B events for five women entrepreneurs were organized • As part of the conference SME Vision 2020, Skopje, Macedonia, business events attended by two enterprises from Montenegro were organized • In order to strengthen the competitiveness of enterprises, with the financial support of the EEN, four seminars were organized with the topics: "Transition to the ISO 9001:2015 standard"; "Quality standard – bases for development of innovation in wood processing"; and "Differentiation of products – bases for development of innovation"

<table>
<tr>
<td rowspan="1">• Timeline of implemented actions
• Difficulties and delays in implementation
• Whether the reform will continue in 2018

If no, explain why not</td>
<td colspan="2">• In cooperation with the Ministry of Science, the EEN organized an information event on the usage of the available EU funds, with the focus on the Horizon 2020 programme, which took place at Tehnopolis in Nikšić. The event was an opportunity to better connect innovative communities in Montenegro, networking with foreign partners, as well as discussion about innovation. Enterprises from the region also shared their experiences, as well as enterprises from Montenegro.

Support for cluster development
• As part of the technical support for preparation of project proposals for applying for foreign and domestic sources of financing, and support in preparation and implementation for the programme of support to clusters for applying for grants, a consultant was hired to provide assistance to clusters in preparing applications for the state-aid programme and was also tasked with monitoring and supporting the implementation of approved projects (joint project of the Ministry of Economy and UNDP – Improving the Competitiveness of the Economy in Montenegro).

- Non-financial support for SMEs to be implemented continuously from 1 January to 31 December 2017.

The reform will continue in 2018 as well.</td>
</tr>
<tr>
<td rowspan="2">Actual cost of implementation and impact on the 2017 annual budget</td>
<td>Actual cost</td>
<td>Actual cost of implementation and impact on the 2017 annual budget</td>
</tr>
<tr>
<td>€179,409.57</td>
<td>€173,213.00</td>
</tr>
<tr>
<td>Source of funds</td>
<td colspan="2">Government budget/donation
Government budget – €150,165.07
EU donation – €29,244.50</td>
</tr>
</table>

Priority Reform Measure 15: Establishing a science and technology park in Podgorica

Brief description of activities planned for 2016 Brief description of activities planned for 2017	The measure contained in the 2016 ERP related to the development of an innovation and entrepreneurial centre – Tehnopolis – in Nikšić, and this was fully implemented. During 2017, implementation of the following activities is planned in phases: Preparation: • Securing a facility for accommodation of the STP Implementation: • Implementation of the tender for developing a conceptual design and a detailed design for the STP
Have the activities planned for 2016 been implemented? Have the activities planned for 2017 been implemented?	**Yes** **Partially**
If yes/partially, include: • Description of steps taken • Timeline of implemented actions • Difficulties and delays in implementation • Whether the reform will continue in 2018 If no, explain why not	– At a session held on 8 June 2017, the government gave its consent to the Conclusion of the Management Board of the University of Montenegro, for repurposing the content of "Building No. 1" – university facilities, at urban parcel No. 12 under the coverage of the DUP "University Centre – Amendments", Deed of Title No. 974 CM Podgorica, for the needs of establishing the STP MNE in Podgorica as a form of a business organization, the co-founders of which will be the Government of Montenegro and the University of Montenegro. The repurposing of the contents of the existing University of Montenegro building under construction is approved, with rough construction works completed, the purpose of which was for the Faculty of Political Sciences, the Institute for Foreign Languages and the Faculty of Pharmacy, on Mihailo Lalić Boulevard in Podgorica. – The activities of the Ministry of Science and University of Montenegro on preparing and publishing the tender for development of the conceptual design

	and detailed design are in process and will be funded from the "INVO" project. The reform will continue in 2018.	
Actual cost of implementation and impact on the annual budget	Actual cost	Planned cost
	The detailed design will specify the amount of required funds	
Source of funds	**World Bank loan – "INVO" project for development of the detailed design.** In addition, the Ministry of Science applied for funding for the STP from the 2018 Capital Budget of Montenegro and through the GAP (Gap Assessment of the Project) Sector Other infrastructure – Science.	

Priority Reform Measure 16: Developing business zones with a view to encouraging direct investment and increasing employment

Brief description of activities planned for 2017	During 2017 implementation of the following activities is planned: • Proclaiming and establishing the first business zone of strategic significance in Montenegro • Establishing a business organization to manage the business zone of strategic significance • Preparing a plan of activities required to be undertaken for the purpose of establishing and the smooth operation of the business zone of strategic significance • Phased equipping of the first business zone of strategic significance with infrastructure, in accordance with the needs of potential investors.
Have the activities planned for 2017 been implemented?	**Partially**
If yes/partially, include: • Description of steps taken • Timeline of implemented actions • Difficulties and delays in implementation • Whether the reform will continue in 2018 If no, explain why not	Mojkovac Municipality harmonized the Decision on Establishing Business Zones of Local Significance with the provisions of the Decree on Business Zones. The Decree on Business Zones was amended in terms of extending the deadline for harmonizing the local self-government's operations with the provisions of the Decree – the reason are difficulties in resolving property-related legal issues on specific locations and the provision of infrastructure – the deadline has been extended until 21 June 2018 when the remaining seven municipalities are expected to harmonize their Decisions on Establishing Business Zones of Local Significance with the provisions of the Decree on Business Zones. The amendments to the Decree on Business Zones are under preparation in terms of regulating the provisions related to providing infrastructure at the local level, as well as regulating property-related legal issues and operating model of business zones if a location or a portion of a location

	is under private ownership – the rights and obligations of founders, managers and owners The new project with UNDP will plan the development of terms of reference in view of providing the infrastructure of each business zone location of local significance separately. Difficulties have arisen due to the lack of financial resources and insufficient engagement of local self-government units in view of harmonizing the project documentation and local regulations with laws and enabling regulations from the central government level. The reform will also continue in 2018.	
Actual cost of implementation and impact on the annual budget	Actual cost	Planned cost
	€40,000	€150,000
Source of funds	**Government budget/donation**	

Priority Reform Measure 17: Developing qualifications in accordance with labour market needs

Brief description of activities planned for 2016 Brief description of activities planned for 2017	During 2016 implementation of the following activities is planned: • Analysis of the existing qualifications and vocational education curricula for the purpose of establishing the need for a review thereof, as well as establishing the need to develop new curricula. Also, the development of five vocational education curricula and 12 examination catalogues for verification of non-formally and informally acquired occupational titles was planned. During 2017 implementation of the following activities is planned: • Development of 10 education curricula, a minimum of 150 teachers trained to implement outcome-based education and eight schools equipped for implementation of modernised curricula.
Have the activities planned for 2016 been implemented? Have the activities planned for 2017 been implemented?	**Yes** **Yes**
If yes/partially, include: • Description of steps taken • Timeline of implemented actions • Difficulties and delays in implementation • Whether the reform will continue in 2018 If no, explain why not	Analysis has been carried out on the existing qualifications and education curricula with recommendations about which qualifications and curricula should be reviewed and which are lacking in the labour market. The Qualifications Council and National Council adopted: - 39 vocation standards - 19 qualifications standards - 12 examination catalogues The methodology for developing vocational education curricula, which was adopted by the National Education Council in December 2016, supports the modularization of education curricula, which are in accordance with the concept of outcome-based learning and ensures better inter-subject connection, as well as connecting theory and practice. For all education

	curricula the number of apprenticeship classes to be carried out with an employer is stipulated. Three education curricula (in geodesy, hospitality and graphics) and two education curricula for students with special educational needs (in services and auto mechanics) have been developed. In the 2017/2018 school year the application of 10 education curricula that contain modules and are outcome-based learning curricula commenced. The development of the curricula was preceded by a whole set of activities. Methodologies have been developed for vocation standards, qualifications standards, examination catalogues and education curricula. The methodologies were adopted by the Qualifications Council and National Education Council. The following have been developed: - Guidelines for teachers in vocational schools for the development of new education curricula - Guidelines for teachers in vocational schools for the implementation of new education curricula - Guidelines for teachers in vocational schools for the implementation of apprenticeships in line with new education curricula The following have been developed: - 29 vocation standards - 26 vocational qualifications standards - 10 standards for education level qualifications Based on these documents the curricula from the following areas have been developed: - Energy – two curricula: Electrical Engineering Technician, IV1 and Electrician, III

	- Mechatronics – Mechantronics Technician, IV1 - Economics and law – two curricula: Economics Technician, IV1 and Legal-Administrative Technician, IV1 - Construction and spatial planning – two curricula: Architecture Technician, IV1 and Plumber, III - Hospitality – two curricula: Restaurateur, IV1 and Waiter, III - Services – Fashion Design Technician, IV1. The entirely new curricula are Fashion Design Technician and Mechatronics Technician, and the rest have been modernized. In the new curricula for high vocational school lasting four years, the numbers of mathematics and foreign language classes have been equalized at three classes in each grade. In this way the four-year education standard is improved, taking into account the significance of mathematics and language literacy. Also, in four-year curricula the number of IT classes is increased, while IT was previously studied only in the first grade with two classes, now it is studied in two classes in the first grade and two classes in the second grade. This is for the reason that digital skills are required for everyday life and for the type of work with modern technologies that the current students will encounter in the course of their work. For new education curricula, new curricula have been developed for the subjects: Mathematics, Montenegrin and foreign languages, Physics, Chemistry, Biology and others. Curricula for general-education subjects have been developed according to the outcome-based learning concept. The curricula will be implemented in 22 vocational and combined schools.

<table>
<tr><td></td><td colspan="2">Twelve examination catalogues have been developed according to which the adults can verify non-formally and informally acquired knowledge.

Over 280 members of working groups from all schools in Montenegro that will be implementing the new curricula, different institutions and 17 business organizations took part in developing all these documents.

Over 180 teachers were trained in a five-day training programme regarding the following topics: the labour market and vocational education; the concept of outcome-based learning; analysis of education curricula and modules; development of a module implementation plan; planning of implementation of a class according to outcome-based learning and the annual work programme of teachers; planning of evaluation and evaluation instruments.

There were no delays in the implementation of the activities.
In 2018, 15 new education curricula and training courses are planned for a minimum of 250 teachers for the purpose of implementing outcome-based-learning education.</td></tr>
<tr><td rowspan="2">Actual cost of implementation and impact on the annual budget</td><td>Actual cost</td><td>Planned cost</td></tr>
<tr><td>€891,466.83</td><td>€891,466.83</td></tr>
<tr><td>Source of funds</td><td colspan="2">Government budget €184,560.00
IPA €706,906.83</td></tr>
</table>

Priority Reform Measure 18: Aligning higher education with labour market needs

<table>
<tr><td>Brief description of activities planned for 2017</td><td>During 2017 implementation of the following activities is planned:
Adoption of the Law Amending the Law on Higher Education
Develop a Tracer Study
Introduce system to detect plagiarized papers
Develop a proposal of the Law on Academic Integrity
Implement a reformed 3+2+3 study model at the University of Montenegro, with exception of programmes for regulated professions and programmes for the education of teachers
Implement a programme for the professional training of university graduates in 2017/18
Preparation for implementation of the so-called follow-up evaluation of higher education institutions by the EUA–IEP
Introduce of the new so-called contract-based model of financing at the University of Montenegro</td></tr>
<tr><td>Have the activities planned for 2017 been implemented?</td><td><u>Yes</u></td></tr>
<tr><td>If yes/partially, include:
Description of steps taken
Timeline of implemented actions
Difficulties and delays in implementation
Whether the reform will continue in 2018
If no, explain why not</td><td>On 29 June 2017, the Parliament of Montenegro adopted the Law Amending and Supplementing the Law on Higher Education. The core objective of amendments and supplements to the law was to resolve the problem of needs mismatch in education and the labour market, which also leads to an increase in the unemployment rate. Rationalization of enrolment policy, observing labour market developments, cooperating with employers, regular analysis of supply/demand developments, and the introduction of mandatory practical curricula of 25% minimum for all study programmes will contribute to further alignment of enrolment policy with labour market needs and avoid creating surpluses in qualifications.</td></tr>
</table>

	The University of Montenegro carried out a reform of the study model, whereby the existing studying model of 3+1+1+3 was replaced with 3+2+3, except for regulated professions. At its session in March 2017, the government was informed about the defined learning outcomes for all the study programmes being implemented at the University of Montenegro. As part of the Higher Education and Research for Innovation and Competitiveness Project, and based on the prepared feasibility study for setting up the Tracer Study system, a survey of students was carried out who graduated in 2009 and 2013. A detailed analytical report, based on the data obtained from the survey of students and its presentation was held on 24 October 2017. The results of the survey show, among other things, that out of the total number of students who graduated in 2009, 82% are currently employed, while 66% of those who graduated in 2013 are employed. In line with the Higher Education Reform Strategy 2016–2020, and in order to finalize the required documentation relating to guaranteeing the quality of higher education, a feasibility study on introducing an adequate system to prevent plagiarism in Montenegro was prepared, with defined activities for implementation of the proposed model. In June 2017 a contract on the purchase of software to detect plagiarism (iThenticate) was signed with the US company Turnitin LLC, which enables access to the best-known global databases, both open and restricted, in order to enable the comprehensive cross-checking of papers. In line with the stated individual needs of all higher education institutions, precisely signed contracts and the inspection of up to 5,600 papers is enabled over a two-year period. The system is fully operational. In order to further improve the quality of higher education, a law on academic

	integrity is planned to be drafted, which will govern protection against plagiarism, as one of the most severe forms of abuse of intellectual property rights. The subject matter of the law will include, among other things, measures to avoid any failure to comply with moral and professional principles, as well as sanctioning them. A working group to draft the law was created, while the advisory support of the Council of Europe had already been agreed in the form of foreign experts' participation. In order to improve the quality of higher education and ensure the independence and transparency of the working bodies tasked with quality assurance, the Agency for Higher Education Control and Quality Assurance was established. Preparations for follow-up coordinated evaluation of the higher education institutions which will be carried out by the EUA–IEP during 2017/2018. Activities concerning the preparation of the new model of higher education financing have commenced, a so-called contract-based financing model, based on each institution's results. The new model will provide for the more efficient financing and financial stability of the University. Activities concerning works for refitting four faculty buildings of the University of Montenegro (faculties of Philosophy, Civil Engineering, Law, and Tourism and Hospitality) are currently underway to enable access for disabled people. The value of these works is estimated at €220,000.00. The planned completion of works will be in mid-2018. The programme for the professional training of university graduates has been implemented for six years in a row, in accordance with the Law on the Professional Training of University Graduates. After the procedure was carried out electronically to link beneficiaries and employers, 2,969 university graduates have received the opportunity for nine-month

	professional training with a selected employer in the first round, and thus are entitled to take professional examinations or state examinations. Two hundred and seventy-two beneficiaries were not assigned an employer, while more than 7,000 jobs remained vacant for professional training in the public and private sectors. In the period 1–5 December 2017, the second round of electronic linking of the remaining beneficiaries and employers took place for those that were without an assigned employer at the end of the first round. After the second round, 86 beneficiaries received the opportunity for professional training with a selected employer. Given the set strategic objectives, the reform activity will also continue in the forthcoming period.	
Actual cost of implementation and impact on the annual budget	Actual cost	Planned cost
	€8,450,000.00	€8,500,000.00
Source of funds	Government budget – €8,000,000 Credit – €450,000	

<u>Priority Reform Measure 19: Amending legal provisions in the field of the labour market</u>

<table>
<tr><td>Brief description of activities planned for 2017</td><td colspan="2">During 2017 implementation of the following activities is planned:
• Drafting the proposal of the Labour Law
• Drafting the proposal of the Law on Employment and Exercising Rights arising from Insurance against Unemployment (including new job titles)</td></tr>
<tr><td>Have the activities planned for 2017 been implemented?</td><td colspan="2"><u>Partially</u></td></tr>
<tr><td>If yes/partially, include:
• Description of steps taken
• Timeline of implemented actions
• Difficulties and delays in implementation
• Whether the reform will continue in 2018

If no, explain why not</td><td colspan="2">Drafting the proposal for the Labour Law:
The working group for drafting the new Labour Law prepared a text of the draft Labour Law and submitted it for public consultation on 4 August 2017.

Drafting the proposal for the Law on Employment and Exercising Rights arising from Insurance against Unemployment.
The working group for drafting the new Law on Employment and Exercising Rights arising from Insurance against Unemployment prepared a text of the draft Law on Employment and Exercising Rights arising from Insurance against Unemployment and submitted it for public consultation on 5 August 2017.

With a view to extending the public consultation, as well as the procedure of further alignment with relevant institutions and the need for alignment with the European Commission, this reform measure will continue in 2018 as well.</td></tr>
<tr><td rowspan="2">Actual cost of implementation and impact on the annual budget</td><td>Actual cost</td><td>Planned cost</td></tr>
<tr><td></td><td></td></tr>
<tr><td>Source of funds</td><td colspan="2">Government budget/donation</td></tr>
</table>

Priority Reform Measure 20: Amending legal provisions in the field of social protection

Brief description of activities planned for 2017	- The reform measure envisages amendments to the legal provisions regarding reducing benefits for mothers of three or more children by 20% nominally and postponing until 1 July 2017 application of the entitlement to child benefit for children attending primary or secondary education, provided that their parents are not beneficiaries of social welfare or financial benefits on any grounds and are registered with the Employment Office as unemployed, which will lead to more rational use of the funds and their allocation towards beneficiaries who are the most needy.
Have the activities planned for 2017 been implemented?	**Yes**
If yes/partially, include: • Description of steps taken • Timeline of implemented actions • Difficulties and delays in implementation • Whether the reform will continue in 2018 If no, explain why not	In January 2017, the Law on Amending and Supplementing the Law on Social and Child Protection (Official Gazette of Montenegro, No. 01/2017) was published, which reduced the benefits for mothers of three or more children, and thus the benefit amounting to 70% of the average net wage (€336) was reduced to the amount of €264, while the benefit amounting to 40% of the average net wage (€192) was reduced to the amount of €144, and the application of the entitlement to child benefit for children attending primary or secondary education, provided that their parents are not beneficiaries of social welfare or financial benefits on any grounds and are registered as unemployed with the Employment Office was postponed until 1 July 2017. There were no difficulties or delays in implementing the measure. The reform measure will not continue in 2018, given that the Law on Executing the Decision of the Constitutional Court of Montenegro U-I No. 6/16 of 19 April 2017 (Official Gazette of Montenegro, No. 42/17) was adopted on 29 June 2017, and Article 12 thereof abolished the execution of decisions setting the right to benefits for

	mothers of three or more children; also, on 29 June 2017 the Law Amending and Supplementing the Law on Social and Child Protection (Official Gazette of Montenegro, No. 42/17) was adopted and the provisions of Articles 28 and 29 thereof removed the right to a benefit for mothers of three or more children. Moreover, the provision of Article 23 of the Law Amending and Supplementing the Law on Social and Child Protection (Official Gazette of Montenegro, No. 42/17) removed a provision pertaining to the entitlement to child benefit for children attending primary or secondary education, provided that their parents are not beneficiaries of social welfare or financial benefits on any grounds and are registered as unemployed with the Employment Office. The Law on Executing the Decision of the Constitutional Court of Montenegro U-I No. 6/16 of 19 April 2017 (Official Gazette of Montenegro, No. 42/17) defined the right to a benefit for former beneficiaries of benefits for mothers of three or more children who were entitled to such benefit based on their years of service, provided that they had regular employment with an open-ended contract before exercising the right to the benefit and that they left employment voluntarily. Activities concerning the adoption of the decision on exercising this right followed after that.	
Actual cost of implementation and impact on the annual budget	Actual cost	Planned cost
	For the first six months of 2017, €26,006,341.29 was paid for benefits for mothers of three or more children, which represents a **saving of €6,843,037.71 for the first six months of 2017,** if we take as the baseline parameter the data	Based on the data for December 2016, 21,597 beneficiaries were entitled to receive the benefit. For the category of beneficiaries where the reduction would have been from €336 to €264, the planned annual saving in 2017 will

	for December 2016 when it was paid €5,474,896.50. Moreover, due to the deferred application of child benefit until 1 July 2017, a saving of approximately €800,000 was made, which makes a total saving of €7,643,031.71 for the first six months of 2017.	be €7.63 million (i.e. a reduction in expenditure from €35.6 million to €27.97 million), while for the category where the reduction was from €193 to €144, the planned annual saving was around €7.35 million (a reduction in expenditure from €29.41 million to €22.06 million). The plan for the resolution, adopted by the Parliament of Montenegro for the period 2017–2019, estimated that the saving for this item on the expenditure side of the budget in 2017 would amount to €14.9 million. This would amount to €7.45 million for the first six months of 2017. The fiscal impact of deferring the application of the provisions of this law, relating to payouts under the law, until 1 July 2017 for child benefits for children whose parents are registered unemployed with the Employment Office of Montenegro is approximately

		€800,000, and we can conclude from this data that the planned total savings for the first six months of 2017 **was around €8.25 million.**
Source of funds	Government budget	

Annex 2: External contribution to the preparation of the 2018–2020 Economic Reform Programme

COMMENTS ON THE DRAFT ERP

1. Stakeholders' contributions during the consultative process and the roundtable held on 27 December 2017

   a) Representatives of business associations

Montenegrin Employers' Union. The representative of the Employers' Union, Mr. Mirza Muleskovic, took part in the roundtable and expressed his satisfaction with the content and completeness of the document. He emphasized that it fully reflects the development priorities and addresses the challenges that the economy is facing.

Montenegrin Chamber of Commerce. The representative of the Chamber of Commerce, Ms. Nina Drakic, participated in the roundtable, emphasizing the quality of the document, as well as the fact that most of the proposals submitted by the Chamber during the drafting of the document had been noted and included in the 2018–2020 draft ERP. She concluded that any increase in tax burdens that would spill over into the private sector would result in a deterioration in the business environment, which is at this moment heavily burdened with parafiscal charges, especially at the local level.

Chamber of Commerce: A large number and high rate of levies, at the national and local levels, are burdening business conduct, and it is necessary to re-examine their amounts and, if possible, reduce them in such a way as to reflect the actual costs of the services provided.

Action/stance of the document's sponsor regarding the comment on the 2018–2020 draft ERP
The document's sponsor agreed that the analysis of parafiscal levies performed by employers' representatives was an important starting point for further improvement of the business environment. Accordingly, parafiscal charges, which are an obstacle to the strengthening of competition, are recognized in Chapter 4.3.4 *The business environment and the reduction of the informal economy.*

The Chamber of Commerce's representative also suggested that activities should continue on improving the conditions for investment, primarily through the further development of business zones of strategic and local importance, which would contribute to more intensive use of resources and to attracting investments, which are significant drivers of economic growth.

She pointed out that the inadequate level of qualification and the age structure of the workforce require more intensive cooperation between educational institutions and the economy, and continued activities in the development of dual education, with the aim of creating an appropriate environment for the development of the economy.

Action/stance of the document's sponsor regarding the comment on the 2018–2020 draft ERP
The document's sponsor replied to the above recommendation via two priority reform measures within the field of Education and Skills: Reform Measure 18: *Developing qualifications in line with labour market needs*, and Reform Measure 19: *Carrying out apprenticeships with employers*. The above recommendation was also addressed by Reform Measure 15, which deals with the establishment of a science and technology park in Podgorica, which, among other things, aims at establishing and fostering the link between education and business.

The Chamber's representative also pointed out that legislation concerning labour relations should be regulated in an adequate way in order to achieve the appropriate level of labour market flexibility and improve the conditions for job creation. Within the framework of labour legislation, special attention should be paid to social dialogue (social council), which is currently not regulated in an adequate way.

Action/stance of the document's sponsor regarding the comment on the 2018–2020 draft ERP
The mentioned recommendation of the Chamber of Economy was addressed by Reform Measure 20 relating to the implementation of legal provisions in the field of labour market with a focus on active employment policy. The measure relates to the preparation of a new Labour Law and the Law on Mediation in Employment and Rights during Unemployment, due to the prolongation of certain activities. The new Labour Law will more effectively regulate the field of labour relations and significantly increase flexibility and mobility in the labour market.

The Chamber also suggested that in the agricultural sector it is necessary to encourage the production of organic products, products with geographical origin indications, early fruit and vegetable production, as well as production in the protected area, since these are specific products of higher quality and value, appealing to the end customer, i.e. the market.

Action/stance of the document's sponsor regarding the comment on the 2018–2020 draft ERP
The above recommendation contributes to the elaboration of Priority Reform Measure 7 in the ERP relating to *Supporting investments in the food-production sector in order to reach EU standards*. This measure contains activities that specifically deal with the increased planting of the mentioned agricultural species, as well as encouraging the production of organic products. The measure is implemented with the aim of raising production and processing standards through harmonization with European standards for the growing, production and processing of agricultural products.

Chamber of Commerce: In the energy sector it is necessary to persevere in efforts to build a larger power facility that would ensure the country's independence, security and stability in the energy supply and address the issue of the deficit. In addition, incentives for investment in renewable energy should be continued.

Action/stance of the document's sponsor regarding the comment on the 2018–2020 draft ERP
The document's sponsor considers the above recommendation in the ERP's section on energy and transport reforms, and through Priority Reform Measure 5: *Fostering investments in the industrial sector* and Measure 6: *Supporting development and modernization of the industrial sector*.

Chamber of Commerce: In the tourist sector, further promotion and development of all forms of tourism, especially health, sport, cultural, religious, rural and nautical tourism, should be undertaken in order to improve the quality and diversification of the tourist offer, extend the season and increase earnings from tourism. In addition, investment in the construction of hotel facilities should be encouraged in order to increase and improve the overall accommodation capacities and quality of the tourist offer. Efforts should be made in encouraging greater participation of domestic agricultural products in the tourist offer through activities for linking supply and demand, creating joint projects for ensuring the quality, quantity and continuity of the supply of domestic products, with the aim of raising the level of quality and competitiveness in the world tourism market.

Action/stance of the document's sponsor regarding the comment on the 2018–2020 draft ERP
The document's sponsor acknowledged this recommendation and formulated Priority Reform Measure 8: *Diversifying the tourist product*, aimed at diversifying the Montenegrin tourist offer and positioning Montenegro as a high-end tourist destination. The above recommendation is also partly addressed by

Measure 7: *Supporting investments in the food-production sector in order to reach EU standards*, which will contribute to increased quality and thus better marketing of domestic products.

Chamber of Commerce: In order to eliminate the limiting factors of IT development, it is necessary to work on the development and availability of telecommunication infrastructure, as well as the development and availability of services of state administration, local governments and banks. Also, it is necessary to work continuously on the promotion of the information society and organization of IT education for citizens.

Action/stance of the document's sponsor regarding the comment on the 2018–2020 draft ERP
The Programme's sponsor partially addressed the recommendation by formulating Priority Reform Measure 16: *Improving the legislative and regulatory framework with a view to reducing the cost of deploying high-speed electronic communications networks*. This measure will create the necessary conditions for the valorization of the potential of the digital economy and the development of the digital economy.

Chamber of Commerce: In the construction sector, it is necessary to consider the possibility and ways to encourage the substitution of imported building materials by revitalizing existing facilities and equipment and acquiring new ones, which would allow the valorization of the available resources (timber and mineral resources) and development of the domestic economy.

Action/stance of the document's sponsor regarding the comment on the 2018–2020 draft ERP
The document's sponsor partially addressed the recommendation through Reform Measure 5: *Fostering investments in the industrial sector* and Measure 6: *Supporting development and modernization of the industrial sector*. One of the activities under Measure 6 is precisely the possibility of purchasing equipment that will improve the existing production.

Montenegro Business Alliance. The MBA was represented at the roundtable by Mr. Milan Dragic, while the suggestions for the Programme were provided by Ms. Bojana Kalezic in writing. In her letter, Ms. Kalezic expressed an affirmative opinion on the 2018 draft ERP and stressed the importance of the document for the economic development of Montenegro.

MBA: The document should underline the need for synchronized cooperation between public institutions and services, which implies the timely exchange of information in the interest of faster business development.

Action/stance of the document's sponsor regarding the comment on the 2018–2020 draft ERP
In view of these recommendations, Chapter 4.3.4. *Business environment and the reduction of the informal economy* addresses the need to strengthen coordination between public institutions and services, especially in the fight against the informal economy.

MBA: The Programme should consider the possibility of optimizing the number of employees in the public sector as a process which, in the opinion of the government, should start as soon as possible.

Action/stance of the document's sponsor regarding the comment on the 2018–2020 draft ERP
Optimization of the number of public employees is envisaged by the Public Administration Reform Strategy, which is stated in Chapter 3 of the 2018 ERP, where the text of the ERP was expanded in line with the MBA's comment.

b) Representatives of trade union organizations

Union of Free Trade Unions of Montenegro. The representatives of the UFTUM at the roundtable were Ms. Lidija Pejovic and Mr. Marko Subotic. Ms. Pejovic took part in the roundtable, stating that she would submit her comments in writing.

UFTUM: An increase in corporate income tax. Montenegrin corporate income tax is 9% and is currently the lowest in Europe and there is room for an increase. In EU countries and in our region, this tax is 2, 3 or 4 times as high as in Montenegro. On the other hand, a low CIT has not resulted in the expected attraction of foreign investment, especially not high-quality investments where CIT is not crucial for deciding to invest in a country.

Action/stance of the document's sponsor regarding the comment on the 2018–2020 draft ERP
The document's sponsor has not included the above recommendation in the ERP because of the opinion that CIT is to the greatest extent favourable for micro, small and medium-sized enterprises, which are dominant in the structure of companies. Also, Montenegro has developed its recognizable international position as a favourable investment destination by having a competitive tax system, and any change in the CIT would cause a significant deterioration in the business environment and disrupt Montenegro's position.

UFTUM: Further growth of the tax debt should be stopped. In the period from 2013 to date, the tax debt has grown on average by more than 120 million euro annually. This means that by preventing the emergence of new tax debt in 2018, the budget is expected to receive at least 120 million euro. Therefore, we expect the Tax Administration to collect taxes and contributions efficiently and regularly, and to sanction any deviation from the prescribed deadlines. In this regard, when it comes to the payment of taxes and contributions on employees' salaries, it is necessary to prescribe that this tax liability is due at the end of every month for the previous month, i.e., on the day when the employer is obliged to pay salaries to employees under the Labour Law.

Action/stance of the document's sponsor regarding the comment on the 2018–2020 draft ERP
In the 2017–2019 ERP, the Programme's sponsor already responded to this recommendation by adopting the Law on the Rescheduling of Tax Claims, the application of which is still ongoing. Hence, measures have already been taken to collect the tax debt, and in 2017, some 23 million euro of rescheduled tax debt has been recovered. By the end of 2021, it is expected to collect at least 20 million euro per year. All of the above is described in Chapter 3 of the 2018 ERP. The ERP Working Group certainly agrees with the proposal of the UFTUM, and it has been taken into account in Chapter 3 through measures for strengthening fiscal discipline and fighting the informal economy, as shown by the projection of the budget revenues from taxes.

UFTUM: A mechanism for creating new jobs should be provided.

Action/stance of the document's sponsor regarding the comment on the 2018–2020 draft ERP
The 2018–2020 ERP has proposed a series of reform measures aimed at boosting the environment for business creation and growth, and therefore job creation. In order to promote business branches with high added value and to create high-quality jobs, the document's sponsor has proposed Priority Reform Measures 5, 6, 7 and 8 in the field of Sector Development, accepting the UFTUM's comment. Moreover, measures are also proposed aimed at fostering the transition from school to work (Measures 18, 19 and 20).

UFTUM: A tax on financial transactions that exceed a certain limit should be introduced for legal entities and entrepreneurs.

Action/stance of the document's sponsor regarding the comment on the 2018–2020 draft ERP

The document's sponsor considered this recommendation but did not include it in the document because the analysis of the Central Bank of Montenegro on introduction of a tax on financial transactions showed that it would have a negative impact on the financial environment as the entire cost would be picked up by the client (the banking sector has already been protected from said measure). Also, the analysis carried out by the government in considering the above recommendation shows that an additional tax would negatively affect the overall competitiveness and liquidity of the economy.

UFTUM: Tax and other reliefs for companies should be eliminated, as many of them leave room for manipulation to the detriment of the budget (this relates to incentives such as VAT, tax and contribution reduction, fuel prices reduction, etc.).

Action/stance of the document's sponsor regarding the comment on the 2018–2020 draft ERP

Tax incentives are important for Montenegro from the aspect of the competitiveness of the country as an investment destination. This comment from UFTUM is discussed in Chapter 3 within the tax exemption analysis, in accordance with Recommendation 2 from the Ministerial Meeting in Brussels, held in May 2017. Since such tax exemptions are mostly related to supporting investments, which are the main growth drivers of the Montenegrin economy, it can be concluded that the existence of those exemptions has a positive effect on the attractiveness of the Montenegrin investment environment and overall economic activity. Certainly, in the forthcoming medium-term period, in line with EU recommendations, the possibility of abolishing certain tax exemptions will be considered, in accordance with Montenegro's obligations in the framework of EU membership negotiations.

UFTUM: The grey economy should be converted to formal flows. According to unofficial data, 40,000 people are involved in the grey market in the country. It requires concrete rather than declarative activity in order to bring part of the population into a legal labour relationship, for which a dedicated, well-designed and comprehensive campaign at the state level is needed.

Action/stance of the document's sponsor regarding the comment on the 2018–2020 draft ERP

The document's sponsor included this recommendation in Measure 20 referring to the implementation of legal provisions in the field of labour market, with a focus on active employment policy, as well as in the reform area related to the improvement of the business environment through the suppression of the informal economy. The strengthening of fiscal discipline and the fight against the grey economy are also addressed in Chapter 3, in line with the UFTUM's recommendation. These measures significantly contributed to the increase in the number of formal employees in the previous year.

UFTUM: Prudent spending of the budget funds should be ensured by increasing the level of accountability of all budget users through the sanctioning of any irresponsible and unlawful conduct.

Action/stance of the document's sponsor regarding the comment on the 2018–2020 draft ERP

The above recommendation has been considered and resulted in improvement of Chapter 3 through the strengthening of managerial accountability in the public sector. Strengthening managerial accountability in the public sector is part of Reform Area 1 "Public Finance Management" in Chapter 4 of the 2018 ERP. The priority measure which is a part of this area is under implementation, but it is not covered in more detail in ERP 2018 due to the limited number of reforms that can be included in the Programme (20).

UFTUM: A luxury tax should be introduced.

Action/stance of the document's sponsor regarding the comment on the 2018–2020 draft ERP

A luxury tax as a category does not exist in the European legislation which Montenegro has been harmonizing its own legislation with. Certainly, appreciating the meaning of this recommendation, taxes, i.e. excise duties on cigarettes and alcohol, are considered a luxury tax, and these have already been increased in Montenegro. Also, pursuant to the Real Estate Tax Law, any secondary immovable property owned by an owner is taxed at an additional rate, which is in line with the UFTUM's view of luxury taxation.

UFTUM: The privilege whereby public officials receive salary compensation from the budget for a year or two years, if they have that much time left until retirement, should be abolished.

Action/stance of the document's sponsor regarding the comment on the 2018–2020 draft ERP
Pursuant to the Law on Salaries of Public-Sector Employees, public officials receive remuneration for one year after the expiration of their public office. This is not considered a privilege because, under the Law on the Prevention of Corruption, a public official has no right to enter into a contractual relationship with any organization or institution with which the respective state administration body/local self-government was cooperating while he held the office, for two years after the termination of his/her term. Therefore, this comment would require amendments to several laws, and cannot be taken as a measure in ERP 2018.

Federation of Trade Unions of Montenegro. The representative of the Federation of Trade Unions (FTU) of Montenegro at the roundtable was Ms. Stanica Dragas, and the FTU submitted its proposals for the 2018 ERP in written form.

FTU: Increasing the VAT rate from 19% to 21% will potentially weaken the competitiveness of the economy, and it will also reflect on the living standard of the population, and it is necessary to look for a new model for balancing public finance. First of all, this refers to further differentiation of the VAT rate by introducing other, lower rates for basic products for human consumption, and the application of a single lower VAT rate on raw and processed meat, milk and flour. As a possibility to substitute the proposed facilities, the replacement of the zero-percent rate by a certain rate relating to products and services for the construction and furnishing of five-or-more-star hotels, as well as for the construction of large power facilities should be considered.

Action/stance of the document's sponsor regarding the comment on the 2018–2020 draft ERP
The recommendation has been considered, but it could not be part of the 2018 ERP because the VAT rate increase from 19% to 21% is part of Montenegro's Fiscal Strategy 2017–2020 that was adopted in 2017, and the VAT Law was accordingly changed in terms of a general VAT rate of 21% and the medium-term projections of VAT revenues were made. As for the zero-percent rate and the lower 7% rate, they will apply to all products and services as before, with an expansion of the coverage to the food and beverage services in hotels with four stars in the northern region and five stars or more in the central and coastal regions. Thus, about 30% of the turnover will still not be taxed at the rate of 21%, but at 0%, 7% or will not be subject to taxation. In the context of the consolidation situation, this is considered an optimal solution.

FTU: The minimum wage should be increased, the withholding of taxes and contributions should be decreased and the informal economy and unfair competition should be reduced.

Action/stance of the document's sponsor regarding the comment on the 2018–2020 draft ERP
Any activity on changing the minimum wage is considered to be a matter for discussion with the relevant stakeholders and any consideration of such a change must be preceded by a detailed analysis of the effects of such decision, which requires a lot of time, and therefore the response to this recommendation could not be part of the 2018–2020 ERP. Certainly, a tentative estimate of the

government, as well as the UNDP, is that an increase in the minimum wage up to 250 euros net for those who currently receive the minimum wage, as demanded by trade unions, would result in an increase in the cost of employers of about 40 million euros and would have a negative impact on the further growth of formal employment, which is definitely a common goal of both the trade unions and the government. Therefore, this request will be examined in more detail in the coming period, so as not to adversely affect the revenues of the state budget and further employment growth, but this may not be part of the 2018 ERP.

FTU: Actions aimed at improving the conditions for investment should be continued, as that will contribute to the more intensive usage of resources, and investors whose activities will yield new jobs should be particularly incentivized.

Action/stance of the document's sponsor regarding the comment on the 2018–2020 draft ERP
These recommendations were taken into account and addressed through Priority Reform Measure 5: *Fostering investments in the industrial sector*, whose implementation requires investments subject to the requirement to create a certain number of permanent jobs.

FTU: The trade deficit should be mitigated by encouraging domestic production, increasing exports of finished products instead of raw materials and semi-finished products and substituting imports by domestic products. It is necessary to intensify the activities on branding domestic products, services and supply in general, which is an opportunity for Montenegro in the coming period.

Action/stance of the document's sponsor regarding the comment on the 2018–2020 draft ERP
This recommendation has been appreciated and addressed through a number of sector-based measures, such as Measure 7: *Supporting investments in the food-production sector in order to reach EU standards*, which aims at increasing the production of import-dominant products. It has also been addressed by Measure 8: *Diversifying tourist products*, which will facilitate indirectly, through the promotion of Montenegro as a gastronomic destination, the sale of domestic products in tourist and hospitality facilities. Also, this comment is covered the measure relating to the strengthening of trade cooperation in the region by implementing CEFTA Additional Protocol 5.

FTU: Cooperation between educational institutions and businesses should be intensified and activities in the development of dual education should be continued in a more comprehensive way, thus removing the longstanding mismatch between supply and demand in the labour market and providing the necessary human resources for the development of the economy.

Action/stance of the document's sponsor regarding the comment on the 2018–2020 draft ERP
This recommendation has been accepted and addressed through two multiannual reform measures in the field of Education and Skills, and these are Measure 18: *Developing qualifications in line with labour market needs* and Measure 19: *Carrying out apprenticeships with employers*. The above measures aim to improve the link between the labour market and education, thereby increasing employability and facilitating the transition from school to work.

FTU: Training of business entities in better use of pre-accession funds, as well as of EU funds after accession, should be conducted.

Action/stance of the document's sponsor regarding the comment on the 2018–2020 draft ERP
This recommendation is included in Reform Measure 13 relating to improving non-financial support for the SME sector. Activities within the mentioned measure will include training of local entrepreneurs (SMEs) on how to identify, apply for and manage EU projects.

FTU: The strengthening of the competitiveness of SMEs requires further enhancement of financial and non-financial support (improvement of specific knowledge and skills), and improvement of the framework for development of the business infrastructure (business zones, technological parks, business incubators, quality infrastructure system, scientific and research infrastructure).

Action/stance of the document's sponsor regarding the comment on the 2018–2020 draft ERP

The ERP has partially responded to the above recommendation. The 2018 ERP includes Measure 12 concerning the strengthening of financial support for the SME sector, and Measure 13 for improvement of non-financial support to the SME sector. The measure referring to the strengthening of the business infrastructure is also part of the 2018 ERP – Measure 15, concerning the establishment of a science and technology park in Podgorica. Measures related to the establishment and strengthening of business zones and technological parks were part of the 2016 and 2017 ERPs and they have been completed (see Table 11 of the Annex to the ERP).

FTU: Improvement of the transport infrastructure and regional integration are important for the development of the overall economy, especially tourism.

Action/stance of the document's sponsor regarding the comment on the 2018–2020 draft ERP

This recommendation has been taken into consideration; however, pursuant to the EC's Guidance Notes for the 2018–2020 ERP, it was not possible to include infrastructure projects. The status of implementation of the transport infrastructure projects that were part of the 2016 and 2017 ERPs can be seen in Table 11 of the Annex to the ERP. These are Measure 5: *Construction of the Smokovac—Mateševo priority section of the Bar–Boljare highway*, and Measure 6: *Modernization of the Vrbnica–Bar section of the Bar–Belgrade railway line that goes through Montenegro*.

2. Contribution of the Parliamentary Committee on Economy, Finance and Budget to the 2018–2020 draft ERP

At the session of the Parliamentary Committee on Economy, Finance and Budget, the 2018–2020 draft ERP and its objectives were presented by the document's sponsor. The document was commented on by the committee chairperson as being very important for economic development.

The committee also included a representative of the Union of Free Trade Unions, who repeated all of the union's suggestions made at the roundtable on the draft ERP organized on 27 December 2017.

The committee made the conclusion that any comments on the 2018 draft ERP by MPs should be submitted in writing by no later than 24 January 2018.

Annex 3:

GDP (€ millions)	4,202.1		4,397.7		4,569.4		4,729.6	
Budget of Montenegro	**Estimate 2017**		**Estimate 2018**		**Estimate 2019**		**Estimate 2020**	
	€ millions	**% GDP**	**€ millions**	**% GDP**	**€ millions**	**% GDP**	**€ millions**	**% GDP**
Direct revenues	**1,580.02**	**37.6**	**1,705.25**	**38.8**	**1,770.01**	**38.7**	**1,822.92**	**38.5**
Taxes	**979.1**	**23.3**	**1,086.3**	**24.7**	**1,146.7**	**25.1**	**1,193.1**	**25.2**
Personal income tax	117.7	**2.8**	134.1	**3.1**	136.8	**3.0**	139.5	**2.9**
Corporate profit tax	48.7	**1.2**	49.9	**1.1**	51.9	**1.1**	53.6	**1.1**
Tax on immovable property transactions	1.5	**0.0**	3.4	**0.1**	3.5	**0.1**	3.5	**0.1**
Value-added tax	550.5	**13.1**	617.3	**14.0**	647.0	**14.2**	675.6	**14.3**
Excise taxes	225.6	**5.4**	246.4	**5.6**	271.8	**5.9**	284.6	**6.0**
Tax on international trade and transactions	25.8	**0.6**	25.1	**0.6**	25.5	**0.6**	25.8	**0.5**
Other government revenues	9.2	**0.2**	10.0	**0.2**	10.3	**0.2**	10.5	**0.2**
Contributions	**500.5**	**11.9**	**511.5**	**11.6**	**519.4**	**11.4**	**529.6**	**11.2**
Duties	**13.4**	**0.3**	**18.7**	**0.4**	**17.0**	**0.4**	**14.3**	**0.3**
Fees	**18.1**	**0.4**	**26.0**	**0.6**	**26.3**	**0.6**	**26.7**	**0.6**
Other revenues	**35.6**	**0.8**	**33.4**	**0.8**	**33.8**	**0.7**	**34.3**	**0.7**
Receipts from repayment of loans	6.7	**0.2**	4.8	**0.1**	4.9	**0.1**	5.0	**0.1**
Donations	26.6	**0.6**	24.5	**0.6**	21.8	**0.5**	20.0	**0.4**
Expenditures	**1,752.02**	**41.7**	**1,821.47**	**41.4**	**1,813.34**	**39.7**	**1,615.94**	**34.2**
Current budgetary spending	**1,493.4**	**35.5**	**1,533.8**	**34.9**	**1,529.5**	**33.5**	**1,535.9**	**32.5**
Current expenditures	**738.1**	**17.6**	**779.0**	**17.7**	**779.9**	**17.1**	**779.0**	**16.5**
Gross wages and contributions charged to employer	**439.1**	**10.5**	**439.0**	**10.0**	**441.6**	**9.7**	**442.4**	**9.4**
Other personal earnings	**10.1**	**0.2**	**12.5**	**0.3**	**12.0**	**0.3**	**12.0**	**0.3**
Expenditure on goods and services	**79.1**	**1.9**	**96.2**	**2.2**	**92.5**	**2.0**	**93.0**	**2.0**
Current maintenance	**20.6**	**0.5**	**22.3**	**0.5**	**22.0**	**0.5**	**22.0**	**0.5**
Interest	**95.4**	**2.3**	**85.5**	**1.9**	**91.4**	**2.0**	**91.4**	**1.9**
Rent	**9.1**	**0.2**	**9.6**	**0.2**	**9.5**	**0.2**	**9.5**	**0.2**
Subsidies	**27.3**	**0.7**	**27.0**	**0.6**	**26.0**	**0.6**	**24.5**	**0.5**
Other expenditures	**32.8**	**0.8**	**38.6**	**0.9**	**38.0**	**0.8**	**37.0**	**0.8**
Capital expenditures in the current budget	**24.4**	**0.6**	**48.3**	**1.1**	**46.9**	**1.0**	**47.2**	**1.0**
Social protection transfers	**562.4**	**13.4**	**551.4**	**12.5**	**553.9**	**12.1**	**560.2**	**11.8**
Social-protection-related rights	112.4	**2.7**	79.8	**1.8**	79.6	**1.7**	79.1	**1.7**
Funds for redundancies	15.4	**0.4**	20.4	**0.5**	16.1	**0.4**	14.6	**0.3**
Pension- and disability-insurance-related rights	410.2	**9.8**	425.7	**9.7**	433.2	**9.5**	440.5	**9.3**
Other health-protection-related rights	15.9	**0.4**	16.5	**0.4**	16.0	**0.4**	16.5	**0.3**
Other health-insurance-related rights	8.5	**0.2**	9.0	**0.2**	9.0	**0.2**	9.5	**0.2**
Transfers to institutions, individual, non-governmental and public sector	**167.8**	**4.0**	**183.5**	**4.2**	**179.0**	**3.9**	**180.0**	**3.8**
Capital budget	**258.6**	**6.2**	**287.7**	**6.5**	**283.8**	**6.2**	**80.0**	**1.7**
Borrowing and loans	**2.4**	**0.1**	**2.9**	**0.1**	**2.4**	**0.1**	**2.4**	**0.1**
Reserves	**22.8**	**0.5**	**17.0**	**0.4**	**14.3**	**0.3**	**14.3**	**0.3**
Repayment of guarantees	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Repayment of liabilities from the previous period	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Net increase in liabilities	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Surplus/deficit	**−172.0**	**−4.1**	**−116.2**	**-2.6**	**−43.3**	**−0.9**	**207.0**	**4.4**
Adjusted surplus/deficit	**−172.0**	**−4.1**	**−116.2**	**-2.6**	**−43.3**	**−0.9**	**207.0**	**4.4**
Primary deficit	**−76.6**	**−1.8**	**−30.8**	**-0.7**	**48.1**	**1.1**	**298.4**	**6.3**
Debt repayment	**220.4**	**5.2**	**179.7**	**4.1**	**529.3**	**11.6**	**759.5**	**16.1**
Debt repayment to residents	51.9	**1.2**	50.7	**1.2**	77.6	**1.7**	147.6	**3.1**
Debt repayment to non-residents	134.8	**3.2**	100.6	**2.3**	436.7	**9.6**	596.9	**12.6**
Repayment of liabilities from the previous period	33.7	**0.8**	28.4	**0.6**	15.0	**0.3**	15.0	**0.3**
Shortfall	**−392.4**	**−9.3**	**−295.9**	**-6.7**	**−572.6**	**−12.5**	**−552.5**	**−11.7**
Financing	**392.4**	**9.3**	**295.9**	**6.7**	**572.6**	**12.5**	**552.5**	**11.7**
Borrowing and loans from domestic sources	100.0	**2.4**	0.0	**0.0**	100.0	2.2	100.0	2.1
Borrowing and loans from foreign sources	292.4	**7.0**	295.9	**6.7**	472.6	10.3	452.5	9.6
Proceeds from privatization	0.0	**0.0**	0.0	**0.0**	0.0	0.0	0.0	0.0
Increase/decrease in deposits	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**

GDP (€ millions)	4,202.1		4,397.7		4,569.4		4,729.6	
Public spending	**2017**		**2018**		**2019**		**2020**	
	€ millions	**% GDP**	**€ millions**	**% GDP**	**€ millions**	**% GDP**	**€ millions**	**% GDP**
Direct revenues	**1,787.84**	**42.55**	**1,941.82**	**44.16**	**2,019.96**	**44.2**	**2,077.86**	**43.9**
Taxes	**1,114.88**	**26.53**	**1,229.42**	**27.96**	**1,292.64**	**28.3**	**1,342.02**	**28.4**
Personal income tax	156.22	3.72	173.39	3.94	176.82	3.9	180.31	3.8
Corporate profit tax	48.75	1.16	49.88	1.13	51.95	1.1	53.65	1.1
Tax on immovable property transactions	13.67	0.33	15.78	0.36	16.10	0.4	16.40	0.3
Value-added tax	550.46	13.10	617.34	14.04	646.97	14.2	675.64	14.3
Excise taxes	225.62	5.37	246.37	5.60	271.76	5.9	284.56	6.0
Tax on international trade and transactions	25.79	0.61	25.14	0.57	25.48	0.6	25.81	0.5
Local taxes	85.15	2.03	91.46	2.08	93.28	2.0	95.15	2.0
Other government taxes	9.21	0.22	10.05	0.23	10.28	0.2	10.49	0.2
Contributions	**500.46**	**11.91**	**511.55**	**11.63**	**519.44**	**11.4**	**529.56**	**11.2**
Charges	**19.46**	**0.46**	**24.83**	**0.56**	**23.32**	**0.5**	**20.71**	**0.4**
Fees	**65.02**	**1.55**	**93.87**	**2.13**	**104.22**	**2.3**	**106.12**	**2.2**
Other revenues	**48.82**	**1.16**	**46.87**	**1.07**	**47.59**	**1.0**	**48.31**	**1.0**
Receipts from repayment of loans	**6.73**	**0.16**	**4.83**	**0.11**	**4.89**	**0.1**	**4.96**	**0.1**
Donations	**32.47**	**0.77**	**30.46**	**0.69**	**27.86**	**0.6**	**26.19**	**0.6**
Public spending	**1,919.80**	**45.69**	**2012.61**	**45.77**	**2,017.05**	**44.1**	**1,823.72**	**38.6**
Current public spending	**1,619.57**	**38.54**	**1662.45**	**37.80**	**1,660.76**	**36.3**	**1,669.79**	**35.3**
Current expenditures	**818.44**	**19.48**	**860.97**	**19.58**	**863.53**	**18.9**	**864.31**	**18.3**
Gross wages and contributions charged to employer	**485.14**	**11.55**	**485.90**	**11.05**	**489.43**	**10.7**	**491.19**	**10.4**
Other personal earnings	**14.57**	**0.35**	**17.13**	**0.39**	**16.67**	**0.4**	**16.76**	**0.4**
Expenditure on goods and services	**94.67**	**2.25**	**112.02**	**2.55**	**108.66**	**2.4**	**109.48**	**2.3**
Current maintenance	**26.45**	**0.63**	**28.26**	**0.64**	**28.05**	**0.6**	**28.17**	**0.6**
Interest	**99.53**	**2.37**	**89.72**	**2.04**	**95.76**	**2.1**	**95.85**	**2.0**
Rent	**9.62**	**0.23**	**10.12**	**0.23**	**10.03**	**0.2**	**10.04**	**0.2**
Subsidies	**28.08**	**0.67**	**27.76**	**0.63**	**26.77**	**0.6**	**25.28**	**0.5**
Other expenditures	**35.98**	**0.86**	**41.81**	**0.95**	**41.26**	**0.9**	**40.33**	**0.9**
Capital expenditures in the current budget	**24.41**	**0.58**	**48.25**	**1.10**	**46.90**	**1.0**	**47.20**	**1.0**
Social protection transfers	**563.53**	**13.41**	**552.54**	**12.56**	**555.07**	**12.1**	**561.39**	**11.9**
Social-protection-related rights	113.53	2.70	80.95	1.84	80.79	1.8	80.31	1.7
Funds for redundancies	15.40	0.37	20.40	0.46	16.11	0.4	14.61	0.3
Pension- and disability-insurance-related rights	410.15	9.76	425.67	9.68	433.17	9.5	440.47	9.3
Other health-protection-related rights	15.93	0.38	16.50	0.38	16.00	0.4	16.50	0.3
Other health-insurance-related rights	8.53	0.20	9.03	0.21	9.00	0.2	9.50	0.2
Transfers to institutions, individual, non-governmental and public sector	**209.74**	**4.99**	**226.36**	**5.15**	**222.67**	**4.9**	**224.55**	**4.7**
Capital budget	**300.23**	**7.14**	**350.16**	**7.96**	**356.28**	**7.8**	**153.93**	**3.3**
Borrowing and loans	**3.11**	**0.07**	**3.57**	**0.08**	**3.14**	**0.1**	**3.15**	**0.1**
Reserves	**24.76**	**0.59**	**19.01**	**0.43**	**16.35**	**0.4**	**16.39**	**0.3**
Repayment of guarantees	0.00	0.00	0.00	0.00	0.00	**0.0**	0.00	**0.0**
Net increase in liabilities	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**	**0.0**	**0.00**	**0.0**
Repayment of liabilities from the previous period	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**	**0.0**	**0.00**	**0.0**
Surplus/deficit	**–131.96**	**–3.14**	**–70.79**	**–1.61**	**2.91**	**0.1**	**254.14**	**5.4**
Adjusted surplus/deficit	**–131.96**	**–3.14**	**–70.79**	**–1.61**	**2.91**	**0.1**	**254.14**	**5.4**
Primary deficit	**–32.44**	**–0.77**	**18.93**	**0.43**	**98.67**	**2.2**	**349.98**	**7.4**
Debt repayment	**280.42**	**6.67**	**240.66**	**5.47**	**582.31**	**12.7**	**810.51**	**17.1**
Debt repayment to residents	78.91	1.88	77.68	1.77	94.62	2.1	164.64	3.5
Debt repayment to non-residents	137.79	3.28	104.60	2.38	440.69	9.6	600.87	12.7
Repayment of liabilities from the previous period	63.72	1.52	58.38	1.33	47.00	1.0	45.00	1.0
Shortfall	**–412.38**	**–9.81**	**–311.45**	**–7.08**	**–579.40**	**–12.7**	**–556.37**	**–11.8**
Financing	**412.38**	**9.81**	**311.45**	**7.08**	**579.40**	**12.7**	**556.37**	**11.8**
Borrowing and loans from domestic sources	106.00	2.52	10.00	0.23	110.00	2.4	110.00	2.3
Borrowing and loans from foreign sources	296.41	7.05	299.89	6.82	476.64	10.4	456.53	9.7
Proceeds from privatization and sale of property	5.00	0.12	5.00	0.11	5.00	0.1	5.00	0.1
Transfers from the Budget of Montenegro	3.00	0.07	3.00	0.07	4.00	0.1	4.00	0.1
Use of government deposits	**1.96**	**0.05**	**–6.44**	**–0.15**	**–16.24**	**–0.4**	**–19.16**	**–0.4**

Annex 3: Investments on which economic growth is based in the period 2017-2020 (in millions of euros)

INVESTMENTS SECTOR/PROJECTS	2017–2020
TRANSPORT TOTAL	**976.1**
I Bar–Boljare Highway (Smokovac–Uvač–Mateševo section)	**618.2**
II Regional and arterial roads	**251.0**
Rožaje bypass phase II	20.0
Reconstruction of the road section (boulevard construction) Podgorica–Petrovac section, from the turn-off to Golubovci Airport to the start of the Golubovci bypass	3.3
Reconstruction of the Vilusi–Vraćenovići road, Petrovići–Vraćenovići section, length of 9 km	3.2
Reconstruction of part of the Slijapač most–Tomaševo–Pljevlja road, Crkvice–Vrulja section	2.0
Reconstruction of the Berane–Petnjica road	9.0
Reconstruction of the Pljevlja–Metaljka road	6.0
Reconstruction of the Ulcinj–Krute road	5.5
Reconstruction of the Berane–Kolašin road, Lubnice–Jezerine section	34.0
Reconstruction of the Cetinje–Njeguši road	5.0
Reconstruction and rehabilitation of the M-6 Ilino brdo–Vilusi road from km 129+700 to km 135+500	1.3
Reconstruction and rehabilitation of the M-2 Debeli Brijeg–Herceg Novi road from km 859+800 to km 861+900	0.9
Reconstruction of 8 bridges on the Slijepač most–Pavino polje road	0.8
Reconstruction and remediation of 48 points on the M 2.4 Cetinje–Budva road	1.0
Investment resurfacing of sections in Kotor	1.2
Investment resurfacing of sections in Podgorica	1.2
Investment resurfacing of sections in Nikšić	1.2
Investment resurfacing of sections in Berane	1.2
Investment resurfacing of sections in Pljevlja	1.2
M-2.3 Podgorica–Cetinje, site of Mekavac Tunnel	1.2
M-2.3 Podgorica–Cetinje–Budva from km 30+000 to km 35+900, Ulići–Ugnji roundabout site	2.5
M-2.3 Cetinje–Budva from km 35+900 to km 37+300, Ugnji–Obzovica crawler lane site	1.2
M-2.3 Cetinje–Budva from km 45+700 to km 51+000 Brajići–Lapčići	5.0
Reconstruction of the M-18 Danilovgrad–Podgorica arterial road from km 114+500 to km 129+500 Boulevard	25.0
M-2 Rožaje–Špiljani from km 1148+200 to km 1168+200 with remediation of tunnels and bridges	12.0
M-21 Barski most–Bijelo Polje from km 131+200 to 135+300 Barski most–Dobrakovo border crossing site	4.0
M-21 Barski most–Bijelo Polje from km 135+300 to 145+600 Dobrakovo–Bijelo Polje	3.5
M-8 Pljevlja–Mihajlovica	4.0
M-2 Tivat–Jaz–Budva from km 885+500 to km 901+500	19.2

Reconstruction of the M-2 arterial road Lepenac–Ribarevina section, length 12.90km, sections: km 1075+200-km 1081+800 and km 1083+600 km 1089+872	5.4
Reconstruction of the M-2 arterial road Ribarevina–Poda section, length 14.70, from km 1089+872 to km 1104+559	6.1
Reconstruction of the M-2 arterial road Poda–Berane section, length 12.20 km, from km 1104+559 to km 1117+300	6.4
Reconstruction of the M-2 arterial road Berane–Lokve Tunnel section, length 16.2 km, from km 1117+300 to km 1133+507	11.2
Reconstruction of the M-2 arterial road Lokve Tunnel–Rožaje section, length 14.7 km, from km 1133+507 to km 1148+200	6.0
Reconstruction of the M-21 arterial road Bijelo Polje bypass–Ribarevina section, length 3.0 km, from km 149+950 to km 153+000	2.0
Reconstruction of the M-2 arterial road Kamenovo–Petrovac section, length 11.3 km, from km 911+700 to km 923+000	5.4
Reconstruction of the M-2.4 arterial road Petrovac–Bar section, length 12.0 km	6.7
Development of database for the road network and programme for assessing safety	1.2
Construction of the Lepenac crawler lane	3.0
M-2.3 Cetinje–Budva from km 57+000 to km 58+800 km. 48 Košljun–Zavala	1.0
Reconstruction of the Krstac–Ivanova Korita arterial road, length 9 km	4.0
Reconstruction of the Dinoša–Cijevna Zatrijebačka road, length 15 km	15.0
Reconstruction of the R-1 Cetinje–Njeguši regional road, Voli supermarket to Bajička crkva section, length 3.6 km	2.0
III Air Transport	**67.2**
Study on compliance for Tivat Airport with International Civil Aviation Organization standards	0.2
Construction of new terminal building at Tivat Airport with supporting infrastructure	30.0
Expansion and reconstruction of taxiway and apron/ramp areas at Tivat Airport	25.0
Reconstruction and expansion of taxiway and apron/ramp areas at Podgorica Airport	12.0
IV Rail Transport	**35.7**
Urgent remediation measures for four steel bridges	0.3
Supervision of works on urgent remediation measures for four steel bridges	0.0
Remediation of the Morača Bridge	0.3
Oversight for works on remediation of the Morača Bridge	0.0
Remediation of three tunnels	2.1
Overhaul of the permanent railway track on the Kolašin–Kos section	2.1
Decommissioning of the existing, and procurement and installation of the new Trebešica power substation	2.7
Supervision of works on the substation	0.1
Overhaul of the permanent railway track on the Virpazar–Sutomore section (Sozina Tunnel)	4.1
Supervision of works on the overhaul of the permanent railway track on the Virpazar–Sutomore section (Sozina Tunnel)	0.1
Replacement of signalling/safety system in at Podgorica railway station	6.0
Supervision of works on replacement of the signalling/safety system at Podgorica railway station	0.2
Works on remediation of six slopes and five pre-stressed concrete bridges	4.3
Supervision of works on remediation of six slopes and five pre-stressed concrete bridges	0.6

Procurement and installation of heaters for points at railway stations in Nikšić and Ostrog	0.4
Remediation of drainage pipes and watercourse regulation	0.6
Development of main design for slope remediation on the Nikšić–Podgorica railway	0.2
Works on slope remediation on the Nikšić–Podgorica railway	1.0
Overhaul of permanent railway track on the Kos–Trebješica section	4.4
Development of main design for urban and technical development of the border railway station at Bijelo Polje	0.1
Inspection of 106 tunnels and development of main designs	1.6
Development of main design for remediation of 86 concrete bridges	3.0
Development of main design for signalling/safety devices at railway stations between Podgorica and Bar	1.5
V Maritime Transport	**4.0**
Procurement of equipment for protection of the sea from pollution	1.2
Refurbishing of marine signalling devices and maintenance of maritime waterways – IPA II	0.4
Second phase of VTMIS and establishment of the NSW (National Single Window) – IPA	2.4
TELECOMMUNICATIONS	**156.2**
Montenegro Post (*Pošta Crne Gore*)	**5.0**
RDC – expansion of network and reconstruction of IP network in RDC	**5.4**
Montenegrin Telecom (*Crnogorki telekom*) – investment in software, network, platforms	**48.2**
Telemach	**16.4**
Creating a modern monitoring centre as a base for providing services of physical and technical security, development of mobile security in the new business unit in Podgorica - Securitas Montenegro Ltd. Nikšić	**0.5**
M Tel	**80.8**
ENERGY SECTOR	**699.8**
Construction of small hydroelectric power plants	**88.4**
Construction of wind turbines	**91.4**
Oil and gas – at this moment it is not possible to provide information on investments by year, since the contracts have not been concluded	**98.0**
Energy efficiency in public buildings Programme – Phase II (funds intended for building of the public preschool institution JPU"Naša radost" Herceg Novi – cluster V (phase 1)	**1.1**
Energy efficiency in public buildings Programme – Phase II	**13.9**
Montenegro Energy Efficiency – Additional financing	**1.9**
Project of construction of the 2nd block of TPP Pljevlja	203.5
Connection of Montenegro with Italy via undersea cable – CGES part	**59.4**
Terna	**110.0**
Coal Mine Pljevlja JSC (AD Rudnik Uglja Pljevlja)	**24.7**
Berane Mines Ltd. (*Rudnici Berane DOO Berane*) (former lignite mines)	**7.5**
MINING AND QUARRYING	**17.7**
Uniprom Consortium Ltd. Nikšić (*Konzorcijum Uniprom DOO Nikšić Uniprom*) (exploitation of red bauxite ore)	**17.7**
INDUSTRY	**118.5**
Investments in the metals industry – Tošćelik Nikšić	8.1
Investments in the metals industry – KAP	100.6
Production of cattle fodder – reconstruction and refurbishing of existing buildings and equipment – Spuž Cattle Fodder Factory (*Fabrika stočne hrane Spuž*)	**0.1**
Programme of support to development of entrepreneurship, small and medium-sized enterprises and industry (support for development of entrepreneurship in cooperation with SMED and IDF Montenegro	6.6
Construction and equipping of sawmill in Žabljak – Pelengic trade doo Bijelo Polje	**0.1**

Factory for production of non-smoked processed meat products in Bijelo Polje – Meso-promet d.o.o.	**0.9**
Completion of the project for production of sterile nasal sprays; mobile shelving units - Hemomont doo Podgorica	**2.1**
COSME – Enterprise Europe Network – MonteNegro (2015–2016)	**0.1**
TOURISM	**1004.9**
Construction of tourist complex in Kumbor (Herceg Novi)	**180.0**
Construction of Luštica tourist complex (Tivat)	**240.0**
Construction of Plavi horizonti tourist complex, marina and supporting infrastructure, Tivat	**150.0**
Construction of Porto Montenegro tourist complex, marina and supporting infrastructure	**75.0**
Other major hotel resorts and hotels:	
- Monterose	**140.8**
- Projects in the north	**35.0**
Construction of Kraljičina Plaža in Sveti Stefan	**50.0**
Value capture of Bjelasica and Komovi site	**59.4**
Value capture of Durmitor site	**26.1**
Construction of Hotel Kristal Rivijera in Petrovac,	**6.0**
Mamula Island – Herceg Novi (capturing value)	**14.0**
Construction of Hotel Jadran Perast, Kotor	**10.0**
Construction of Hotel Jezera, Žabljak	**3.3**
Construction of Hotel Durmitor, Žabljak	**10.0**
Construction of Hotel Berane, Berane	**4.5**
Refurbishment and reconstruction of Hotel Onogošt in Nikšić - Comp Comerce d.o.o. Nikšić	**0.8**
AGRICULTURE	**91.2**
ADMAS	27.6
IFAD	10.5
IPARD II	49.7
Projects (“House of Fruits”, “House of Wine”, “House of Olives”)	3.4
MUNICIPAL UTILITY INFRASTRUCTURE	118.5
Remediation of “Vasove vode” uncontrolled dump site , Berane	**0.7**
Remediation of “Čarkovo polje” uncontrolled dump site , Žabljak	**0.0**
Remediation of “Komarača” uncontrolled dump site, Plav	**0.4**
Remediation of “Ćafe” uncontrolled dump site, Bar	**2.8**
Remediation of “Vrtijeljka” uncontrolled dump site, Cetinje	**1.8**
Construction of system for landfill leachate treatment at “Livade” landfill, Podgorica	**2.2**
Construction of system for landfill leachate treatment in Pljevlja municipality	**4.1**
Construction of water supply pipeline Krkori, Andrijevica	**0.1**
Construction of sewerage network, Berane	**4.5**
Construction of wastewater treatment plant, Berane	**5.8**
Improvement to water supply, Berane	**0.9**
Construction of sewerage network, Bijelo Polje	**2.8**
Construction of wastewater treatment plant, Nikšić	**0.2**
Project for implementing urgent measures in the area of the water supply, Cetinje	**1.9**
Construction of wastewater treatment plant and sewage network in Danilovgrad municipality	**4.0**
Design and construction of wastewater treatment plant and main sewerage collector, Podgorica	**50.3**
Construction of the sewerage network in settlements Kodra, Totoši, Bijela Gora and Donja Bratica, Ulcinj	**4.2**
Connection of Herceg Novi municipality to the regional water supply system	**1.3**
Construction of wastewater treatment plant, Herceg Novi	**0.6**

Construction of water supply and sewerage network, pumping stations and underwater outlet, Herceg Novi	**2.8**
Construction of water supply and sewerage network, pumping stations and underwater outlet, Bar	**5.7**
Improvement to water supply and sewerage infrastructure, Kotor – urgent measures	**0.7**
Improvement to water supply and sewerage infrastructure, Tivat – urgent measures	**2.7**
Improvement to water supply and sewerage infrastructure, Herceg Novi – urgent measures	**0.0**
Improvement to water supply and sewerage infrastructure, Ulcinj	**18.0**
TRADE	**18.1**
"Voli"	**18.1**
TOTAL	**3,201.0**