



GOVERNMENT OF MONTENEGRO

MONTENEGRO ECONOMIC REFORM PROGRAM

2016 - 2018

Podgorica, January 2016

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LIST OF ABBREVIATIONS

CEFTA - Central European Free Trade Agreement

CGES- Crnogorski elektroprenosni sistem AD (Montenegrin Electricity Transmission System)

COSME- EU program for the Competitiveness of Enterprises and SMEs

EBRD- European Bank for Reconstruction and Development

EIB- European Investment Bank

EIF- European Investment Fund

EEN- Enterprise Europe Network

EFP- Economic and Fiscal Program

EC - European Commission

EPCG-Elektroprivreda Crne Gore (Montenegro Electric Power Company)

IPA -Instrument for Pre-Accession Assistance

IPARD- IPA Rural Development

IRFCG- Investment and Development Fund of Montenegro

PE - Public Enterprise

PPP- Public-Private Partnership

KfW- German Development Bank

SME –Small and Medium-sized Enterprises

ERP –Economic Reform Program

NQF - National Qualifications Framework

OECD - Organization for Economic Development and Co-operation

PEP - Pre-Accession Economic Program

MDD 2014-2017 – Montenegro Development Directions 2014-2017

RRC- Regional Cooperation Council

SEETO- South East Europe Transport Observatory

FDI - Foreign Direct Investments

SEE Strategy 2020 - South East Europe 2020 Strategy

WTO - World Trade Organization



1 ECONOMIC FRAMEWORK AND ECONOMIC POLICY GOALS

Montenegro's Economic Reform Program (ERP) is the economic policy of Montenegro in the medium term and the basis for economic dialogue with Brussels. ERP is the most important economic document of the country, structured according to the requirements and methodology of the European Commission. In this way, for the second year in a row, Montenegro is preparing a comprehensive, consistent and, with EU member states and candidate countries, comparable document that is discussed at the Government commissions and adopted by the Government. From 2016 ERPhas been available to all stakeholders through the organized public discussion.

Euro-Atlantic framework of economic policy

In 2015, there were significant positive developments on the Montenegrin road to Euro-Atlantic integration. By receiving invitation to join NATO, the country has achieved one of its most important political objectives set in the time of renewal of independence. Membership in this organization provides Montenegro long-term stability and security, and also brings along significant economic benefits. The experience of other new NATO members point to the fact that membership in NATO as a rule contributes to the improvement of business environment, increase in the attractiveness of the country for investors, both foreign and domestic, often raising the country's credit rating.

Montenegro's membership in NATO is complementary to the process of integrating the country into the EU. This process not only continued but was also intensified in 2015. As far as the negotiations are concerned, from January to September four more chapters of the acquis were opened (16 - Taxation, 30 - External Relations, 9 - Financial Services and 21 - Trans-European Networks). That brings the total number of open chapters to 20, and in addition 2 chapters are provisionally closed. In 2016 the remaining chapters are expected to be opened, and some to be provisionally closed. The focus of the challenge that lies ahead of Montenegro in the coming period is moving from the harmonization of the national legislation with the EU acquis to the process of its implementation. In accordance with the planned schedule adopted in the Program of Montenegro's accession, in the next three years all necessary measures will be taken to ensure that by the end of 2018 a maximum level of compliance with the EU acquis has been reached and to establish appropriate administrative capacity for its effective implementation, in order to finalize to the accession negotiations.

Significant progress has been achieved in other segments of the EU integration process as well. Thus, Montenegro has signed inter-state border agreements with two neighboring countries - Bosnia and Herzegovina and Kosovo. These agreements, which were made without the participation of the European Union or of a third party, are a model for solving border issues in the region. The positive role of Montenegro in resolving border issues in the Balkans has been strongly noted at the Vienna conference on the Western Balkans. At this conference, which is part of the Berlin process, agreement was reached on specific infrastructure projects in the region, and Montenegro was approved two projects in the field of energy and transport, with a total value of 45 million euros. These projects will greatly contribute not only to connecting Montenegro with the region and further to Europe, but also to the implementation of the overall connectivity agenda as one of the pillars for the development of the region as a whole.

During 2015 the implementation of projects under the Instrument for Pre-Accession Assistance – IPA continued. Use of funds under the IPA I is slowly coming to an end and it is expected that projects will be completed in 2017. Montenegro reports a high degree of absorption of funds on that basis, which confirms the readiness of Montenegrin institutions and organizations, not only for planning and

programming, but also for implementation of the projects.¹On the other hand, efforts have been invested in high-quality programming for IPA II. In accordance with the new concept of pre-accession assistance, which now focuses on the sectoral approach, priority sectors in which assistance will be targeted in the next medium-term period have been agreed with the European Commission, and all the necessary activities started for the introduction of sectoral budgetary aid as the new pre-accession financial instrument.

The goal of economic policy

Although 2016 is year of parliamentary elections in Montenegro, Government aims, not only to continue realization of planned policy measures, but to create the new plan of reforms that will support reaching the main goal of economic policy in mid term

The goal of economic policy in the period from 2016 to 2018 is more intense and sustainable economic growth along with job creation.

More intense economic growth implies that Montenegro needs higher rates of real economic growth in order to attain the level of GDP per capita of EU countries that is to increase the living standard of the Montenegrin population and achieve one of the elements of the strategic goal - quality of life of every individual in Montenegro. This growth must be sustainable in the future so that the reform measures to be applied in order to achieve it do not cause major economic problems. In other words, the government will avoid changes that increase short-term economic indicators, and in the long run threaten the stability of the economic system.

The focus of economic policy in the period from 2016 to 2018 will be the growth of competitiveness of the Montenegrin economy through the implementation of structural reforms and infrastructure development aimed at increasing domestic and foreign direct investment.

The economic prosperity policy was the commitment of the Government of Montenegro in the previous period, and will remain so in the coming mid-term period. Model of economic growth in Montenegro is largely based on foreign direct investment. The Government of Montenegro recognizes the potential for growth of Montenegrin economy in tourism, energy, agriculture and industry, but it also sees room for improvement in the investment environment. In other words, regardless of Montenegro being a country of great natural potential on an important geo-strategic position on the European continent, and politically stable and successful on its path of Euro-Atlantic integration, the preconditions for economic prosperity are the developed infrastructure and the institutional framework that facilitates the growth of labor productivity. As a result of unfavorable structure of Montenegrin economy and low labor force activity rate, Montenegrin economy has been facing a decade of high deficits in the balance of payments, caused by big minuses in foreign trade.

Compliance of EU recommendations and Montenegrin Government priorities

ERP is a living document. It is made such due to its compliance with the annual budget and the medium-term budgetary framework and the fact that the European Commission annually assesses the reform measures and policies, and the European Union gives recommendations for improvement. Eight recommendations for Montenegro with the Ministerial meeting in May 2015 in Brussels, in October were the basis for defining national priorities for economic policy in the medium term. In the ERP for 2016 Montenegro presents structural reform measures with macro-fiscal and sectoral impact

¹Only in the area of cross-border and transnational cooperation,69 projects were implemented in 2015 in the value of 15.6 million euros in Montenegro, in the areas of economic cooperation, environment, tourism, agriculture, culture, education, social cohesion, as well as a number of small infrastructure projects.

that are aligned with the recommendations of the Ministerial Meeting (detailed overview of measures as answers to EU recommendations is presented in the next table). Because of the economic policy commitment of the Montenegrin Government to increase the competitiveness of the economy through the development of infrastructure and structural reforms that require large expenditures in the medium term, Montenegro is not giving up sustained growth harmonized with the EU agenda that basically contains fiscal sustainability. On the contrary, by building and developing the economic system in a way presented in the 2016 ERP, Montenegro demonstrates its intention to create for its citizens and economy, through investment and systemic changes, an environment close to the one in the EU.

The priorities of the Montenegrin economic policy in the period from 2016 to 2018 are: further development of transport infrastructure, fiscal sustainability, a favorable investment climate, systematic reduction of informal employment, the creation of conditions for growth of loans for the growth and development of SMEs, the strengthening of the external position of the country and capacity building, which is also a common measure pervading the implementation of the seven objectives. These priorities are response to the obstacles to economic growth and are in line with EU recommendations for Montenegro.

Table: Concise overview of the measures taken of planned to be taken over the duration of the programme to implement the targeted policy guidance that was adopted by the Economic and Financial Dialogue in May 2015.

| Joint conclusions of the Economic and Financial Dialogue of May 2015 State of play |
|--|
| <p>1. Sustain the commitment to fiscal discipline, establish a credible track record on the basis of the new rules-based fiscal framework and revise the public debt management strategy to bring the public debt into a downwards trajectory in line with the ERP medium-term framework. In this context, municipalities are also called to contribute by strengthening their own budgetary position. In order to improve transparency, develop the necessary administrative capacity to implement the European System of Accounts (ESA2010).</p> |
| <p>- In December 2015, as one of the key areas of the public administration reform, the Government adopted Public Finance Management (PFM) Reform Programme 2016 – 2020. PFM reform is needed to ensure fiscal sustainability and sound management of public finances in line with EU legislation.</p> <p>- In September 2015, the Government adopted a package of measures² for reducing informal employment, and therefore, broaden the tax base and improve fiscal discipline.</p> <p>- The government has set as one of the ERP priorities for 2016, the issuance of electronic fiscal invoices in order to reduce informal economy (to be implemented in the period 2016 - 2018)</p> <p>- MoF is obliged to prepare a strategy for correction of fiscal imbalances in a period of maximum five years, and submit it to Parliament after public debt will exceed the 60% of GDP threshold established in the fiscal rules. This strategy is expected to be adopted in November 2016.</p> <p>- IMF has provided technical help for revision of Public Debt Management Strategy and according to that expertise support would be engaged in drafting the Strategy.</p> <p>- In July 2015, the MoF improved the fiscal position of the municipalities by advancing by one year (to 2015) the programme for rescheduling their debts in exchange of rationalising their workforce.</p> <p>- The MoF, together with the Central Bank and MONSTAT, continues their activities according to the Action Plan for Implementation of ESA 2010 methodology in the Public Finance Statistics. Full implementation is planned before end-2017.</p> |

² Report “Informal economy – overcoming exclusion and marginalization”

2. Consider additional reforms for attaining long-term sustainability of the budget, such as the introduction of further restriction for early retirement and the consideration of options for individual participation into the old-age pension system on a mandatory basis, as well as the implementation of a common policy for public sector wages in the context of rationalisation and modernisation of the public sector.

- In January 2016, the Government adopted the law on amendments to the Labour Law regarding adjustments to Law on Administrative Procedure. The amended law is at present in parliamentary procedure and it is expected to be adopted in 2016.

- Legal provisions that temporarily allowed the retirement under more favourable conditions have ceased to be valid in 2015.

- The government decided, due to budget constraints, to postpone further development of individual participation into the old-age pension system (i.e. second pillar).

-- In November 2015, the Government adopted the Law on wages for public sector employees. The law is at present at parliamentary procedure and it is expected to be adopted in February 2016.

3. Implement the planned voluntary financial restructuring programme (the so-called "Podgorica approach") to address the high burden of non-performing loans on bank balance sheets from a flow perspective. In order to address the NPL stock issue, improve deadlines and efficiency of contract enforcement. Introduce effective supervision of factoring companies to improve the transparency of the financial system.

-In April 2015 was adopted the Law on Consensual financial Restructuring of Debts to Financial Institutions (i.e. Podgorica approach),and it is implemented from 1st May 2015 with validity period of 2 years. The Law is on voluntary basis with aim to contribute to further decreasing NPLs in total loans portfolio. So far, the level of NPLs have declined from 17% in 2014 to 13% in 2015.

- In May 2015was adopted the Draft Law on Amendments to the Law on Enforcement and Security, improving the measures related to contract enforcement, and stipulating normative changes in terms of functional competence to decide on legal remedies against decisions of public bailiffs.

- As far as plans on introduction of supervision of factoring companies is concerned, the Government of Montenegro extended its coverage by introducing in its Program for 2016 the adoption of a Proposal Law on Financial Leasing, Factoring, Micro-Crediting and Credit-Guarantee Activities in accordance to EU regulation. The adoption of this regulation will additionally ensure stability of the financial system. Implementation of this Law is expected in 2017.

4. Amend labour legislation in order to introduce further market flexibility. Reinforce sanctions to discourage undeclared work. Better target active policies for workers at risk of losing their employments and enhance labour market participation in view of an ageing population.

-In order to create conditions for further flexibility in the labour market, activities have started to amend the labour legislation. Representatives of the Government, in cooperation with the social partners and the civil sector, are preparing the new Labour Law, and its adoption is foreseen in 2017. In addition to further harmonization with the EU acquis and international standards, the focus of the new Act will be to review decisions related to employment contracts, both open-end and limited.

-Development of qualifications based on learning outcomes in accordance with the needs of the labour market will start in 2016 and end by mid-2017.

5. Actively continue education reform with a view to better aligning education and skills with labour market needs, and strengthening cooperation between education and business.

- *The Program of professional training of university graduates* is implemented as part of one group of ERP priority measures as a multi-year programme, that was also included within the priority reform measure in the 2015 ERP. This measure will continue in 2016, and the 2016 budget allocated EUR 8.5 million for this purpose.

- *Development of qualifications based on learning outcomes in accordance with the needs of the labour market will start in 2016 and end by mid-2017.*

- *In July 2015 started the construction of the Innovation-Entrepreneurship Centre "Tehnopolis" in Nikšić. The building will be completed at the end of 2016, and procurement of equipment for its three laboratories (biochemical, industrial design and ICT) is planned until 2018. The Centre will facilitate the cooperation of scientific and research institutions with businesses to promote innovation and the creation of new products and services.*

6. Strengthen the transport development strategy ensuring alignment with the regional agenda on connectivity, with a particular focus on the core investment priorities (core network), and establish a credible planning and funding mechanism in the form of a single sector pipeline.

- *In August 2015, at the Western Balkans Summit in Vienna, the Core Transport Network in the Western Balkans region was confirmed. Montenegro's projects (road, railway, port and airport) on the indicative extension of the Core Trans-European Network (TEN-T) until 2020 were prepared and adopted, as well as the action plan to contribute to the elimination of market barriers in the area of transport.*

- *Harmonization of the Transport Development Strategy with the regional Agenda is planned for 2016 with the possibility to be postponed for 2017-in case that grant form EBRD is not provided)*

7. Further improve the business environment by ensuring the timely implementation of the so-called "regulatory guillotine" (simplification) project, enhancing the functioning of one-stop shops at municipal level for the issuing of construction permits and the quality of the land registry.

- *The implementation of outstanding recommendations from the Regulatory "Guillotine" will continue in 2016 and completed in 2017.*

- *The process of issuing construction permits through upgrade of existing ICT solutions is underway and it will be developed and implemented in the period 2016-2017.*

- *In 2015 was adopted the Law on State Surveying and Immovable Property Cadastre. To improve the quality of the land registry, the Cadastre administration will render decisions in line with the new and shortened deadlines envisaged under this law. Activities will continue in 2016, and completed (including regional cadastral offices) in 2017.*

8. Make further progress with a comprehensive and strategic approach in the field of EU food safety and sanitary and phytosanitary standards to receive accreditation for exporting agricultural and food products to the EU. Efforts in this direction should commence with those products where preparations are advanced and where Montenegro sees the biggest export potential.

-*Support to investments in the primary agricultural production and manufacturing capacities in view of achieving food safety standards will continue in 2016 and 2017.*

- *The government will also continue with the programme to increase regional and local competitiveness*

through harmonisation with international business standards. The programme consists in the refund of costs for accreditation as well as of implementation of standards, certifications and re-certification. In 2016, the programme will be extended –in addition to agriculture– to manufacturing, tourism, and trade companies, with the objective of increasing their competitiveness through harmonization with the requirements of international quality standards.

Developed infrastructure and structural reforms

Montenegro cannot realize its vision of development as an exclusive tourist destination without a modern and developed infrastructure. Undertaking these projects for Montenegro and the Government is a responsible job that carries risks, but also awareness of the role of the state to enable the present and future generations of taxpayers good life and work. In the area of infrastructure, Montenegro needs innovative solutions and effective partnerships between the public sector, private companies and donors in order to exploit the unused potential and provide better living standards. Also, as part of the EU agenda, namely "Berlin Process", regional connectivity and institutional compliance in this area is one of the priorities for the Government of Montenegro. Important infrastructure projects which Montenegro presented in the ERP, or started or plans to implement in the coming period are: Bar-Boljare highway, the Adriatic-Ionian corridor, modernization and construction of railway to Serbia and Albania, the construction of the second block of the thermal power plant, connecting power systems of Montenegro with Italy and Serbia, improvement of municipal and rural infrastructure. In addition to these projects, the National Investment Commission adopted in December 2015 a unified list of priority infrastructure projects (see Appendix) which has 64 projects that will be implemented in the period 2016-2025. Of the total number, 10 projects are in the energy sector, 9 in the transport sector³, 30 in the environmental sector and 15 in social services. The indicative cost of the projects amounts to € 4.3 billion. Their implementation is creating a stable infrastructure base for more intensive and sustainable economic growth that is for higher quality of life of individuals in Montenegro.

On the other hand, the best and the hardest applicable instrument of economic policy that ensures competitiveness of the economy and the sustainability of public finances is the implementation of comprehensive and consistent structural reforms. In a situation where the state is committed to the development budget by investing in the infrastructure without which economic growth and development cannot be achieved, structural reforms are the main instrument of economic policy of Montenegro to increase the competitiveness and fiscal consolidation. The fall in aggregate demand caused by the economic crisis and the freezing of public sector wages and pensions is leading to a fall in the money supply in the Montenegrin market, namely the liquidity crisis. The state has the opportunity to use structural reforms to influence on the demand in the short term and at the same time create conditions for economic growth in the long term. It is of great importance for long-term growth that the reforms be designed in such a way to reduce the possibility of repetition of similar adverse events in the future. In addition to infrastructure projects, the implementation of which started or is planned by the budget, the ERP presents a set of priority measures within the framework of structural reforms:

Area 1: Public finance management

1. Implementation of e-procurement

Area 2: Infrastructure

2. Harmonization of Transport Development Strategy with the regional agenda

³Not including the projects presented in the 2016 ERP.

3. Construction of the Smokovac-Mateševo priority section of the Bar-Boljare highway
4. Modernization of the railway network
5. The project of connecting power systems of Montenegro and Italy with the construction of transmission infrastructure in the country and the interconnection with Serbia
6. Improvement of communal infrastructure

Area 3: Development of economic sectors

7. Support to investments in primary agricultural production and processing facilities
8. Promotion of investments in priority industrial sectors
9. Improvement of tourism offer in the North of Montenegro through the construction of necessary infrastructure in ski resorts

Area 4: Business environment, corporate governance and reduction of informal economy

10. Implementation of recommendations of the regulatory “guillotine”
11. Improvement of the process of issuing building permits through the upgrade of existing IT solutions
12. Operation of cadasters in line with timeframes stipulated by the Law on State Survey and Real Estate Cadaster
13. Introduction of electronic focalization of fiscal cash registers
14. Improvement of financial and non-financial support to SMEs

Area 5: Absorption of technology and innovation

15. Construction of Tehnopolis innovation and entrepreneurship center in Niksic

Area 6: Trade integration

16. Increase of competitiveness of companies through compliance with requirements of international quality standards

Area 7: Employment and labor market

17. Development of qualifications based on learning outcomes in line with labor market needs

Area 8: Fostering social inclusion, fighting poverty and promoting equal opportunities

18. Implementation of the service contract and grant scheme with the aim of improving human resources and increasing employability
19. Construction of preschool institutions in order to increase coverage of children in preschool education

Besides the 19 measures introduced as a priority, the ERP presents other measures that also have an important impact on the economic system of Montenegro, which will be implemented in the coming mid-term period.

Both the reform measures presented in the ERP and the structural reforms to be designed place the greatest emphasis on raising the labor productivity, and investing in human capital. The initiative launched in December 2016 relates to the preparation of a package of structural reforms as a basic instrument for achieving fiscal sustainability and favorable investment environment⁴. As a good basis for the design of a set of future reforms, the Government of Montenegro will use the research of UNDP in the area of informal economy with a focus on informal employment and a set of measures that the Ministry of Labor and Social Welfare recommended towards its formalization⁵, i.e. towards achieving decent work and poverty reduction. Total share of those who are fully or partially involved in informal work is at the level of about one-third (32.7%) of the total number of employees. In this

⁴The new package of structural reforms will be addressed in ERP for 2017.

⁵ “Informal economy – overcoming exclusion and marginalization”

regard, the Government adopted a set of recommendations for structural reforms aimed at formalizing employment and overcoming exclusion and marginalization. Recommendations are related to the reform and improvement of the education system; health care; social protection systems; taxation system; regulatory system with emphasis on the regulation of labor market; public sector; operations and actions of inspection and misdemeanor authorities and the culture of (dis)trust.

Macroeconomic framework

The objective of macroeconomic policy is to maintain stability.

As a result of favorable situation on international financial markets, the applied structural reforms in Montenegro in the previous period and the natural resources of the Montenegrin economy, economic growth recorded higher real rates. After anemic growth in 2014, the year 2015 recorded a real GDP growth of 4.3%⁶ as a result of intensive construction activities (investments) and record growth rates in tourism industry.

Both the Government and the international financial institutions expect a similar trend of economic growth in the medium term. Conservative projections of real growth of the Montenegrin economy range from 4.1% in 2016, 4% in 2017 and 3% in 2018. Stable inflation is expected, with an average of 1.3% in the period 2016-2018, and a decline in the unemployment rate to the level of 16.6%. Volatile political situation in Europe and consequences of the terrorist attacks on the perception of tourists, coupled with structural instabilities in the Montenegrin economy, could cause slower economic growth, which is in the lower scenario envisaged at the level of 1.3% in 2016, but 4% in 2017 and 3.2% in 2018.

The projected economic growth rates are the result of prudent and realistic review of the situation, primarily in the international environment and investment circumstances outside of Montenegro, and then their influence in Montenegro. Implementation of most large-scale investment projects goes according to plan, and new, both private and public projects are being considered. Their impact on the Montenegrin economy can be large and crucial for achieving the economic policy goal. The main risk on the road to achieving this goal is security and political situation in the world.

The structure of the Montenegrin economy, its size and openness, and hence vulnerability to exogenous factors, as well as instable foreign policy and security situation in Europe and the world, create the need for the low-growth scenario. That scenario in the ERP implies worsening refugee crisis and the threat of terrorists, which can affect Montenegro through consequences for the tourism sector due to significantly lower revenues from foreign tourists. In such a situation, increased investor caution would mean weaker investment activity, which would all combined result in the fall in public revenues.

Fiscal framework

The objective of fiscal policy in the period 2016-2018 is that state investments in infrastructure and balanced current consumption contribute to the economic growth, from which public debt will be funded in the long term.

Fiscal picture of Montenegro looked through the final indicators can be considered as less favorable than in the previous period. However, analytical approach shows that the fiscal framework of Montenegro is developing in the direction of reducing the current account deficit due to increased revenues and reduced current spending, on the one hand, and in the direction of increasing

⁶ Assessment made by the Ministry of Finance in end September 2015.

government investment in infrastructure, on the other. Thus, the Montenegrin public finances can be assessed as developmentally oriented. Public debt projected at over 70% in 2016 is caused exclusively by borrowing for infrastructure projects that support economic growth and development and allow such projects in the future to be funded from the economic growth. The deficit of public finances in 2016 and 2017 amounts to 6.1%, and from 2018 onwards, it will have a falling trend, being 5.3%. Sustainability of public finances will be supported by a series of reforms that have a direct fiscal impact, such as administrative reform, health system reform and parametric pension reform.

The low growth scenario worsens the fiscal situation in Montenegro in the period 2016-2018, increasing the deficit to GDP ratio to 7.6% in 2016 and 7.7% in 2017, and reducing it again in 2018 to 7.1%. The growth of the deficit would cause new borrowing, i.e. the growth of public debt to GDP ratio to 70.6% in 2016, 74.2% in 2017 and 83% in 2018.

2 MACROECONOMIC FRAMEWORK

According to the forecasts of *World Economic Outlook* (WEO) in October this year, the real growth rate of the world economy in 2016 is projected at 3.6%, higher than the 2015 projection at 3.1%. Forecasts of growth in developed economies in the medium term remain lower due to unfavorable combination of lower investment, demographic factors and weak productivity growth. The growth of economic activity in emerging economies (4.5%) will be the result of lower than expected fall in 2015 (Brazil, Russia and the Middle East), as well as spillover effect of growth in developed economies, removal of sanctions on Iran, while the Chinese growth declines in line with projections.

- Growth in the US was weaker than expected, despite a very strong second quarter of 2015, as a result of the harsh winter in the first quarter and lower capital spending in the oil sector. Despite slower growth, the unemployment rate fell to 5.1% at the end of August, which is 1 percentage point less than in the same month last year. For 2016, growth rate is projected at 2.8%, while the estimate for 2015 was 2.6%.
- As regards the euro area, recovery is in line with the April IMF forecasts, with higher growth than expected in Italy, Ireland and Spain. The estimated growth rate for 2015 is 1.5%, while the projection for 2016 stands at 1.6%. The refugee crisis and the risks related to the recent terrorist attacks could jeopardize the economic recovery of these countries, as well as have other side effects, because of the political consequences of this event. Necessary reforms of the security system through the revision of the Schengen agreement may restrict the freedom of movement of people and capital, and thus threaten the economic recovery, but also the very foundations of the European Union and the euro area.
- After strong growth in the first quarter, the second quarter in Japan is marked by a drop in activity, primarily due to declining exports. Growth for 2015 is estimated at 0.6% while the 2016 growth is projected at 1.0%.
- In China, growth is in line with previous forecasts of the IMF. Investment growth has slowed compared to the previous year, while consumption growth remained stable. Import of goods was lower, just as the export (falling significantly more than expected). For 2016, the growth is projected at the rate of 6.2%, while the forecast for 2015 is 6.8%.
- The fall in GDP in Russia, after the first quarter of 2015, was higher than predicted, but the estimate of the recession in 2015 was slightly lower than expected and amounted to 3.8%, while the GDP for 2016 is projected to decline by 0.6%.
- The inflation rate in developed economies is recording a decline, mainly due to falling oil prices. According to Eurostat, inflation in the euro area in October was 0.0%. The unemployment rate in euro area in September fell to 10.8%, and in the EU28 it fell to 9.3%, the lowest recorded rate in the EU28 since September 2009.

Table 1 Real GDP growth rates for SEE6

| | 2015 | 2016 | 2017 |
|--------------------|------|------|------|
| Albania | 2.7 | 3.4 | 3.5 |
| Bosnia Herzegovina | 1.9 | 2.3 | 3.1 |
| Kosovo | 3 | 3.5 | 3.7 |
| Macedonia, FYR | 3.2 | 3.4 | 3.7 |
| Montenegro | 3.4 | 2.9 | 3 |
| Serbia | 0.5 | 1.5 | 2 |
| SEE6 total | 1.8 | 2.4 | 2.8 |

Source: World Bank

SEE countries recorded weak growth of economic activity in 2015. According to the regular economic report of the World Bank for SEE6-autumn 2015, in 2015 the growth rate in the region was expected to be 1.8%. The main driver of growth was domestic demand caused by increased investment activity. These positive trends were also fostered by the growth of demand in the European Union as the main trading partner of the region. The labor market in the region is also

gradually recovering. Number of employees increases slowly, but even so, unemployment remains a key problem, particularly youth unemployment (youth unemployment rate is 46% or 24 percentage points above the EU28). Also, despite the efforts to achieve fiscal consolidation, level of fiscal deficit and public debt is high in almost all countries in the region.

Medium-term growth prospects of the region are positive, with an average annual growth rate of 2.7% in the period 2016-2017. Positive trends that will define this growth are further recovery of domestic demand and the low cost of fuel. Factors that present potential risk to thus projected growth are: slowing growth at the global level, changes in global financial markets, migration and delay in structural reforms.

The following table provides a comparative overview of the real growth rate from the Ministry of Finance and international institutions that suggest a similar view of the Montenegrin economic prospects. The data show that the growth rates are consistent. The rates given by the European Commission (EC) are almost identical, those of International Monetary Fund are somewhat more conservative in the period 2017-2018, while the World Bank growth rates are lower (still not updated).

Table 2 Real growth rates - projections

| | 2015 | 2016 | 2017 | 2018 |
|------------|------|------|------|------|
| MoF | 4.3 | 4.1 | 4.0 | 3.0 |
| CBM | 4.2 | 4,4 | - | - |
| EC | 4.0 | 4.1 | 4.0 | - |
| World Bank | 3.4 | 2.9 | 3.0 | - |
| IMF | 3.9 | 4.5 | 2.5 | 2.5 |

Technical assumptions and projections of the euro exchange rate, interest rates, oil prices and other indicators used in this document are taken from the autumn forecast of the European Commission and are presented in the annex to this document.

2.1 Current economic developments

2.1.1 Gross domestic product

After realizing the GDP growth of 1.8% in 2014, Montenegro's growth strengthened in 2015. According to Monstat data, GDP grew at a real rate of 3.2% in the first quarter, 3.4% in the second quarter, while the third quarter recorded a growth of 4.2% so that the growth rate in the period January-September was 3.8%. All sectors had a positive impact on the growth, especially construction and tourism. We estimate that by the end of 2015, Montenegro's economy will achieve a much higher growth rate than projected at the end of 2014. The real growth could reach 4.3%, with strong growth in tourism turnover in the period January-September and the expected strong growth in the construction sector due to the start of the main works on the relevant highway section.

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

Tourism (consumption by foreign tourists in the tourism and related sectors was 20% of GDP in 2015, and the share of food and accommodation services makes 9% of gross value added-GVA). The available data for the period January-September 2015 indicate a high growth of tourism turnover. For the nine months, Montenegro was visited by 1.6 million tourists, who accounted for 10.6 mil. overnight stays, an increase of 13.0 and 15.5%, respectively. In the structure of overnight stays, 93.6%

were foreign tourists, with the number of nights growing at the rate of 19.8%, while domestic guests participated with 6.4% and for the nine months decreased by 24.0%. A significant increase in overnight stays was related to guests from Bosnia and Herzegovina (56.9%), Serbia (43.8%) and Germany (68.1%). Tourists from Russia, who recorded the highest growth rate last year, for the nine months in 2015 recorded a growth of 3.8% in overnight stays, while tourists from Ukraine had 2.7% fewer overnight stays in the first nine months than in the same period in 2014.

Industrial output (13.5% of GDP in 2015); Industrial output for 9 months of 2015 increased by 9.2%, primarily as a result of growth in the "manufacturing industry" sector (16.1%). Growth was also recorded in the "electricity, gas and water supply" systems (1.1%), while the "mining and quarrying" sector recorded a slight decline of 0.1%. The growth of the manufacturing industry was determined by growth of manufacture of basic metals (13.7%), pharmaceuticals (58.8%) and other non-metallic minerals (9.7%). The growth in the pharmaceutical industry is the result of strong fluctuations in the production sector, the production of the uneven flow. Manufacture of basic metals increased due to the growth of steel production (a low base from the previous year), while the production of aluminum was at the last year's level.

Retail sales (trade accounted for 14.2% of GVA in 2015); For the period January-September, retail sales (at current prices) was higher by 4.0% compared to the same period of 2014, while the sales at constant prices increased by 1.8%. The highest annual growth was achieved in July and August (6.0 and 7.2%, respectively), primarily as a result of the increased tourist traffic.

Transport (4.5% of GVA in 2015); According to preliminary data for the period January-September 2015, an increase was recorded in transported goods and passengers by rail (22.6 and 11.1%, respectively), increase in turnover of goods at airports by 5.1%, increase of goods in road transport (1.9), increase in trans-shipment in ports (2.0%) and the growth in performed mobile telephony services (1.4%). The decline was recorded in the transport of goods and passengers by sea (2.7 and 6.3%, respectively).

Construction industry (4.6% of GVA in 2015); The growth of value of construction works in January-September 2015 amounted to 7%, while the growth of completed effective working hours in the same period was 4.8%.

2.1.2 Inflation

For nine months of 2015, inflation in Montenegro was strongly influenced by developments in the external market, which, with a slight increase in the consumption of the population, caused positive growth rates, with slight variations during the year. The annual inflation rate, measured by consumer price index, was 1.7% in September 2015, while the average rate in the period January-September was 1.6%. The lowest annual inflation rate was recorded in January (0.2%), and the highest in May (2.3%). The movement of prices of basic categories that determine the level of inflation during the period shows a rise in food prices, the fall in fuel prices and the stagnation of prices of electric power. The growth of consumer prices is predominantly determined by growth of prices in the field of "food and non-alcoholic beverages" as a result of the low base from the previous year. Prices in the field of "transport" have recorded a decrease from the beginning of the year, due to falling prices of oil and oil products on the world market. The decline was briefly halted in Q2 2015, but the introduction of a 7 cent fee per liter for the purposes of highway construction and financing of representative sports had an effect on increasing the price of fuel and lubricants in Montenegro in Q2 compared to the previous quarter of the current year. Electricity prices did not increase in 2015. Inflation measured by HICP in September recorded an annual growth of 2.3%.

2.1.3 Employment and wages

In September 2015, the number of employees amounted to 177,027, which is 1.8% over September 2014. The average number of employees during the period January-September 2015, compared to January-September 2014 increased by 1.2%, and refers to 15 sectors. In Q3 2015, according to the LFS, the employment rate stood at 45.9%, the number of employees was 229,900, the unemployment rate stood at 17.7% and the number of the unemployed was 45,500. The number of persons registered for employment in September 2015, according to the Employment Agency, amounted to 33,773 or 6.9% more than in September 2014, while for the nine months in 2015, it increased by 1.5%. Registered unemployment rate in September 2015 amounted to 14.6%, which is 0.4 percentage points higher than in September 2014.

The latest data of the Employment Agency of Montenegro shows that, from September to the end of November, there was a significant increase in the number of unemployed, and the number reached 37,600, while the unemployment rate rose to over 16%. Because of these trends, the unemployment rate (Monstat) is approaching the unemployment rate by LFS (16.5 at the end of Q3). Such dynamics on the labor market is a consequence of the application of new legislation, as well as the cyclical movements in employment. The changes in legislation relate to the application of amended Law on Social and Child Protection, the realization of the Program for training of persons who acquired higher education and more liberal approach to the employment of foreigners. The provision of the Law on Social and Child Protection that refers to an allowance received on the basis of birth of three or more children, is a significant cause of rising unemployment. It is foreseen that the woman who gave birth to three or more children is entitled, if she wishes so, to a life-long monthly benefit, and a necessary condition for the exercise of this right is to be registered for at least 15 years in the records of the Employment Agency. As a result of the application of the Law, the number of women at the Agency records rose by 2,500 or 15% in the period January-November 2015. From September through November, the number of university graduates with no work experience has increased more than 100 percent. In September, when invitation was published for employers to participate in the professional training program, 2,690 graduate students were founding the records, and now there are just over 6,000 ready for professional training. Due to cyclical movements, unemployment would typically decline in the summer season, but this year it was not the case, because employers were relaxed in the employment of non-residents due to time limited suspension of the application of the provisions of the Foreigners Act (1 November 2015).

The average wage, in September 2015, amounted to €720 for the nine-month period, an increase of 0.3% y-o-y. The average wage without taxes and contributions in September 2015 amounted to €477, an increase of 0.6% compared to the same period in 2014. In August 2015, Montenegro had 111,484 pensioners, or 2.0% more than in August 2014. Average pension in August 2015 amounted to €271.40.

2.1.4 Banks' lending activity

The banking sector is stable, solvent and liquid, and there are three new banks on the market promoting competition in addition to the existing 11. Banking business in the first nine months is characterized by the growth of assets, loans, deposits and capital. Although still limited, bank lending showed signs of recovery. Deposit potential reached a maximum in the period January-September 2015, which was reflected in the price at which banks raise funds, but not to a significant extent on the price at which they grant loans. Although there was an improvement in asset quality parameters, credit risk is still significantly present and materialized through a high amount and share of non-performing loans to total loans. The problem of real sector illiquidity is still very strong.

Total deposits at the end of September amounted to €2,623.9 mil., representing a growth of 15.7% per year. In the structure of deposits, dominant position still belongs to retail deposits with a share of 53.8% and growth of 8.6% annually. Corporate deposits, with a share of 31%, achieved strong growth of 28.4% in the same period. Total loans at the end of September amounted to €2,543.6 mil. and increased by 4.1% annually, which is in line with last year's projections. Lending activity in 2015, although limited due to the growing bank liquidity and available funds, recorded a significant increase compared to 2014. Newly approved bank loans for 9 months of this year rose to the level of €650.3 mil., which is an increase of 26.1% y-o-y. Non-performing loans at the end of September amounted to €351.6 mil.⁷ or 13.83% of total loans, which is 12.1% lower y-o-y. At the end of September, there were 14,516 insolvent legal entities and entrepreneurs, or 19.1% of the total of 75,920. The value of debt exposed to the blockade amounted to €541 mil., which is 9.1% more than in December 2014.

2.1.5 External sector

2.1.5.1 Current account

During the nine months of 2015, the current account deficit dropped by 26.6%, which was primarily the result of positive developments in tourism, i.e. services, and increased surplus of primary income.

| <i>Table 3 Balance of payments</i> | Jan.-Sep. 2014 | Jan.-Sep. 2015 | Change % | Exports of goods decreased by 12.1%, primarily due to a decrease in exports of meat and meat products by 81%, aluminum and aluminum products by 19% and electricity by 23%. This decline in exports is a consequence of falling aluminum prices on the world market, as well as one-time re-export of meat in the previous year, which caused a high base. At the same time, the growth of iron and steel production has resulted in a significant increase in exports of these products, although these raw materials also witnessed a sharp fall in prices on the world market as part of the general and significant drop in prices of raw materials. On the other hand, imports of goods increased and the main reason should be sought in increased imports of products from the group of "Machinery and transport equipment". The increase in imports of this product group is linked to the importation of the |
|------------------------------------|----------------|----------------|----------|---|
| A. CURRENT ACCOUNT | -284.2 | -208.5 | -26.6 | |
| GOODS | -1040.3 | -1118.8 | 7.5 | |
| 1. Export, f.o.b. | 255.8 | 224.9 | -12.1 | |
| 2. Import, f.o.b. | 1296.1 | 1343.7 | 3.7 | |
| SERVICES | 663.3 | 777.7 | 17.2 | |
| 1. Revenues | 909.0 | 1059.1 | 16.5 | |
| 2. Expenditures | 245.7 | 281.4 | 14.5 | |
| PRIMARY INCOME | 14.2 | 58.6 | 313.3 | |
| 1. Revenues | 167.6 | 180.6 | 7.7 | |
| 2. Expenditures | 153.5 | 121.9 | -20.5 | |
| SECONDARY INCOME | 78.6 | 74.0 | -5.9 | |
| 1. Revenues | 130.7 | 126.9 | -2.9 | |
| 2. Expenditures | 52.1 | 52.9 | 1.6 | |
| B. CAPITAL AND FINANCIAL ACCOUNT | -39.0 | -7.7 | -80.2 | |
| 1. CAPITAL ACCOUNT | 0.0 | 0.0 | | |
| 2. FINANCIAL ACCOUNT | -39.0 | -7.7 | -80.2 | |
| 1. Direct investments-net | 261.1 | 526.4 | 101.6 | |
| 1.1. Assets | -18.9 | -14.3 | -24.3 | |
| 1.2. Liabilities | 280.1 | 540.7 | 93.1 | |
| 2. Portfolio investment-net | 110.1 | 191.1 | 73.6 | |
| 2.1. Assets | -46.6 | 15.7 | | |
| 2.2. Liabilities | 156.6 | 175.4 | 11.9 | |
| 3. Other investments-net | -300.0 | -569.5 | 89.8 | |
| 3.1. Assets | -262.2 | -575.6 | 119.5 | |
| 3.2. Liabilities | -37.9 | 6.0 | | |
| 4. Change in CBM reserve | -110.2 | -155.6 | 41.3 | |
| C. NET ERRORS&OMISSIONS | 323.2 | 216.2 | | |

Source: CBM

⁷Not including interest and accruals.

necessary equipment for the construction of the highway. It will result in deterioration of the balance of goods, but this will be a one-off effect. On the import side, there is an evident decline in imports of meat and meat products by 30% and oil and petroleum products by 16%.

The surplus in the services account in the first nine months of 2015 amounted to €777.7 mil., which is 17.2% more than in the previous year. Total revenues from services amounted to €1.1 billion or 16.5% more than in the same period of 2014, while the actual expenditures amounted to €281.4 mil. (an increase of 14.5%). The increase in service revenues was the result of positive trends in the field of tourism and transport. A significant increase in overnight stays by foreign tourists of 19.8%⁸ was recorded in the observed period.

The primary income account recorded a surplus in the amount of €58.6 mil., which is significantly higher than in the same period of 2014 (€14.2 mil.). Revenues on the basis of primary incomes grew by 7.7% thanks to the increased inflow of employees' compensations, while at the same time expenditures decreased by 20.5% due to lower outflows for dividends and interest. The secondary income account recorded a surplus in the amount of €74 mil., which is by 5.9% less than in the same period of 2014 due to reduced inflow of personal transfers from abroad.⁹

2.1.5.2 Capital and financial account

In the period January-September 2015, net foreign direct investments amounted to €526.4 mil., an increase of 101.6% y-o-y. The increase in net inflows was the result of significant growth of inflow of investments in local companies and banks, as well as smaller withdrawal of foreign investments compared to the previous year. Total FDI inflow amounted to €601.6 mil., which is 71% more than in the previous year. FDI inflows in the form of equity investments amounted to €410.7 mil. and accounted for 68.3% of the total inflow. Within equity investments, €301.9 mil. was related to investments in companies and banks, while the inflow from investment in property amounted to €108.9 mil. The inflow from intercompany debt amounted to €185.3 mil. Total FDI outflow amounted to €75.2 mil., which is 17% less than the same period in 2014. During this period, there is an obvious change in the structure of investments in favor of investments in companies and banks, but it is one-off investment in the banking system and it is early to conclude that this reflects the substantial and long-term change.

In the period January-September 2015, the portfolio investments account recorded a net inflow of €191.1 mil. as a result of government borrowing by issuing Eurobonds in the international capital market. The other investments account recorded a net outflow of €569.5 mil. and is characterized by a reduction in liabilities of banks and other sectors of economy related to borrowings, and increased obligations of the state.

2.2 Macroeconomic projections for the period 2016-2018

The model of growth in the coming period is based on strong investment activity that will have a dominant influence on the economic trends in the future. Although at this point the precise layout and dynamics of investments is not known, it is certain that they will relate to infrastructure, tourism, energy and to a lesser extent agriculture. Undiversified economic base of Montenegro reduce the positive effects of the investment, and the impact on employment is also limited because of the

⁸Methodology for the assessment of overnight stays applied by CBM includes informal sector.

⁹Primary income is part of the current account of balance of payments (BOP Manual No. 6 IMF) showing flows between resident and non-resident institutional units in an economy. It includes transfers of salaries of employees in these units, revenues and expenses from investments and rents. Secondary income shows transfers between residents and non-residents and includes personal transfers (remittances), transfers for social security contributions, the net non-life insurance premiums and more.

mismatch between labor supply and demand. The negative impact on this growth model may come from instability in the external environment concerning the problems of refugees, terrorist threats or weakening of economic activity in the immediate and wider environment. Internal risks are related to the deterioration of the fiscal position, either due to changes in external conditions (instability on the financial markets) or lower revenue collection than planned or unforeseen increase in expenditure (guarantees and social welfare benefits).

2.2.1 Basic macroeconomic scenario 2016-2018

Macroeconomic projections for the period 2016-2018 predict real GDP growth: 4.1% in 2016; 4.0% in 2017 and 3.0% in 2018. In the period from 2016 to 2018, Montenegrin economy will grow faster, due to increased investment activity and involvement of local potential, primarily in the construction sector. Strong contribution from the construction sector will be driven by the inclusion of domestic operations in the construction of the highway, but also new tourist facilities and power plants. The tourism sector will give a stronger contribution to the operational phase of functioning of newly built tourist facilities as well as complementary trade and transportation sectors. We expect a positive contribution from the agricultural sector as a factor of substitution of food imports and increased exports. As a necessary condition for the strengthening of economic activity, moderate increase in credit support is expected. The average projected GDP growth rate for the period 2016-2018 is 3.8%, which is above the potential GDP growth rate (2.9%).

The macroeconomic scenario from 2016 to 2018 has the following components at the expenditure side:

- Domestic demand will grow slightly faster in the first two years of the cycle (4.7% in 2016 and 3.6% in 2017) but the year 2018 will record a rate of 1.5%, as a result of the high base from the previous years;
- Household consumption will be influenced by the increase in earnings and increase in the number of employees, based on the increased demand based on investments, strongly reinforced by the positive impulses of tourism revenue, but real growth will be lower than the real GDP rate; The average real growth rate in this period will be 1.9%;
- Gross investments in fixed assets will grow at an average rate of 10.4% in the medium term, except that the average rate in the first two years of 14.8% is in line with the pace of implementation of investment projects. The growth rate of 1.7% in 2018 is a result of the high base from the previous years;
- Government spending will rise, against a prudent fiscal policy of the current budget, and a significant increase in the capital budget, as a development component; Carrying out the project of building part of the highway will be reflected in the growth of gross fixed capital. For the purposes of highway construction in 2015, €168.5 mil. has been paid in advance;
- Exports of goods and services will grow at an average real rate of 0.4% in the period 2016-2018, whereby a slightly lower growth is projected in exports of services (consumption by foreign tourists) than in exports of goods, due to the exceptionally high base in 2015 coming from the record earnings in tourism;
- Imports of goods and services will grow at a real rate of 0.6%, with the growth of imports of goods conditioned by increased imports for purposes of investment (import of building materials and equipment), and the growth of imports of services relating to the construction (construction of the highway and other projects). We estimate that due to the high base of imports in 2015 and the following two years, imports and goods and services will fall in 2018 (-2.5%);

Macroeconomic indicators

- The external current account deficit will, on an average, be 13.3% of GDP, but, with a drop in imports and a growth in exports in 2018, it will go down to 12.2% of GDP;
- Foreign direct investments (in companies, banks and real estate) in the period 2016-2018 will be around 13.5% of GDP on an average. Such high rates of FDI are based on the assumption of activation of part of the announced investments in infrastructure, tourism and energy, as well as investments in the financial sector and real estate;
- Loans to businesses and households will grow at an average rate of 4.8%, slightly lower than the nominal growth rate of GDP;
- Unemployment will gradually increase during the entire period (an average of 0.7% per year) as a result of growth in economic activity and the unemployment rate should be lowered to 16.1% at the end of the period;
- In the period from 2016 to 2018 we expect the average growth of wages of 1.7%, due to high unemployment rate (increased supply).
- During this period, we expect a moderate growth of prices, based on stable prices of energy products and food and a gentle pressure of increased demand resulting from stronger economic activity. In the first two years of the cycle, we expect an inflation rate of about 1.5%, which would reach 2.0% in the period 2017-2018.

Table 4 Baseline macroeconomic scenario

| Montenegro: Macroeconomic projections, 2015-18 | | | | | |
|--|-------|--------|-------|-------|-------|
| | 2014* | 2015** | 2016 | 2017 | 2018 |
| Nominal GDP in million € | 3,458 | 3,661 | 3,868 | 4,103 | 4,311 |
| Nominal growth | 2.8 | 5.9 | 5.7 | 6.1 | 5.1 |
| Real growth | 1.8 | 4.3 | 4.1 | 4.0 | 3.0 |
| Inflation (at year-end) | -0.5 | 1.5 | 1.5 | 2.0 | 2.0 |
| <i>Core items:</i> | | | | | |
| Current account deficit | -15.2 | -12.6 | -13.8 | -13.8 | -12.2 |
| Export | 40.1 | 41.4 | 40.0 | 38.9 | 37.6 |
| Import | 60.0 | 59.7 | 58.9 | 57.5 | 54.4 |
| Other | 4.6 | 5.7 | 5.1 | 4.7 | 4.6 |
| Household consumption | 80.2 | 79.0 | 77.0 | 75.8 | 74.9 |
| Gross investments | 19.0 | 20.7 | 23.6 | 25.1 | 24.8 |
| Government spending | 19.4 | 18.6 | 18.3 | 17.6 | 17.1 |
| GDP deflator | 1.0 | 1.5 | 1.5 | 2.0 | 2.0 |
| <i>(real growth rates %)</i> | | | | | |
| Real GDP growth | 1.8 | 4.3 | 4.1 | 4.0 | 3.0 |
| Domestic demand | 2.1 | 4.0 | 4.7 | 3.6 | 1.5 |
| Household consumption | 2.9 | 2.7 | 1.5 | 2.3 | 1.8 |
| Gross investments | -2.5 | 13.6 | 18.7 | 10.8 | 1.7 |
| Government spending | 1.4 | 0.0 | 2.5 | 0.0 | 0.0 |
| Export of goods and services | -0.7 | 7.5 | 0.7 | 1.2 | -0.5 |
| Import of goods and services | 1.6 | 3.7 | 2.8 | 1.4 | -2.5 |
| <i>(share in real growth in % GDP)</i> | | | | | |
| Real GDP growth | 1.8 | 4.3 | 4.1 | 4.0 | 3.0 |
| Domestic demand | 3.0 | 3.5 | 5.5 | 4.3 | 1.8 |
| Household consumption | 2.3 | 2.2 | 1.2 | 1.8 | 1.4 |
| Gross investments | -0.5 | 2.6 | 3.9 | 2.6 | 0.4 |
| Change in inventories | 1.0 | -1.2 | 0.0 | 0.0 | 0.0 |
| Government spending | 0.3 | 0.0 | 0.5 | 0.0 | 0.0 |
| Net export | -1.3 | 0.8 | -1.4 | -0.3 | 1.2 |
| Export of goods and services | -0.3 | 3.0 | 0.3 | 0.5 | -0.2 |
| Import of goods and services | -1.0 | -2.2 | -1.7 | -0.8 | 1.4 |
| <i>(annual growth in % if not indicated otherwise)</i> | | | | | |
| <i>Core assumptions:</i> | | | | | |
| Employment growth | 1.2 | 1.2 | 0.9 | 0.8 | 0.5 |
| Growth of wages | -0.4 | 0.3 | 2.0 | 2.0 | 2.0 |
| Unemployment (LFS) | 18.0 | 17.0 | 16.6 | 16.2 | 16.1 |
| FDI % GDP | 10.5 | 16.1 | 14.2 | 13.4 | 12.8 |
| Domestic loans (corporate and retail) | 2.4 | 5.0 | 4.8 | 5.2 | 4.3 |

Source: Statistics Bureau (*); MoF projections (**)

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

- The projected real growth in the agricultural sector in the period 2016-2018 will amount to 3.7% on an average. Such significant growth is projected on the assumption of increased investment in agriculture and the growth of credit support to this sector in the period 2016-2018, as well as the gradual substitution of imports by increased domestic production.
- The mining and quarrying sector will grow at 8.0% per year in the medium term on average, as a result of increased activity due to increased demand for the materials required for the highway project (stone, gravel and the base materials).
- Manufacturing will have a growth of 4.3% in the coming period, assuming that the positive trend from previous years will continue and that the measures proposed in the Industrial Policy of Montenegro by 2020, expected to be adopted by the end of 2015, will give results in terms of eliminating bottlenecks and revitalizing the sector. Special contribution is expected from the growth in the sub-sectors of food and meat processing, the wood industry and the metal complex.
- Construction industry, driven by the announced investments, will have the greatest growth, averaging at around 20% in the first two years, and slowing down in 2018 as a result of the high base in the previous years (2%), relating primarily to the construction of the highway. The involvement of domestic construction companies will have a multiplier effect on the industries that are related to this sector: trade, transportation, financial and insurance services, small manufacturing services, etc. although this effect will be limited due to the structure of the economy, i.e. the lack of supply.

In this scenario, the growth of accommodation and food services, which partially cover the tourism sector, is projected at 4.0%. Phased completion of the started investments in tourism will increase the supply of facilities of higher categories, which is a prerequisite to strengthen the contribution of this sector to GDP growth, although the possibility of lower growth in 2016 is not excluded because of transitory effects from the previous year.

The following table provides an overview of real growth rates, the contribution to growth and participation in GVA in the medium term, in aggregate production sectors:

Table 5 Production sectors – real growth rates and share of GDP

| | | | | | | | | | |
|---|------|------|-----|-----|-----|-----|-------|-------|-------|
| GDP | 4.1 | 4.0 | 3.0 | 4.1 | 4.0 | 3.0 | | | |
| Agriculture | 4.0 | 3.5 | 3.5 | 0.3 | 0.3 | 0.3 | 9.8 | 9.7 | 9.7 |
| Industry | 4.8 | 3.4 | 2.0 | 0.5 | 0.4 | 0.2 | 13.6 | 13.5 | 13.3 |
| Construction | 22.0 | 17.0 | 5.1 | 0.8 | 0.7 | 0.1 | 5.4 | 6.1 | 6.0 |
| Services | 3.1 | 3.3 | 3.2 | 1.8 | 1.9 | 1.9 | 71.3 | 70.7 | 70.9 |
| -of which accommodation&food | 5.0 | 5.0 | 5.0 | 0.4 | 0.4 | 0.4 | 9.0 | 9.1 | 9.4 |
| Gross value added | 4.3 | 4.1 | 3.0 | 3.5 | 3.3 | 2.5 | 100.0 | 100.0 | 100.0 |
| Taxes-subsidies | 3.0 | 3.5 | 3.0 | 0.6 | 0.6 | 0.6 | | | |

Source: Ministry of Finance

The growth model based on investment and the high share of foreign ownership in the economy of Montenegro significantly increase the rate of growth of economic activity, but also imposes some restrictions:

- strong growth of real GDP rates is not accompanied by strong growth in household consumption due to the repatriation of profits and earnings of non-residents and the lack of stronger earnings growth; disposable income for consumption is reduced;
- this effect will be felt in the public finances, because revenue collection will not fully follow increased economic activity and a nominal GDP growth rate, due to the fact that the acquisition of necessary goods for investments is subject to VAT refund, but also to a number

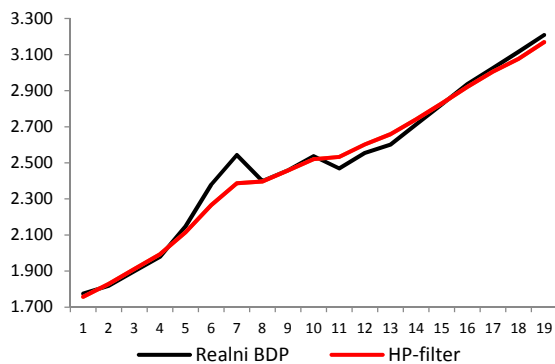
of exemptions or reductions in the payment of taxes. (Law on VAT, Excise Law, the Law on the Highway);

- Inadequate labor supply in Montenegro prevents the stronger economic activity from significantly reducing the unemployment rate. Because of this effect, unemployment will be reduced in neighboring countries from which non-residents are coming. By addressing this bottleneck, Montenegro would significantly reduce the unemployment rate (below 10%)¹⁰.

2.2.1.1 Potential growth

In the previous document (ERP) we presented the movement of the Montenegrin economy in recent years and stressed the boom period (growth in the period 2006-2008, average growth of 8.7%) and a double-dip recession caused by the financial crisis (2009 - a decline of 5.7%) and the consequences of the crisis in the euro area and the spillover on the peripheral countries (2012-a decrease of 2.7%). Montenegro's economy has only in 2013 reached the level of GDP that was recorded in 2008, which means that the double-dip recession in this period annulled the overall economic growth that was achieved in that period.

Chart 1 Potential GDP



Source: Ministry of Finance

The unstable movements in the short term and the short series of data on the movement of GDP, complicate precise positioning of the economy in the business cycle. In the period 2016-2018 Montenegro's economy will be, with projected growth rates, moving along the potential trend after the fall in 2009 and 2012 and moderate growth in 2010, 2011, 2013 and 2014.

The average real growth rate in the period 2002-2018 was 3.2%, while the potential growth rate in the period 2014-2018 will reach a value of 3.0%.

We expect that the strong investment activity in

the future in the sectors of transport, tourism, energy and agriculture will raise the value of capital, and this will impact the potential growth rate of economic activity. The investment in the highway section also creates a generational balance, as the repayment of future installments for the highway will overlap with benefits from the investments that are currently running. Additional impetus to potential growth will come through further implementation of structural reforms in the labor market, as well as the removal of bottlenecks for stronger economic growth, which relate to various types of business barriers (see Chapter 4). However, if we exclude the cyclical impact of highway construction and other investments on the economy of Montenegro, then we come to a more realistic picture of potential growth, as higher growth rates are not the result of powers inherent in the Montenegrin economy, but growth based on foreign investment, thereby reducing the effects on the available income and well-being of the citizens of Montenegro

The long-term problem for stronger economic growth in the aging population and thereby the availability of manpower for the growth of economic activity and potential pressure on the sustainability of the pension and health care system (see Chapter 3), which will be even more pronounced in the future. A significant problem is structural unemployment, which is reflected in the

¹⁰If we take into account that about 15,000 work permits were issued this year and the assumption of 5% of employees in informal economy, and then apply it data on the number of unemployed (LFS), we get the unemployment rate below 10% on the assumption that employees in Montenegro got employment in occupations that are now "imported". The calculation is made in the Ministry of Finance.

mismatch between supply and demand of labor, in the sense that the supply of educational and occupational profile does not match the demand of employers.

Structural unemployment is reflected in high unemployment of the young who are registered with the Employment Agency for more than one year, which reduces their chances of re-employment. Unemployed over 40 years of age make up 44% of the total, while older than 50 make up 30% of the total. The unemployed who are registered with the Employment Agency for more than one year account for 58% of the total number of the unemployed. Inadequate supply of labor for the execution of investments has a double negative effect: (i) Montenegro "imports" unemployment from neighboring countries by recruiting foreign workers, (ii) the employment of local labor force refers to the low-tech profiles (demand in the construction and tourism).

2.2.1.2 Inflation

Options for the conduct of monetary policy in euroized economies are disabled due to the lack of the issuer role, low influence on the reference interest rate and exchange rates. In such limited circumstances, the objective of monetary policy of the Central Bank is the conservation and promotion of financial stability, control of the financial system, including the conservation and promotion of a healthy and stable banking system, and the CBM has no authority or tools to control inflation. In 2014, the Ministry of Finance, with the expert assistance of Slovakia and UNDP, developed a model for projecting inflation, which is based on historical data on inflation trends, and includes exogenous variables which are mentioned in Table 2:

- The index of food prices and its projections for the future;
- Historical data on the growth of oil prices and projections of price growth for 2016 (the technical requirements of the EC);
- Historical data and projections of the euro exchange rate against the dollar (the technical requirements of the EC);
- The projections and historical trends of the dinar against the euro;
- Next year the excise law is expected to change by imposing additional excise duty on petroleum products for certain types of users, which could lead to an increase in fuel prices by about 5%.

By the end of the year, slight slowdown in inflation is expected, with the annual inflation rate in December of 1.5%, although due to the decrease in prices of petroleum products in November 2015, because of the constitutional court decision on the abolition of fees for funding the highway and top-level sport, somewhat lower inflation rate can be expected for 2015.

For the period 2016-2018, inflation projections have taken into account the inflation trend forecasts in the EU, and we have projected a gradual rise in prices that should stabilize at around 2% in 2018.

2.2.1.3 External sector and its medium-term sustainability

If we look at the current account deficit as the difference between what Montenegro earns by exporting goods, services and investments abroad and funds that it pays for imports of goods, services and investment, potential problem caused by its high level becomes clearer. The current account balance of a country reflects competitiveness the economy of that country in the international trade. The high current account deficit, as measured by its share in GDP, indicates low competitiveness of the Montenegrin economy, since the export-import ratio shows that there is no supply of goods that are imported or their price is more favorable than of those produced in Montenegro¹¹. The current

¹¹ Key obstacles to competitiveness growth are given in Chapter 4.1 Identification of key obstacles to growth and competitiveness (diagnostic)

account deficit is also the difference between savings and investment in the national economy, and its high level indicates that the high level of investment is financed from external sources, whether from indebtedness of the country, corporate sector or banks. The main negative contribution to the current account deficit refers to the balance of goods, which in 2014 accounted for 39.8% of GDP, but it was partially corrected by surpluses in services account (20% of GDP), and the balance in the primary and secondary income accounts of 4.6% of GDP. The current account deficit is largely covered by foreign direct investment and government borrowing on the international capital market. The existence of long-standing trade deficit indicates a deep external imbalance, where the deficit financing from foreign capital inflow, sovereign debt or private sector debt is only a temporary solution that will, together with resolution of the fiscal deficit, pose a major challenge for the government's economic policy.

Table 6 Share of total investments by countries in the period January-September 2015

| Country | Amount in € mil. | % of total inflow |
|-----------------------------|-------------------------|--------------------------|
| Austria | 249.83 | 46.0 |
| Russian Federation | 46.14 | 8.5 |
| The Netherlands | 45.81 | 8.4 |
| UK | 22.36 | 4.1 |
| Switzerland | 22.14 | 4.1 |
| Serbia | 20.23 | 3.7 |
| France | 18.89 | 3.5 |
| Turkey | 16.30 | 3.0 |
| United Arab Emirates | 16.23 | 3.0 |

Source: CBM and calculation of Ministry of Finance

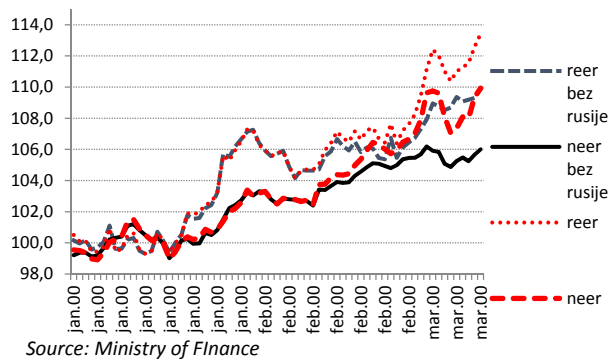
Structure of FDI inflows in the country and type of investments in 2015 shows that the investment structure changed and that most of the investment related to equity investments (68.3%), of which investments in companies and banks represent 74%, and the acquisition of real estate (26%). The rest of the total inflow of 185.3 mil. € refers to intercompany transactions. The table above shows that investors from Austria have the highest percentage of investments this year and that most of the investments in this country (238 mil. €) related to investments in banks and companies.

However, the structure of the current account deficit and its financing represents a risk to the sustainability of the external position, which could lead to deterioration or balance of payments crisis due to the following events:

- The decrease in revenue from tourism in the next year due to the transient effect in 2015, which is reflected in the record visits and the expected high earnings on this basis;
- The decrease in FDI inflows due to political or financial instability in the countries from which the capital is coming, which would lead to deterioration and reduction of the sources for current account deficit financing;
- The reduction of FDI inflows due to political instability in Montenegro;
- Instability in the world financial markets, which may lead to higher prices of sovereign debt and reduced demand for riskier securities, which would also reduce the sources of financing the current account deficit.

Materialization of all these risks at the same time, or their combination, would lead to the need for sharp adjustments of the public sector, along with decreased import and multiplying negative effects (decrease in public revenues), as well as decrease in economic activity growth rates. But the announced investment projects and favorable situation on the Eurobonds market reduce any chances of adverse developments.

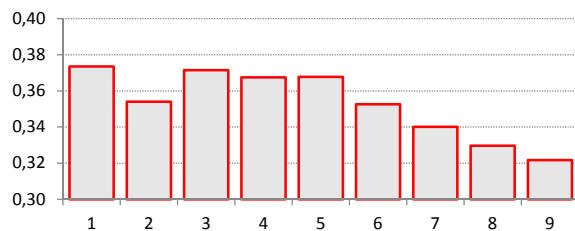
Chart 2 Real and nominal effective exchange rates in MNE



Source: Ministry of Finance

remittances, with a potential increase in transfers from Montenegro relating to dividends, interest and employee wages. The macroeconomic scenario for 2016-2018 envisages strong FDI inflow averaging 13.5% of GDP in the medium-term, which will be enough to cover the imbalance on the current account. Sources of such a strong investment inflow are projects in the sector of energy, tourism and infrastructure. The competitiveness of the Montenegrin economy, measured by conventional indicators of the real effective exchange rate, shows relatively stable real effective exchange rate movements and the strengthening of competitiveness measured by unit labor costs. REER analysis based on comparison of weights for 26 countries¹², with which Montenegro has foreign trade that covers 93.8% of its foreign trade and tourism revenues, represents real value of the basket of currencies in which Montenegro performs foreign trade exchange and tourism services. The applied model uses weighted geometric mean to calculate the nominal effective exchange rate in exchange (NEER). Inflation is also calculated on the basis of the same weights. The biggest impact on nominal and real effective exchange rate is made by Serbia, Russia and China, as they use their own currencies and have the greatest weights. As the Serbian currency was at a relatively stable level, changes in REER are predominantly due to variations of the Russian ruble, and it affects the competitive position of the tourism industry, because the exchange of goods with this country is symbolic. This shows the shortcomings of the analysis of competitive position of Montenegro measured by REER, through the inclusion of tourism, which has a significant share in the economy of Montenegro, and has strongly seasonal character.

Chart 3 Unit labour cost – co-efficient



Source: Ministry of Finance

Competitiveness analysis that was made on the basis of unit labor costs (ULC)¹³ shows that price competitiveness is improving, although reliability of the analysis is limited due to changes in data source for the number of employees (2010) and fight against gray economy, i.e. legalization of employment. The projected increase in competitiveness will be achieved through a growth of GDP in the medium term, which will be faster than the combined growth of employment and wages. Employment growth in the medium term (0.7%) will be enhanced by the increase in demand caused by the strong

¹²The model for the calculation of REER is developed by the Montenegrin MoF, Economic Policy and Development Directorate.

¹³ The model for the calculation of unit labor costs is developed by the Montenegrin MoF, Economic Policy and Development Directorate. The co-efficient shows how much is the share of gross earnings in gross value of production, i.e., total economic output. The co-efficient of 0.37 indicates that on 1 euro of total value of production, the share of gross earnings is 0.37 euros. This model was developed on the basis of data on wages, employment (LFS) and gross value of production, published by MONSTAT. Gross value of production for the period 2015-2018 has been prepared as an extrapolation based on the nominal GDP rate.

investment cycle, while low growth of salaries (1.7%) is caused by high unemployment rate and thus significantly higher supply than demand.

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

2.2.1.4 Financial sector

The high level of non-performing loans (NPLs) remains a key vulnerability of the banking sector, and therefore the potential risk to the state of the financial stability, so that the bank costs and created perception of high risk on that basis have a major impact on the formation and maintenance of high interest rates that, in turn, lead to a level of lending significantly lower than it would be realistically possible, and to the fact that new loans cannot be duly serviced, because they are too expensive, which, consequently, leads to a rise in the NPLs. Although in the period 2009-2015 banks transferred and/or sold non-performing assets worth over €700 mil., in end September 2015 non-performing loans amounted to €351.6 mil.¹⁴

However, it is evident that they reduced by 12.1% annually, which indicates that, to a certain extent, the efforts of banks to resolve this problem yielded results. The big challenge in addressing the banks' burden with non-performing loans in terms of inflows (flows) in 2016 will be adequate implementation of the Law on Voluntary Financial Restructuring of Debts to Financial Institutions (see Chapter 4), while from the aspect of the status and level of non-performing loans it will be necessary to improve the timeframes and efficiency in the contract enforcement. However, even though the law came into force in May 2015, it seems that its application is limited. It is therefore necessary to immediately initiate and encourage dialogue between businessmen and bankers.

Years-long conservative lending policy of banks inevitably led to the creation of a high general liquidity level, which resulted in liquidity and solvency parameters being above the prescribed level. These funds were not in the function of lending aimed at development projects, because banks based their lending activity on their own perception of general operating risk and client credibility and opted for less risky investments. However, caution is reflected in this type of investment as well because banks placed the largest part of their funds in government securities.

There has been an increasing rise in inter-company debts and increase in liquidity in the economy, as evidenced by the fact that 19.1% of all registered economic entities have blocked accounts. Compared to September last year, the number of blocked accounts increased by 7.2%. The continuous blockade of up to one year occurred in 2,147 debtors, the blocked funds being €42.7 mil., which makes 7, 9% of the overall amount of blocked funds, while 12,369 judgment debtors were blocked for longer than a year, for the amount of €498.3 mil., which makes 92.1% of the total blocked amount.

At the end of September 2015, weighted average effective interest rate on total loans amounted to 8.89%, and 9.63% on new loans. The falling trend of weighted average nominal and effective interest rates (WANIR and WAEIR) started in the last quarter of the previous year and continued in the current year. So at the end of September 2015, the interest rate on total bank loans was lower by 0.68 percentage point's y-o-y. On the other hand, with the exception of growing WAEIR on new loans from banks, at the end of September 2015, this rate decreased by 1.14 percentage points per annum.

¹⁴ This amount does not include interest and accruals.

2.2.2 Low-growth scenario

As a small and non-diversified economy in a volatile external environment and open to all external influences, Montenegro will in the medium term future be faced with a number of external and internal risks that can significantly reduce the projected growth rates, and thus undermine the projected macroeconomic, fiscal and financial system parameters. In these circumstances, it is reasonable to consider a scenario that is based on the realization of certain risks.

Low-growth scenario is based on the materialization of the following risks:

- Due to the worsening refugee crisis and the threat of terrorists and thus endangered security situation, the Montenegrin economy is suffering consequences through the tourism sector and therefore receives considerably lower income from foreign tourists. These effects are transmitted to related trade and transport sectors and segments of culture and entertainment. This dynamic is exacerbated by a high base from 2015, when we had record high revenues from tourism.
- In the event of materialization of the aforementioned risks, fiscal parameters will get worse, and budget revenues will not be executed in the planned amount, but there will be a need for adjustment of public spending, which will put additional pressure on aggregate demand, and thus further lower public revenues. This development and lower nominal GDP growth will increase the budget deficit, thereby increasing the amount of necessary funds for its financing, which exacerbates the dynamics of public debt and its parameters.
- In this scenario, there is a moderate slowdown in investment activity due to the unstable environment, and thus the increased caution of investors. Major works on the highway section are slow because of obstacles regarding the application of international standards of construction

The following table presents a low-growth scenario:

Table 7 Macroeconomic low-growth scenario

| Montenegro: Macroeconomic projections under low-growth scenario 2015-18 | | | | | |
|---|-------------|-------------|-------------|-------------|-------------|
| | <u>2014</u> | <u>2015</u> | <u>2016</u> | <u>2017</u> | <u>2018</u> |
| Nominal GDP in million € | 3,458 | 3,661 | 3,747 | 3,953 | 4,139 |
| Nominal growth | 2.8 | 5.9 | 2.3 | 5.5 | 4.7 |
| Real growth | 1.8 | 4.3 | 1.3 | 4.0 | 3.2 |
| Inflation (at year-end) | -0.5 | 1.5 | 1.0 | 1.5 | 1.5 |
| Core items: Share in GDP in % | | | | | |
| Current account deficit | -15.2 | -12.6 | -15.2 | -14.3 | -12.2 |
| Export | 40.1 | 41.4 | 39.3 | 39.0 | 38.3 |
| Import | 60.0 | 59.7 | 60.0 | 58.3 | 55.5 |
| Other | 4.6 | 5.7 | 5.5 | 5.1 | 5.0 |
| Household consumption | 80.2 | 79.0 | 77.0 | 75.8 | 74.9 |
| Gross investments | 19.0 | 20.7 | 25.6 | 26.0 | 24.9 |
| Government spending | 19.4 | 18.6 | 18.0 | 17.6 | 17.3 |
| GDP deflator | 1.0 | 1.5 | 1.0 | 1.5 | 1.5 |
| Real GDP growth | 1.8 | 4.3 | 1.3 | 4.0 | 3.2 |
| Domestic demand | 2.1 | 4.0 | 3.4 | 2.8 | 1.2 |
| Household consumption | 2.9 | 2.7 | 1.0 | 1.0 | 0.5 |
| Gross investments | -2.5 | 13.6 | 13.9 | 11.3 | 4.4 |
| Government spending | 1.4 | 0.0 | 2.0 | 0.0 | 0.0 |
| Export of goods and services | -0.7 | 7.5 | -3.7 | 3.0 | 1.4 |
| Import of goods and services | 1.6 | 3.7 | 1.9 | 1.1 | -2.0 |

| | Share in real growth rate | | | | |
|---------------------------------------|----------------------------------|------|------|------|------|
| Real GDP growth | 1.8 | 4.3 | 1.3 | 4.0 | 3.2 |
| Domestic demand | 3.0 | 3.5 | 4.0 | 3.4 | 1.5 |
| Household consumption | 2.3 | 2.2 | 0.8 | 0.8 | 0.4 |
| Gross investments | -0.5 | 2.6 | 2.9 | 2.6 | 1.1 |
| Change in inventories | 1.0 | -1.2 | 0.0 | 0.0 | 0.0 |
| Government spending | 0.3 | 0.0 | 0.4 | 0.0 | 0.0 |
| Export of goods and services | -0.3 | 3.0 | -1.5 | 1.2 | 0.5 |
| Import of goods and services | -1.0 | -2.2 | -1.1 | -0.6 | 1.1 |
| Other macroeconomic indicators: | In %, if not indicated otherwise | | | | |
| Employment growth | 1.2 | 1.2 | -0,5 | 0.8 | 0.5 |
| Growth of wages | -0.4 | 0.3 | 0.0 | 1.0 | 1.0 |
| Unemployment (LFS) | 18.0 | 17.0 | 18.0 | 17.5 | 17.0 |
| FDI % GDP | 10.5 | 16.1 | 10.7 | 11.4 | 10.9 |
| Domestic loans (corporate and retail) | 2.4 | 5.0 | 2.0 | 4.7 | 4.0 |

Source: Ministry of Finance

Table 8 presents differences between the scenarios. The realization of low-growth scenario would significantly worsen the performance of the Montenegrin economy measured by macroeconomic indicators. Low-growth scenario would reduce the nominal amount of GDP and real growth rates, and the nominal GDP in 2018 would be lower by €171.4 mil., or about 4% of GDP compared to the base

| <i>Table 8 Differences between scenarios</i> | 2016 | 2017 | 2018 |
|--|-------|-------|-------|
| Nominal GDP in € mil. | 121.5 | 149.5 | 171.3 |
| <i>Nominal growth</i> | 3.3 | 0.6 | 0.4 |
| <i>Real growth</i> | 2.8 | 0.0 | -0.2 |
| <i>Inflation (end of year)</i> | 0.5 | 0.5 | 0.5 |

Source: Ministry of Finance

scenario, while the real GDP growth rate would be lower by 2.8% in 2016. In this scenario, employment would fall in the first year, as a result of weaker demand, and the recovery would occurring 2017. Inflation would be lower than in the base scenario and so would the net FDI. Such a scenario could have very probable consequences in terms of

falling credit rating, which would send a negative signal to potential investors in respect of investment projects, and in terms of demand for bonds as a source of financing growing deficits.

3 FISCAL FRAMEWORK

3.1 Fiscal Policy Strategy and Medium-term Objectives

The basic fiscal policy objective in the following medium-term period is that investments in capital i.e. infrastructure projects and current spending optimization should create preconditions for dynamic economic growth that will ensure public debt financing in the long run. Therefore, the reduction of current spending deficit is in the focus of fiscal policy in order to ensure space for increase of investments in infrastructure that will contribute to long-term economic growth. Public finances in the projected period have dominant development character taking into account that capital expenditures finance the implementation of the priority high-way section construction which makes this investment that has a share of 20% in GDP projected on annual level, the largest investment in infrastructure in newer Montenegrin history.

Implementation of the priority high-way section construction will contribute to faster economic growth, balanced development of the country, and subsequently, better connectivity of Montenegro with the countries from the region and broader. At the same time, implementation of this project will exert additional pressure over public finances so the two basic fiscal parameters, i.e. deficit and public debt will deteriorate. If it is taken into account that deficit is primarily generated in relation to capital expenditures and if the budget excluding expenditures required for financing of development projects is considered, current expenditure balance is obtained which already in 2016 enters the surplus zone, which indicates that the taxpayers' money is spent in a responsible way, primarily for productive purposes and that fiscal consolidation measures are giving results.

The "Analysis of Specific Tax Policy Aspects – Reform Outlooks" adopted in December 2014 defines long-term fiscal objectives, as follows:

- convergence to balanced budget;
- viable public debt level, which will ensure stability and competitiveness of the business environment in the long run;
- ensure sustainable financing of large infrastructure projects.

In accordance with the solutions specified in this Analysis aimed at ensuring sustainability of public finances and enhancement of investment ambience and competitiveness of Montenegrin economy, legislative framework has been amended in the way to ensure higher budget revenues through introduction of earmarked fees on retail fuel price, increase of health insurance contribution rate, introduction of tax on gains from games of chance and tax on coffee, increase of excise on cigarettes and excise on mineral oils as well as introduction of tax concessions for investments in economy sectors of strategic importance. In the context of strengthening the budgetary position of municipalities, tax debt has been rescheduled, guarantees for loan facilities issued and adopted amendments to the Law on Tax on Immovable Property which is to be applied from 1 January 2016, in view of generating larger scale of immovable property tax revenues which will have positive effect on the budgets of local self-governments and their liquidity.

In order to prevent public debt growth to exceed the estimated and ensure its gradual decline, the Debt Management Strategy 2015-2018 was adopted, whereas for the purpose of improving public finance transparency the ESA 2010 Implementing Strategy was adopted in the area of Montenegro

public finance statistics including an action plan, as well as the Strategy for Transition of Public Sector to Accrual Accounting.

In support of the mentioned activities, the Government of Montenegro adopted the *Public Finance Management Reform Program 2016-2020*, which establishes the goals and key areas of reform. The public finance management reform has a dual objective. One is related to capability of Montenegro to identify, prevent and manage fiscal risks, excessive fiscal deficits and macroeconomic imbalances, while on the other hand the reform is to ensure that public spending is structured in the way to maximize developmental impact on economy and ensure better quality of life for all citizens. Adoption and adequate implementation of this program is the assumption for further IPA technical support and a prerequisite for IPA sector budget support.

Implemented measures and establishment of strategic reform directions in the following period represent a response to the European Commission recommendation to maintain the commitment to fiscal discipline, establish credible references based on the fiscal framework that is founded on new rules and review the public debt management strategy. Taking into account the measures implemented in view of public finance consolidation on local level, municipalities are expected to regularly service their liabilities and contribute to the stabilization of the overall fiscal system.

In view of improving public finance management, the Proposal Law on Wages of Public Sector Employees has been established, which creates conditions for long-term sustainability of the wage system, increases transparency of wages and establishes equalization of public sector wages for same or similar jobs, therefore the total wage fund in the budget of Montenegro for 2016 was planned in accordance with this proposal. In the context of public sector rationalization and modernization in 2016, the Montenegro Public Administration Reform Strategy 2016 – 2020 will be adopted to provide strategic reform framework in this area. The implemented measures present a response to the European Commission recommendation inviting Montenegro to consider additional reforms in view of achieving long-term budget sustainability with regard to the implementation of joint public sector wage policy in the context of public sector rationalization and modernization.

Responsible fiscal policy implementation, based on the principles of competitiveness, predictability and consistency is the key commitment of the Government of Montenegro. Ensuring and maintaining fiscal stability is the precondition not only for the overall economic stability and long-term economic growth, but also for international financial markets accessibility, and also it is a condition Montenegro has to meet in the process of EU accession. Taking the foregoing into account, the basic objectives of mid-term public finance management are as follows:

- increase in budgetary revenues by creating an incentive giving business environment and continuing intensive fight against grey economy;
- optimization of current spending with increase in infrastructure investments;
- public debt viability with regard to new borrowings only for financing of development projects and refinancing of the current debt, with restricted issuance of sovereign guarantees;
- further public finance consolidation on the local level.

Taking into account the set long-term objectives in the public finance area, the following will continue in the coming mid-term period: activities on suppression of grey economy and reduction of tax debt, activities aimed at creating assumptions for increased sustainability of the pension and health system, with fiscal audit strengthening and further strengthening of internal and external audit instruments,

public sector reorganization aimed at optimizing the number of employees and overall improvement of public finance transparency.

In addition to the mentioned, pursuant to the key regulatory act in this area, i.e. the Law on Budget and Fiscal Responsibility, in 2016 after elections have been completed and new Government constituted, a Fiscal Strategy will be adopted to establish the key fiscal policy objectives for the period of the Government mandate.

| Macro-economic framework | | Execution | Estimate | Base scenario | | | Low-growth scenario | | |
|---------------------------|---------------------------------|-----------|----------|---------------|---------|---------|---------------------|---------|---------|
| | | 2014 | 2015 | 2016 | 2017 | 2018 | 2016 | 2017 | 2018 |
| Macro-economic indicators | GDP <i>nominal (in mill €)</i> | 3,457.9 | 3,660.7 | 3,868.0 | 4,102.9 | 4,310.5 | 3,747.0 | 3,953.0 | 4,139.0 |
| | GDP, nominal growth | 2.8 | 5.9 | 5.7 | 6.1 | 5.1 | 2.3 | 5.5 | 4.7 |
| | GDP, real growth | 1.8 | 4.3 | 4.1 | 4.0 | 3.0 | 1.3 | 4.0 | 3.2 |
| | Inflation (<i>year-end</i>) | -0.5 | 1.5 | 1.5 | 2.0 | 2.0 | 1.0 | 1.5 | 1.5 |
| | Employment growth (%) | 1.2 | 1.2 | 0.9 | 0.8 | 0.5 | -0.5 | 0.8 | 0.5 |
| | Current account deficit (% GDP) | -15.2 | -15.9 | -15.3 | -14.3 | -12.2 | -15.2 | -14.3 | -12.2 |

| Fiscal framework (in % GDP) | | Execution | Estimate | Base scenario | | | Low-growth scenario | | |
|-----------------------------|-------------------------|-----------|----------|---------------|------|------|---------------------|------|------|
| | | 2014 | 2015 | 2016 | 2017 | 2018 | 2016 | 2017 | 2018 |
| Fiscal indicators | Source public revenues | 44.8 | 41.9 | 42.9 | 40.7 | 39.6 | 42.9 | 40.9 | 39.7 |
| | Public expenditure | 47.9 | 48.4 | 48.9 | 46.8 | 42.4 | 50.5 | 48.6 | 44.2 |
| | Deficit/Surplus | -3.1 | -6.5 | -6.1 | -6.1 | -2.8 | -7.6 | -7.7 | -4.5 |
| | Interest | 2.3 | 2.2 | 2.1 | 2.5 | 2.3 | 2.2 | 2.5 | 2.4 |
| | Primary deficit/surplus | -0.8 | -4.3 | -4.0 | -3.7 | -0.5 | -5.4 | -5.2 | -2.0 |
| | Public debt (% GDP) | 59.9 | 65.5 | 70.7 | 74.4 | 77.9 | 77.4 | 80.9 | 83.0 |

3.2 Public finances 2015

Fiscal policy based on the principles of competitiveness, predictability and consistency was the key commitment in 2015 too. The implemented measures were focused on ensuring public finance sustainability, improving investment environment and adjusting tax and excise policy in accordance with the obligations related to the accession process.

In 2015, the following fiscal policy measures were implemented:

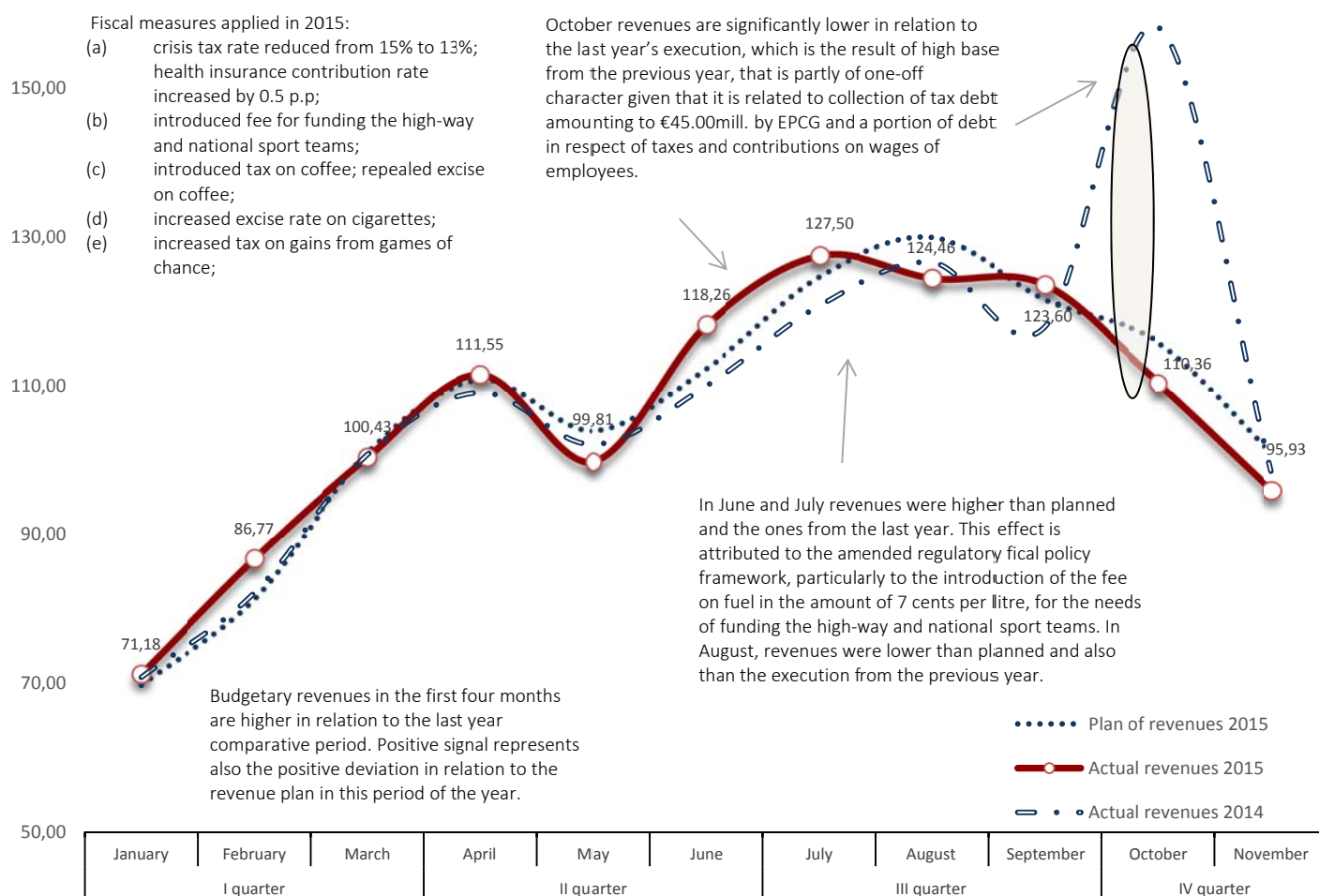
- Personal income tax (that is applied to the portion of the wage exceeding the average) reduced from 15% to 13%;
- Health insurance contribution rate increased by 0.5 p.p;

- Application of the higher VAT rate amounting to 19% continued;
- The Law on Amendments to the Law on Pension and Disability Insurance suspended the provision on “freezing” i.e. non-adjusting of pensions which originally was to be in effect until 31 December 2015. Such amendments envisaged that in case when indicators that affect the amount of pensions in a single year (average wage and inflation rate) require their downward adjustment, such adjustment would not be carried out in order to protect the standard of pensioners. In line with the current and projected macro-economic indicators affecting the amount of pensions, this category in 2015 was to be adjusted downward due to somewhat lower average wage in relation to the previous year and negative inflation rate;
- In April an earmarked fee on retail price of fuel was introduced in an amount of 0.07 Euro per liter, for the purpose of financing a portion of the high-way construction costs and national sport teams, but it was repealed in November upon the decision by the Constitutional Court;
- Tax on gains from games of chance introduced;
- Application of tax on coffee commenced;
- Amendments to the Law on Excise established an "excise calendar"¹⁵ for five-year period, i.e. timing of gradual increase of excise on cigarettes was established;
- For the purpose of further improvement of investment environment and competitiveness of Montenegrin economy, tax concessions were introduced for investments in the following sectors: high end tourism – 5-star and 5+ star hotels, production of food, except for primary agricultural production and capital investments in energy sector;
- As regards the public finance consolidation on local level, the Government approved rescheduling of tax debt in respect of taxes and contributions on wages of employees whereas the Law on Amendments to the Budget Law 2015 envisages issuance of guarantees to local self-government units in the amount of €107 mill. if such municipalities are beneficiaries of the Equalization Fund;
- In 2015 commenced the implementation of the largest and most significant infrastructure project in Montenegro, i.e. the construction of a portion of the Bar-Boljare High-Way, section Smokovac - Matešev, which is funded from the capital budget, and the funds are provided through a loan facility concluded with Exim Bank;
- Efforts were intensified to suppress grey economy with the focus on labor market and excise goods.

Public revenues in 2015 are estimated in the amount of €1532.4 mill. or 41.9% of estimated GDP (€3660.7 mill.), which represents reduction in relation to the last year by €17.4 mill., and significantly results from the high base from previous year contributed by collection of tax debt from EPCG and a portion of debt in respect of tax and contributions on wages of public sector employees. Other reasons for divergence are: estimated decline in tax collection on the central level by €32.2 mill., increased collection of contributions due to increased rate of contributions on health insurance by €11.1 mill., increased collection of fees resulting from introduction of the fee to finance the high-way and national sport teams by €9.4 mill., as well as less estimated collection of local self-government revenues.

¹⁵Introduced excise calendar for five-year period (2014-2019) envisages increase of specific excise on cigarettes from €19 for 1000 pieces (€0.38 per packet) as of 1 November 2014 to €26 for 1000 pieces (€0.52 per packet) in 2019, while proportional excise rate will gradually decrease from 35% (as of 1 November 2014) to 31% of average retail price of cigarettes in 2019.

Chart4: Review of budgetary revenues in 2015



Public expenditure in 2015 is estimated to amount to €1,772.1 mill. or 48.4% GDP. In relation to the previous year, estimated expenses are higher by €114.8 mill. The reason for deviation is mostly the result of increase in capital budget expenses related to financing of the construction of the priority high-way section (estimated outturn in this respect is €179.0 mill.). Positive deviations are recorded in case of Transfers to institutions, individuals, non-governmental and public sector in the amount of €33.1 mill. which is a result of technical adjustment of specific expenses to budget classification that are primarily related to reallocation of expenses planned for University of MNE and planning of the full amount of funds required for financing of RTMNE. In addition, Transfers for social care increased by €7.0 mill. due to increased costs related to payment of pension and disability insurance benefits. Negative deviation is recorded in case of capital expenses in the current budget amounting to €47.2 mill., which is primarily the result of a one-off effect from the previous year that is related to conversion of tax receivables from Elektroprivreda Crne Gore to the state equity. In addition, in 2014 settled were the liabilities related to the guarantees called upon in the amount of €15.3 mill., whereas it is estimated that in 2015 issued guarantees will not be called upon.

In relation to the plan for 2015, gross wages increased by €9.1 mill. due to shortage funds for settlement of wages of employees in education and health care sectors, while negative deviation was recorded in the case of Capital budget in the amount of €37.7 mill., of which costs related to the high-way construction were executed in a lower estimated amount of €27.0 mill.

Taking into account bad indicators of the financial position of the local self-government, in 2015 significant measures were undertaken in view of consolidating public finances on the local level. The Government of Montenegro adopted a Brief on rescheduling municipal debt and approved rescheduling of tax debt in respect of tax and contributions on wages of employees, with the established balance as of 31 December 2014 in the total amount of €89.07 mill. Of this amount €74.45 mill. are rescheduled for the period of 20 years for municipalities that are Equalization Fund beneficiaries, while €14.62 mill. relating to the municipalities of Bar and Budva, whose fiscal capacity is higher than the average, are rescheduled for the period of 5 years. In addition to tax debt rescheduling, the agreement envisages that municipalities that sign the rescheduling agreement are to establish the timing to resolve the redundancy issue in local government authorities, public services, institutions, business organizations and public enterprises founded by municipality, in accordance with the Public Sector Internal Reorganization Plan. The agreement envisages an obligation for municipalities to provide positive opinion from the Ministry of Finance before each new employment.

Public finance deficit in 2015 is estimated to €239.7 mill. or 6.5% GDP. If the deficit calculation excluded expenses related to the high-way construction, the estimated deficit would amount to €60.7 mill. or 1.7% GDP. In relation to the plan, the deficit is higher by €5.1 mill. while estimated central budget deficit is higher by €44.4 mill. which is primarily the result of recording the Repayment of liabilities from previous period within the total expenses. Primary deficit of public finances (deficit reduced by interest) will amount to €157.8 mill. or 4.3% GDP. Debt repayment, which should amount to €608.5 mill. by the end of the year, together with the mentioned deficit will be funded by borrowings from foreign sources in the amount of €651.9 mill., i.e. borrowings from domestic market in the amount of €194.8 mill. Within the Eurobond issue in international market, in March of the current year, issued were bonds in the value of €500.0 mill., for the period of 5 years, with interest rate of 3.875%.

| Annual GDP (in € mill.) | 3,660.7 | | 3,457.9 | | | | 3,547.0 | | | |
|------------------------------------|---------|-------|---------|-------|-----------|--------|-----------|-------|-----------|---------|
| Estimated public finances for 2015 | 2015 | | 2014 | | Deviation | | Plan 2015 | | Deviation | |
| | € mill. | % GDP | € mill. | % GDP | € mill. | % | € mill. | % GDP | € mill. | % |
| Public revenues, of which: | 1,532.4 | 41.9 | 1,549.8 | 44.8 | -17.4 | -1.1 | 1,520.8 | 42.9 | 11.6 | 0.8 |
| Income tax | 128.2 | 3.5 | 136.8 | 4.0 | -8.6 | -6.3 | 139.9 | 3.9 | -11.7 | -8.4 |
| Value Added Tax | 467.9 | 12.8 | 497.6 | 14.4 | -29.7 | -6.0 | 480.2 | 13.5 | -12.3 | -2.6 |
| Excise | 163.8 | 4.5 | 156.5 | 4.5 | 7.4 | 4.7 | 167.7 | 4.7 | -3.9 | -2.3 |
| Local taxes | 72.0 | 2.0 | 71.1 | 2.1 | 0.9 | 1.3 | 66.6 | 1.9 | 5.4 | 8.1 |
| Contributions | 455.4 | 12.4 | 444.3 | 12.8 | 11.1 | 2.5 | 417.5 | 11.8 | 37.9 | 9.1 |
| Public expenditures, of which: | 1,772.1 | 48.4 | 1,657.3 | 47.9 | 114.8 | 6.9 | 1,755.4 | 49.5 | 16.7 | 1.0 |
| Gross wages | 424.7 | 11.6 | 424.2 | 12.3 | 0.5 | 0.1 | 415.6 | 11.7 | 9.1 | 2.2 |
| Interest | 81.9 | 2.2 | 78.9 | 2.3 | 3.0 | 3.8 | 79.9 | 2.3 | 2.0 | 2.5 |
| Subsidies | 22.0 | 0.6 | 18.8 | 0.5 | 3.2 | 16.7 | 21.8 | 0.6 | 0.2 | 0.8 |
| Social care transfers | 499.8 | 13.7 | 492.8 | 14.3 | 7.0 | 1.4 | 505.5 | 14.3 | -5.7 | -1.1 |
| Capital budget | 287.0 | 7.8 | 117.1 | 3.4 | 169.9 | 145.1 | 324.7 | 9.2 | -37.7 | -11.6 |
| High-way | 179.0 | 4.9 | 0.0 | 0.0 | 179.0 | - | 206.0 | 5.8 | -27.0 | -13.1 |
| Guarantees | 0.0 | 0.0 | 15.3 | 0.4 | -15.3 | -100.0 | 0.0 | 0.0 | 0.0 | - |
| Surplus/deficit | -239.7 | -6.5 | -107.5 | -3.1 | -132.2 | 123.0 | -234.6 | -6.6 | -5.1 | 2.2 |
| Surplus/deficit excluding high-way | -60.7 | -1.7 | -107.5 | -3.1 | 46.8 | -43.5 | -28.6 | -0.8 | -32.1 | 112.2 |
| Primary surplus/deficit | -157.8 | -4.3 | -28.6 | -0.8 | -129.2 | 452.3 | -154.7 | -4.4 | -3.1 | 2.0 |
| Debt repayment | 608.5 | 16.6 | 452.2 | 13.1 | 156.4 | 34.6 | 411.8 | 11.6 | 196.7 | 47.8 |
| Financing, of which: | 859.0 | 23.5 | 569.4 | 16.5 | 289.6 | 50.9 | 652.1 | 18.4 | 206.9 | 31.7 |
| Foreign borrowings | 651.9 | 17.8 | 295.4 | 8.5 | 356.5 | 120.7 | 635.5 | 17.9 | 16.4 | 2.6 |
| Domestic borrowings | 194.8 | 5.3 | 250.1 | 7.2 | -55.3 | -22.1 | 6.1 | 0.2 | 188.7 | 3,093.4 |

3.3 Public Finance Outlooks 2016 - 2018

3.3.1 Fiscal Policy Directions 2016 – 2018

The basic fiscal policy strategic goal in the following mid-term period is to reduce public finance deficit, while taking into consideration the need to finance infrastructure projects that will ensure economic growth in the long run.

The fiscal policy goal in the period 2016 – 2018 is that government investments in infrastructure and balanced current spending should contribute to economic growth which will finance public debt in the long run.

Increased budget revenues and further current spending optimization along with the continuation of activities on suppressing grey economy and increasing competitiveness, as well as creating preconditions for public debt reduction represent the basic mid-term fiscal policy objectives.

Taking into account the macro-economic framework, as well as the set of planned and implemented amendments to the fiscal regulatory framework, the assumptions for estimation of public revenues and expenses in the following mid-term period are:

Measures on revenue side:

- "crisis tax" i.e. tax on wages based on the principle of higher tax rate for gross wages exceeding national average remains effective, but from 2016 it will go down from 13% to 11%;
- collection of additional revenues in respect of tax on coffee and gains from games of chance;
- excise will gradually increase in accordance with the established excise calendar, whereas excise on mineral oils will go up by 15% for the purpose of stable financing of a portion of the high-way construction costs;
- tax concessions for investments in strategic development branches – elite tourism, energy and agriculture;
- Amendments to the Law on Tax on Immovable Property introduced new legal provisions aimed at generating greater scale of revenues from tax on real estate which will have a positive effect on the local self-government budgets;
- activities will intensify to strengthen fiscal discipline and efficiency of relevant authorities in order for tax debt to be reduced and therefore budget revenues increased;

Measures on expenditure side:

- pensions will be adjusted according to the current and projected macro-economic indicators that affect pension amounts (average wage and inflation);
- adoption of the Law on Wages of Public Sector Employees will ensure their higher transparency and fiscal sustainability. Negative net effect of this Law in 2016 amounts to €13 mill.;
- further optimization of the current budget spending through rationalization of the number of public sector employees and reduction of discretionary expenses in favor of expenses that contribute to creating of new value;
- currently the most important infrastructure project in the state, the high-way section Smokovac – Mateševo will be executed within the projected time horizon, and it will be funded through capital budget, with borrowings from the Chinese Exim Bank in the value of

85% of the investment and Montenegro contribution in the amount of 15% of the project value. In 2016, within the capital budget for these purposes planned are the funds amounting to €246.5 mill.;

- continuation of finance consolidation measures on the local level through strengthening of fiscal discipline (regular settlement of tax liabilities, issue of guarantees preceded by detailed investment viability analyses, issue of previous consent by the Ministry of Finance on municipal budgets) and rationalization of the number of employees;

Having adopted the Analysis of Specific Aspects of Tax System, Montenegro officially commenced the tax system model reform, which envisages changes to the taxation structure, i.e. transfer to taxes that have weaker negative effect on economic growth. In practice, it means abandoning the policy of dominant taxation of income and profit, and simultaneous transition to taxation of spending and simpler and in terms of administration more cost-effective taxation of income by retaining the higher contribution rate. The intention is to free up growth potential, which together with the reform in other areas will contribute to efficient putting to good use of resources, strengthening of economy competitiveness, achieving higher economic growth rates and increasing standard of living of citizens. In accordance with the provisions of this document, in the medium term excise on tobacco and tobacco goods will gradually go up, tax on gains from games of chance will be introduced, and increasing of excise on mineral oils is under procedure for the purpose of creating conditions for financing a portion of the high-way construction costs, personal income tax rate is reduced in 2016, increased is the contribution rate on health insurance and introduced tax concessions for investments in strategic development branches.

In the medium term, emphasized will be the current spending optimization aimed at creating of preconditions for investments in projects that in the long run will ensure economic growth and development which will also be contributed by the rationalization of the number of employees in accordance with the provisions from the Montenegro Public Administration Reform Strategy 2016 – 2020. In view of creating conditions for long-term sustainability of public finances activities will be undertaken to implement objectives established by the Public Finance Management Reform Program 2016 – 2020 adopted in 2015. The Program is related to five key areas of public finance management, as follows: 1) public finance sustainable fiscal framework, planning and budgeting; 2) budget execution; 3) development of internal financial control system; 4) financial reporting and accounting and 5) capacity of the State Audit Institution to meet INTOASAI standards.

Taking into account the need for increased transparency of public finance, activities will be undertaken in the area of ESA 2010 implementation, pursuant to the ESA 2010 Implementing Strategy in the public finance statistics as well as the Strategy for Transition of Public Sector to Accrual Accounting.

Continuation of implementation of the measures directed to public revenue growth primarily through reduction of the grey economy level, reduction of tax receivables, tax discipline strengthening and tax system improvement still remains one of the priorities in the years to come. Institutional framework in the form of the established working bodies of the Ministry of Finance, Administration of Inspection Affairs, Tax Administration, Customs Administration, Police Administration and other relevant institutions continues its work in accordance with the adopted action plan for suppressing grey economy.

Table 9 Public finance trend 2014 – 2018

| Annual GDP (in € mill.) | 3,457.9 | | 3,660.7 | | 3,868.0 | | 4,102.9 | | 4,310.5 | | 3,747.0 | | 3,953.0 | | 4,139.0 | |
|------------------------------------|----------|-------|---------|-------|---------------|------|---------|-------|---------|------|---------------------|-------|---------|-------|---------|------|
| | estimate | | | | base scenario | | | | | | low-growth scenario | | | | | |
| Public finance estimate 2016-2018 | 2014 | | 2015 | | 2016 | | 2017 | | 2018 | | 2016 | | 2017 | | 2018 | |
| | € mill. | % GDP | € mill. | % GDP | € mill. | % | € mill. | % GDP | € mill. | % | € mill. | % | € mill. | % GDP | € mill. | % |
| Public revenues, of which: | 1,549.8 | 44.8 | 1,532.4 | 41.9 | 1,657.5 | 42.9 | 1,669.5 | 40.7 | 1,708.0 | 39.6 | 1,609.1 | 42.9 | 1,615.3 | 40.9 | 1,644.1 | 39.7 |
| Income tax | 136.8 | 4.0 | 128.2 | 3.5 | 133.1 | 3.4 | 138.3 | 3.4 | 141.6 | 3.3 | 132.2 | 3.5 | 136.4 | 3.5 | 138.7 | 3.4 |
| Value added tax | 497.6 | 14.4 | 467.9 | 12.8 | 488.1 | 12.6 | 513.8 | 12.5 | 531.9 | 12.3 | 459.2 | 12.3 | 480.8 | 12.2 | 495.7 | 12.0 |
| Excise | 156.5 | 4.5 | 163.8 | 4.5 | 183.1 | 4.7 | 190.4 | 4.6 | 193.3 | 4.5 | 180.8 | 4.8 | 188.0 | 4.8 | 191.0 | 4.6 |
| Local taxes | 71.1 | 2.1 | 72.0 | 2.0 | 73.9 | 1.9 | 74.9 | 1.8 | 76.4 | 1.8 | 68.9 | 1.8 | 74.9 | 1.9 | 76.4 | 1.8 |
| Contributions | 444.3 | 12.8 | 455.4 | 12.4 | 483.2 | 12.5 | 489.1 | 11.9 | 501.4 | 11.6 | 479.0 | 12.8 | 480.0 | 12.1 | 487.2 | 11.8 |
| Public expenditures, of which: | 1,657.3 | 47.9 | 1,772.1 | 48.4 | 1,892.8 | 48.9 | 1,920.5 | 46.8 | 1,828.8 | 42.4 | 1,892.8 | 50.5 | 1,920.5 | 48.6 | 1,828.8 | 44.2 |
| Gross wages | 424.2 | 12.3 | 424.7 | 11.6 | 455.8 | 11.8 | 459.3 | 11.2 | 461.9 | 10.7 | 455.8 | 12.2 | 459.3 | 11.6 | 461.9 | 11.2 |
| Interest | 78.9 | 2.3 | 81.9 | 2.2 | 80.6 | 2.1 | 100.7 | 2.5 | 100.9 | 2.3 | 80.6 | 2.2 | 100.7 | 2.5 | 100.9 | 2.4 |
| Subsidies | 18.8 | 0.5 | 22.0 | 0.6 | 21.0 | 0.5 | 21.5 | 0.5 | 21.5 | 0.5 | 21.0 | 0.6 | 21.5 | 0.5 | 21.5 | 0.5 |
| Social care transfers | 492.8 | 14.3 | 499.8 | 13.7 | 534.4 | 13.8 | 544.9 | 13.3 | 560.3 | 13.0 | 534.4 | 14.3 | 544.9 | 13.8 | 560.3 | 13.5 |
| Capital budget | 117.1 | 3.4 | 287.0 | 7.8 | 379.9 | 9.8 | 379.9 | 9.3 | 270.4 | 6.3 | 379.9 | 10.1 | 379.9 | 9.6 | 270.4 | 6.5 |
| High-way | 0.0 | 0.0 | 179.0 | 4.9 | 246.5 | 6.4 | 246.5 | 6.0 | 137.0 | 3.2 | 246.5 | 6.6 | 246.5 | 6.2 | 137.0 | 3.3 |
| Guarantees | 15.3 | 0.4 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Surplus/deficit | -107.5 | -3.1 | -239.7 | -6.5 | -235.3 | -6.1 | -251.0 | -6.1 | -120.9 | -2.8 | -283.7 | -7.6 | -305.2 | -7.7 | -184.7 | -4.5 |
| Surplus/deficit excluding high-way | -107.5 | -3.1 | -60.7 | -1.7 | 11.2 | 0.3 | -4.5 | -0.1 | 16.1 | 0.4 | -37.2 | -1.0 | -58.7 | -1.5 | -47.7 | -1.2 |
| Primary surplus/deficit | -28.6 | -0.8 | -157.8 | -4.3 | -154.7 | -4.0 | -150.3 | -3.7 | -20.0 | -0.5 | -203.1 | -5.4 | -204.5 | -5.2 | -83.9 | -2.0 |
| Debt repayment | 452.2 | 13.1 | 608.5 | 16.6 | 450.2 | 11.6 | 263.0 | 6.4 | 163.5 | 3.8 | 450.2 | 12.0 | 263.0 | 6.7 | 163.5 | 3.9 |
| Financing, of which: | 569.4 | 16.5 | 859.0 | 23.5 | 685.5 | 17.7 | 514.1 | 12.5 | 284.3 | 6.6 | -733.9 | -19.6 | -568.3 | -14.4 | -348.2 | -8.4 |
| Foreign borrowings | 295.4 | 8.5 | 651.9 | 17.8 | 659.1 | 17.0 | 475.0 | 11.6 | 272.4 | 6.3 | 718.1 | 19.2 | 538.5 | 13.6 | 452.9 | 10.9 |
| Domestic borrowings | 250.1 | 7.2 | 194.8 | 5.3 | 14.7 | 0.4 | 28.6 | 0.7 | 3.5 | 0.1 | 15.8 | 0.4 | 29.8 | 0.8 | 4.7 | 0.1 |

On the bases of mid-term fiscal policy direction described in the previous section and basic macro-economic growth scenario, a basic mid-term fiscal scenario has been designed that will be legalized and consequently become operational through the annual Budget Law.

According to the Budget Law of Montenegro 2016, the budget for 2016 is designed in the way to facilitate stable functioning of public institutions and regular servicing of public needs of the state, costs related to the high-way construction and other infrastructure projects, obligations related to the Euro-Atlantic integration process and settlement of liabilities in respect of debt repayment. In 2016, according to the budget plan there will be current budget surplus generated, and most of the capital budget will be covered from source revenues.

Public revenues in 2016 are planned to amount to €1,657.5 mill. or 42.9% GDP. Projection of revenues for 2016 is produced based on the revenues generated in nine months and estimated collection of revenues by the end 2015, macro-economic parameters and amendments to the legislative framework, as well as announced collection of outstanding revenues, EU donations and other one-off transactions. The largest positive deviations, with regard to comparison of the revenue plan for 2016 and estimation for 2015 are related to: other revenues, due to anticipated collection of revenues in respect of digital dividend – purchase of freed up radio-broadcasting spectrum (€25 mill.); excise, due to the Amendments to the Law on Excise according to which the collection of revenues from excise on mineral oils will increase (€15.8 mill.); collection of tax debt through taxpayer's assets, in accordance with the Decree on the procedure of collecting tax claims through taxpayer's assets (€10 mill.); application of the Law on Wages of Public Sector Employees will increase the collection of taxes and contributions for public sector employees (€12.1 mill.); other taxes will increase by €2.0 mill. due to anticipated higher collection of tax on coffee and in respect of EU donations.

Public spending in 2016 is planned to amount to €1,892.8 mill. or 48.9% GDP. Adoption of new and amendments to the current legislative regulations as well as the need to plan expenses related to the high-way construction had dominant impact on planning of spending in 2016. The main deviations in relation to estimated execution of expenditures in 2015 are related to the following categories of expenditures:

Gross wages and contributions at expense of employers increased by €31.1 mill. (application of the new Law on Wages of Public Sector Employees will result in increase of the total gross wage fund by €29 mill. taking into account that the application of this law implies average increase of wages of public sector employees by around 5%);

Social care transfers increased by €34.6 mill., due to the planning of pension and disability insurance benefits in respect of regular adjustment of pensions and increased number of beneficiaries the fiscal effect of which amounts to €7.5 mill., amendments to the Law on Pension and Disability Insurance according to which the insured person whose employment terminated with a business organization where the government had an ownership interest due to bankruptcy will be entitled to old-age pension after having 30 years of service (men) or 25 years of service (women) the effect of which on expenditures amounts to €4.0 mill., as well as Amendments to the Law on Social and Children's Care according to which a mother with three or more children is entitled to a life-long compensation (anticipated negative impact of the law amounts to €12 mill.);

Taking into consideration that expenditure side of the budget is featured by low flexibility and limited space for maneuvering due to high share of mandatory spending in the total expenditures, rationalization of current spending implies optimization of the number of public sector employees, reduction of labor costs and better concentration of personnel, financial-material and technical

resources which will be defined by the Montenegro Public Administration Reform Strategy 2016 – 2020.

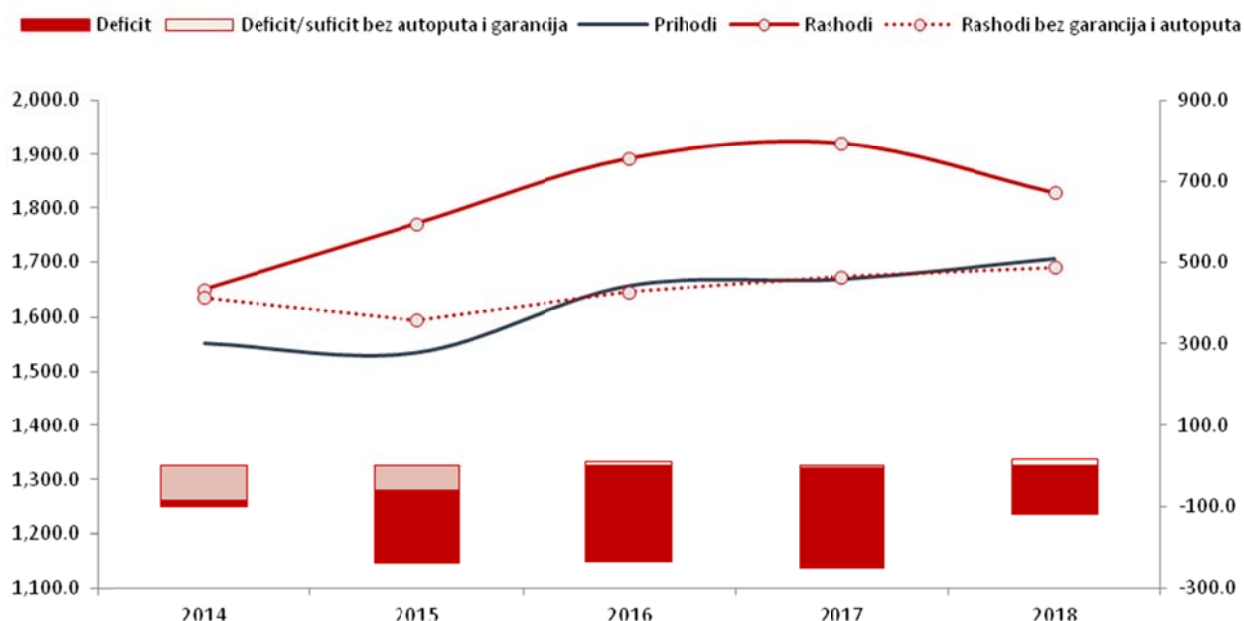
Capital expenditures for 2016 are planned to amount to €379.9 mill. which makes 20.1% of public spending or 9.8% GDP achieving high value of capital investments, which particularly emphasizes the development component of the budget designed to support creation of new value.

According to the mid-term framework, public revenues will range from €1,657.5 mill. in 2016 to €1,708.0 mill. in 2018. In spite of nominal growth of revenues, due to higher growth of GDP, revenues are expected to decrease from 42.9% GDP in 2016 to 39.6% GDP in 2018. The main revenue pillars remain value added tax and contributions, which make on average around 60% of public revenues. Collection of personal income tax will have significant share in revenues, while excise will record constant growth, which serves to harmonize Montenegro excise policy with the European Union requirements.

Public expenditures in the coming three-year period will be relatively high, taking into account that the construction of the high-way section Smokovac – Mateševo will be financed through the capital budget of the central government. In nominal terms, expenditures will range from 48.9% to 42.4% estimated GDP for 2016 and 2018 respectively. It is evident that with the exception of expenses for the high-way, residual expenditures record stagnation or only insignificant increase, which is in line with the commitment of the Government to further decrease current spending deficit in order to create space for investments in development projects. In the observed period capital budget will range between 9.8% GDP in 2016 and 6.3% GDP in 2018. With exception of the high-way expenses, for financing of other capital budget projects around €90 mill. (of which between €15-20 mill. will be related to funding from donor funds) will be allocated.

Public finance deficit will be relatively high in the coming period, as a result of investments into fixed capital of the state and will range between 6.1% in 2016 and 2.8% in 2018. Excluding expenses required for high-way construction financing, public finances would already in 2016 transit to the positive zone and record slight surplus of €11.2 mill. and €16.1 mill. in 2018 which makes 0.3% GDP or 0.4% GDP respectively.

Chart5 Public finance projection 2015 - 2018



3.3.2 Base Fiscal Scenario

On the bases of mid-term fiscal policy direction described in the previous section and basic macro-economic growth scenario, a basic mid-term fiscal scenario has been designed that will be legalized and consequently become operational through the annual Budget Law.

According to the Budget Law of Montenegro 2016, the budget for 2016 is designed in the way to facilitate stable functioning of public institutions and regular servicing of public needs of the state, costs related to the high-way construction and other infrastructure projects, obligations related to the Euro-Atlantic integration process and settlement of liabilities in respect of debt repayment. In 2016, according to the budget plan there will be current budget surplus generated, and most of the capital budget will be covered from source revenues.

Public revenues in 2016 are planned to amount to €1,657.5 mill. or 42.9% GDP. Projection of revenues for 2016 is produced based on the revenues generated in nine months and estimated collection of revenues by the end 2015, macro-economic parameters and amendments to the legislative framework, as well as announced collection of outstanding revenues, EU donations and other one-off transactions. The largest positive deviations, with regard to comparison of the revenue plan for 2016 and estimation for 2015 are related to: other revenues, due to anticipated collection of revenues in respect of digital dividend – purchase of freed up radio-broadcasting spectrum (€25 mill.); excise, due to the Amendments to the Law on Excise according to which the collection of revenues from excise on mineral oils will increase (€15.8 mill.); collection of tax debt through taxpayer's assets, in accordance with the Decree on the procedure of collecting tax claims through taxpayer's assets (€10 mill.); application of the Law on Wages of Public Sector Employees will increase the collection of taxes and contributions for public sector employees (€12.1 mill.); other taxes will increase by €2.0 mill. due to anticipated higher collection of tax on coffee and in respect of EU donations.

Public spending in 2016 is planned to amount to €1,892.8 mill. or 48.9% GDP. Adoption of new and amendments to the current legislative regulations as well as the need to plan expenses related to the high-way construction had dominant impact on planning of spending in 2016. The main deviations in relation to estimated execution of expenditures in 2015 are related to the following categories of expenditures:

Gross wages and contributions at expense of employers increased by €31.1 mill. (application of the new Law on Wages of Public Sector Employees will result in increase of the total gross wage fund by €29 mill. taking into account that the application of this law implies average increase of wages of public sector employees by around 5%);

Social care transfers increased by €34.6 mill., due to the planning of pension and disability insurance benefits in respect of regular adjustment of pensions and increased number of beneficiaries the fiscal effect of which amounts to €7.5 mill., amendments to the Law on Pension and Disability Insurance according to which the insured person whose employment terminated with a business organization where the government had an ownership interest due to bankruptcy will be entitled to old-age pension after having 30 years of service (men) or 25 years of service (women) the effect of which on expenditures amounts to €4.0 mill., as well as Amendments to the Law on Social and Children's Care according to which a mother with three or more children is entitled to a life-long compensation (anticipated negative impact of the law amounts to €12 mill.).

Taking into consideration that expenditure side of the budget is featured by low flexibility and limited space for maneuvering due to high share of mandatory spending in the total expenditures,

rationalization of current spending implies optimization of the number of public sector employees, reduction of labor costs and better concentration of personnel, financial-material and technical resources which will be defined by the Montenegro Public Administration Reform Strategy 2016 – 2020.

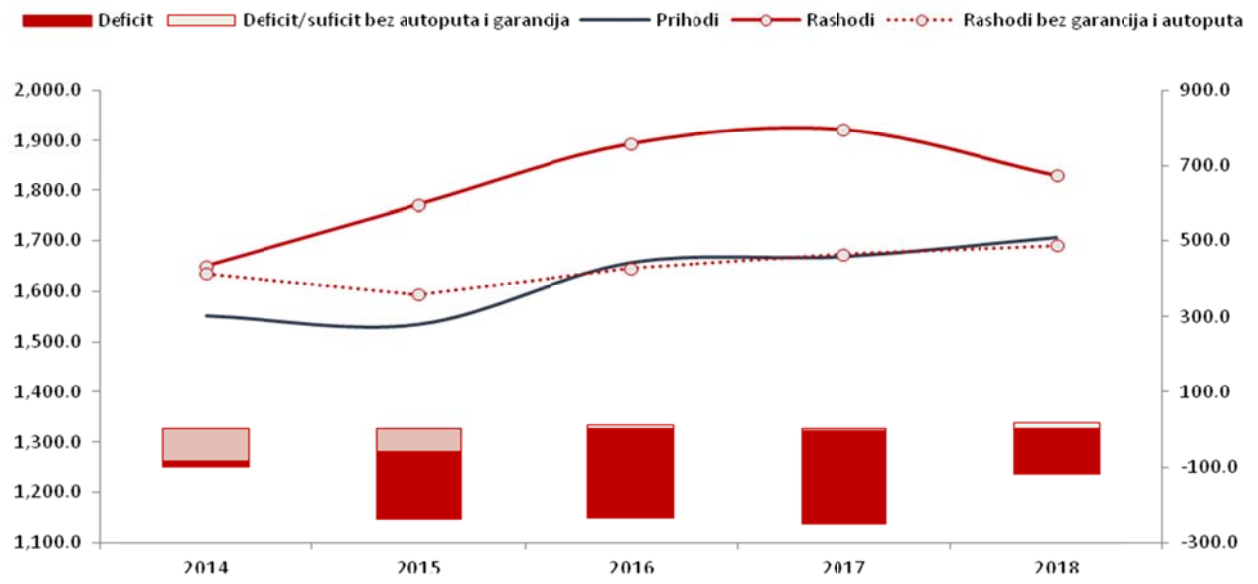
Capital expenditures for 2016 are planned to amount to €379.9 mill. which makes 20.1% of public spending or 9.8% GDP achieving high value of capital investments, which particularly emphasizes the development component of the budget designed to support creation of new value.

According to the mid-term framework, public revenues will range from €1,657.5 mill. in 2016 to €1,708.0 mill. in 2018. In spite of nominal growth of revenues, due to higher growth of GDP, revenues are expected to decrease from 42.9% GDP in 2016 to 39.6% GDP in 2018. The main revenue pillars remain value added tax and contributions, which make on average around 60% of public revenues. Collection of personal income tax will have significant share in revenues, while excise will record constant growth, which serves to harmonize Montenegro excise policy with the European Union requirements.

Public expenditures in the coming three-year period will be relatively high, taking into account that the construction of the high-way section Smokovac – Mateševac will be financed through the capital budget of the central government. In nominal terms, expenditures will range from 48.9% to 42.4% estimated GDP for 2016 and 2018 respectively. It is evident that with the exception of expenses for the high-way, residual expenditures record stagnation or only insignificant increase, which is in line with the commitment of the Government to further decrease current spending deficit in order to create space for investments in development projects. In the observed period capital budget will range between 9.8% GDP in 2016 and 6.3% GDP in 2018. With exception of the high-way expenses, for financing of other capital budget projects around €90 mill. (of which between €15-20 mill. will be related to funding from donor funds) will be allocated.

Public finance deficit will be relatively high in the coming period, as a result of investments into fixed capital of the state and will range between 6.1% in 2016 and 2.8% in 2018. Excluding expenses required for high-way construction financing, public finances would already in 2016 transit to the positive zone and record slight surplus of €11.2 mill. and €16.1 mill. in 2018 which makes 0.3% GDP or 0.4% GDP respectively.

Chart6: Public finance projection 2015 - 2018



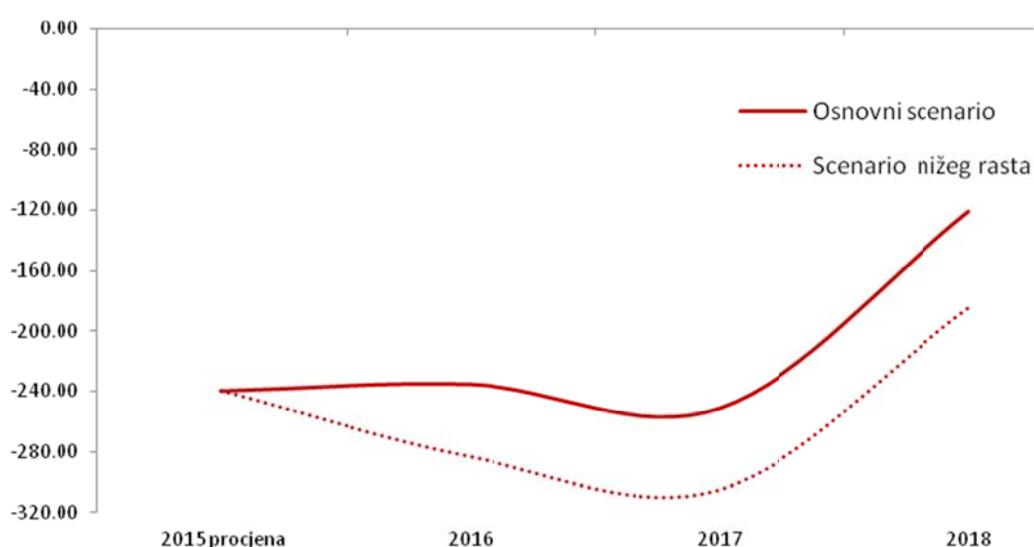
3.3.3 Low-growth Fiscal Scenario

Low-growth fiscal scenario is based on macro-economic low-growth scenario the main assumption of which is deterioration of the refugee crisis and terrorist threat that could result in Montenegrin economy to suffer consequences of jeopardized safety situation in the form of lower inflow of tourists and therefore lower revenues from tourism and branches related to it. In case these risks actually come true, budget revenues will not be generated within the framework planned by the base scenario, which will condition public spending deficit to grow. On the other side, the assumption is that the activities on the high-way construction will continue according to the planned schedule due to already defined arrangement.

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

In case of macro-economic low growth scenario, the revenue side will be adjusted by around 2% in relation to the base scenario, which would be the result of overflow of the mentioned adverse impact from real sector. Simultaneously, there will be adjustment of deficit, so in the scenario of low economic growth, the shortage in public finances would amount to around 7.6% GDP in 2016, whereas it should be noted that the increase of this indicator also results from the reduction of nominal GDP. Such small difference between the base and low growth scenarios is the result of prudential approach in revenue planning in the base scenario.

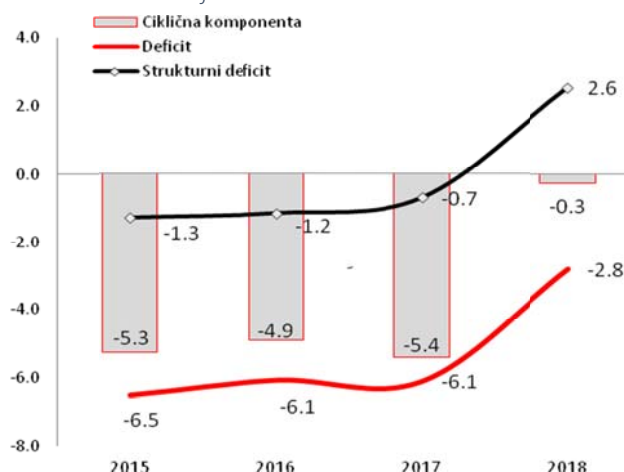
Chart7: Public finance deficit – scenario comparison



3.4 Structural Balance

Public spending structural balance shows actual disbalances in public spending, which depend on economic activity trend, current business cycle position of economy, and also sources of revenues, as well as expenditures related to one-off effects. Structural balance is the difference of public spending revenues and expenditures, where revenues are reduced by one-off collection of revenues (such as collection of the fee for freed up radio-broadcasting space – digital dividend in the budget for 2016), adjusted to the cyclical position of economy, and expenditures reduced by one-off expenditures, subsidies and funds for redundancies (automatic stabilizers). Estimate of structural expenditures excludes transfers for redundancies and subsidies, according to the structural deficit calculation methodology. The value of potential growth rate and the value of potential GDP, required for calculation are explained and calculated in the macro-economic chapter, using Hodrick–Prescott filter. During the period of economic growth, the revenues are higher than the structural ones, whereas they are lower in the so called low side of the business cycle. Public revenues in the periods of

Chart 8: Structural deficit

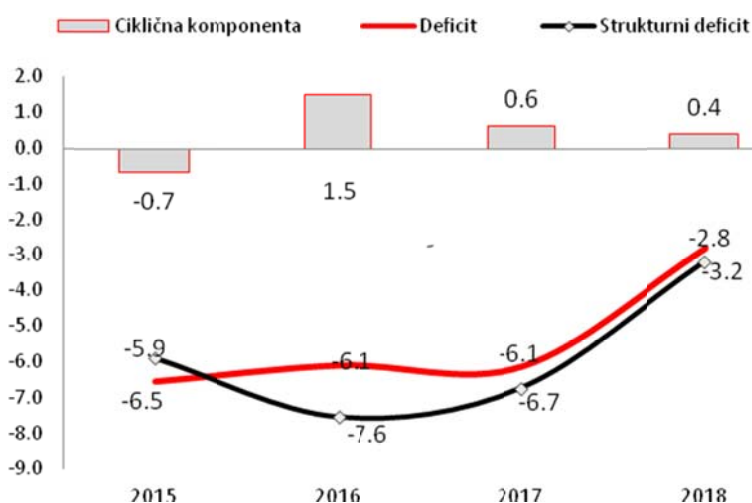


economic expansion grow more than economy growth rate and vice versa. The same can be claimed for expenditures in the expansion period, but it should be emphasized that in the periods of weaker economic activity expenditures grow in line with activation of automatic fiscal stabilizers related to transfers to individuals (funds for redundancies) and subsidies in support to real sector of economy in the period of deteriorated business. The results of the model are somewhat limited by frequent changes of tax rates for source revenues, but they reflect essential trends of structural

and cyclical components of public finance balance. The results (Chart 3) show that public finances, with exemption of cyclical components and the position in business cycle, show high values in the medium term, while in the case of excluding costs of the high-way construction they approximate balanced structural balance in 2018.

Chart 9: Structural deficit excluding high-way costs

Taking into account significant share of the high-way construction costs in the public finance deficit in the observed period, in order to monitor mid-term public finance trend, structural deficit is also calculated in case when effects of the construction of the priority high-way section are excluded from the estimated structural expenditures, given that one-off mid-term expenditures are in question.



3.5 Level and Trend of Borrowing, Analysis of Activities “Below the Line”, and Stock–Flow Adjustment

3.5.1 Government Debt in 2015

At the end of Q3 2015, the government debt amounted to 2,304.3 million euro or 62.9% of estimated GDP. At the end of the same period, the government deposits amounted to 153.5 million euro or 4.2% of GDP, which resulted in the government debt to amount to 2,150.8 million euro or 58.8% of GDP at the end of the Q3.

When comparing with the previous year, at the end of 2014, the government debt was 1,942.9 million euro or 56.2% of GDP, or 54.8% of GDP when deposits are included. The public debt at the end of 2014 was 2,071.7 million euro or 59.9% of GDP, while deposits amounted to 49.5 million euro or 1.4% of GDP, which affected the total public debt to amount to 2,022.2 million euro or 57.9% at the end of 2014.

Table 10 Government Debt Breakdown

| | 31.12.2014 | 31.03.2015 | 30.06.2015 | 30.09.2015 |
|---|------------|------------|------------|------------|
| GDP | 3,457.9 | 3,660.7 | 3,660.7 | 3,660.7 |
| Total Foreign Debt | 1,561.7 | 2,047.7 | 2,160.1 | 1,975.1 |
| <i>Total foreign debt/as % of GDP</i> | 45.2 | 55.9 | 59.0 | 54.0 |
| Total Internal Debt | 381.2 | 395.9 | 372.2 | 329.2 |
| <i>Total internal debt – as % of GDP</i> | 11.0 | 10.8 | 10.2 | 9.0 |
| Total government debt in million | 1,942.9 | 2,443.6 | 2,532.3 | 2,304.3 |
| <i>Total government debt – as % of GDP</i> | 56.2 | 66.8 | 69.2 | 62.9 |
| Deposits in million euro | 49.5 | 505.6 | 372.8 | 153.5 |
| <i>Deposits/as % of GDP</i> | 1.4 | 13.8 | 10.2 | 4.2 |
| Total government debt (including deposits) u mill | 1,893.4 | 1,938.0 | 2,159.5 | 2,150.8 |
| Total Government Debt – as % of GDP | 54.8 | 52.9 | 59.0 | 58.8 |

Total government debt at the end of Q3 2015, if compared to the end of 2014, was increased by around 361 million euro. Reason for sizeable increase of the government debt is the issue of Eurobond at the international market of 500 million euro, which were issued for a 5-year period with the interest rate of 3.875%, as well as due to two advance payments of funds from the China EXIM bank loan for the construction of the highway in total amount of 168 million euro (approx. 188.8 million USD). During first three quarters of 2015, the external debt was increased by 413 million euro if compared to the end of 2014, while the internal debt was reduced by 52 million euro.

During the same period, 26 million euro of loan funds were disbursed for implementation of other infrastructure projects, such as the World Bank (WB) projects for improvement of land administration, agriculture, energy efficiency, and education; and of the European Investment Bank (EIB) for construction and repair of the road infrastructure; the German Development Bank (KfW) for construction of the water supply system, discharge and treatment of wastewaters.

Repayment of the external debt during the same period amounted to 287 million euro, whereby the repayment of the remainder of 2010 Eurobond of 154 million euro was also done.

As for the breakdown of the external debt by creditor, credits under facilities with the International Financial Institutions (WB, EIB, EBRD, KfW, CEB, EU) make 15.2% of GDP; soft loans (liabilities towards

third-country governments) are 2% of GDP; loans for the budget financing needs (Credit Suisse, Deutsche Bank, Erste Bank) around 5.7% of GDP; liabilities arising from issue of Eurobonds around 26.4% of GDP; while liabilities arising from the Chinese loan for implementation of the highway construction are around 4.6% of GDP.

The domestic debt during three quarters of 2015 was reduced by 52 million euro and amounted to 329 million euro. The debt was reduced primarily due to repayment of debt to domestic commercial banks in the amount of around 25 million euro, while the liabilities arising from the foreign currency savings of citizens were reduced by around 12 million euro, as well as repayment of domestically issued bonds by around 10 million euro.

In accordance with the Law on Budget and Fiscal Responsibility, definitions of the government debt and public debt were introduced in the reporting as of the end of 2014. The government debt does not include the debt of local self-government, while the debt of state enterprises is now included in the government debt. The public debt, in addition to the government debt, includes also the local self-government debt and debt of municipal enterprises. In accordance with the Law, the Ministry of Finance has the obligation to report quarterly about the government debt, while it has to report annually about the public debt within 90 days following the end of the fiscal year. Furthermore, the mentioned Law also sets out fiscal rules in the area of public debt, precisely it defines that budget planning and execution are to be carried out in the way that the public debt does not exceed 60% GDP. At the same time, the Law defines as well activities that need to be undertaken in case that the public debt exceeds 60% of GDP.

In October 2014, a loan facility was signed with the China EXIM Bank in the amount of US\$943,991,500.00 for financing the construction of the Bar-Boljare Highway, the priority section Smokovac–Mataševo. This loan amount represents 85% of the total value of the project, which amounts to around 809 million euro. The remaining 15% will be provided from the budget, either from generated revenues or by securing funds from facilities with financial institutions, or by issuing bonds or treasury bills. The mentioned loan is concluded for the period of 20 years, with the interest rate of 2% and grace period of 6 years.

As for the present stock of debt, around 88% of the debt amount is denominated in the local currency, precisely in euro, thus at this time there is no currency risk, precisely a sizeable increase in liabilities cannot occur as a result of market currency exchange rates changes.

Table 11 Breakdown of loans in other currencies

| Creditor | Amount in mill € |
|-------------------------|------------------|
| Paris Club of Creditors | 30.9 |
| IDA | 61.5 |
| Eurofima | 15.6 |
| Chinese loan | 169.6 |
| Total | 277.6 |

Table 12 Share of debt in other currencies in the total government debt

| | |
|---------------------------------------|--------------|
| Total government debt | 2,304.30 |
| Amount of loan in other currencies | 277.6 |
| Share of other currencies as % | 12.05 |

In terms of the further trend of debt in other currencies, bearing in mind future withdrawal of loan funds for the highway construction from the loan of the China EXIM bank, it is expected that the funds in other currencies will have a higher share in the debt stock. Activities will be undertaken in the forthcoming period, due to the risks that may occur to the debt trend, as well as to repayment of liabilities, in order to secure safeguard from the currency risk by signing a hedging arrangement.

3.5.2 Base Scenario for the Government Debt Trend in the Period 2016-2018

The Law on Budget for 2016 envisages borrowings for the mentioned year in the amount of 688 million euro. Out of that, the amount of 433 million euro will be used to finance the debt repayment, for the Health Fund needs, to create fiscal reserves, while for the needs of financing the highway construction costs 255 million euro will need to be provided. Out of the planned borrowing of 433 million euro the majority of the funds, around 391 million euro, will be earmarked for the debt repayment, while 36 million euro will be required to finance the deficit and generate fiscal reserve. Part of the funds, 6 million euro, will be designated to repay liabilities of the Health Fund and public healthcare institutions.

As for securing funds for the construction of the priority highway section Smokovac–Mataševo, 204 million euro, out of envisaged amount of 255 million euro, will be provided from the China EXIM bank loan proceeds, which will represent 85% of required funds, while the amount of 51 million euro will be provided from other sources, which represent the remaining 15% of the Government of Montenegro.

In addition to these borrowings for 2016, according to the plan of liabilities repayment, the amount required for debt repayment in 2017 is considerably lower and amounts to 208 million euro, while for 2018 that amount is reduced to 113 million euro. However, bearing in mind the high level of planned funds for financing the capital budget in these years, the shortfall for budget financing will be around 500 million in 2017 and 380 million euro in 2018, whereby the funds for financing the highway construction are already secured from the concluded loan facility with the EXIM bank.

Keeping in mind the budget financing needs for 2016, funds required for debt repayment liabilities of the Health Fund, for creating a fiscal reserve, payment of liabilities for construction of the priority highway section, will be provided by issuing bonds on the international market, as it was the case in 2015. As for securing funds for 2017 and 2018, a possibility will be considered during 2016 in which manner to provide the funds, having in mind that the deficit in these years would be mainly made of expenditures required for financing the capital expenditure.

The EXIM bank loan in the period 2016-2018 will be executed up to the execution amount or the project implementation schedule and every disbursement of funds during a year will be recorded in the debt stock. In the period 2016-2018, a disbursement of around 40 million euro of funds for financing infrastructure and other projects is also envisaged. Disbursement of funds for implementation of the Bar-Boljare Highway Project, the priority section Smokovac-Mataševo, will have the highest impact on the public debt trend in the period 2016-2018. An initial forecast envisages that the funds will be disbursed at an average of 200 million euro annually.

Table 13 Trend of the Government debt for the period 2015-2018 – base scenario

| Year | 2015 | 2016 | 2017 | 2018 |
|----------------------------|----------|----------|----------|----------|
| GDP | 3,660.70 | 3,868.00 | 4,102.90 | 4,310.50 |
| Domestic debt | 281.80 | 213.70 | 153.70 | 152.70 |
| Foreign debt | 1,940.10 | 2,351.40 | 2,738.70 | 3,053.81 |
| State companies | 34.60 | 40.00 | 40.00 | 40.00 |
| Total government debt | 2,256.50 | 2,605.10 | 2,932.4 | 3,246.51 |
| Total government debt/GDP | 61.64% | 67.35% | 71.47% | 75.32% |
| Local self-government debt | 140.00 | 130.00 | 120.00 | 110.00 |
| Total public debt | 2,396.50 | 2,735.10 | 3,052.09 | 3,356.51 |
| Total government debt/GDP | 65.47% | 70.71% | 74.40% | 77.87% |

As it could be noted in the Table, it is expected that the Government debt at the end of 2015, without deposits, will be 61.6% of GDP, while with deposits, for which it assumed that will amount to around 54 million euro, the Government debt will be around 60.1% of GDP. At the end of the observed period, the public debt will be 65.5% of GDP without deposits, while with deposits the public debt would be 63.9%.

Further debt growth is expected in 2016, due to costs for the highway construction, thus it is expected that the Government debt would be 67.4% of GDP at the end of the period, while the public debt would be around 70.7% of GDP. As for the debt stock in 2017 and 2018, according to the current projections, which assume also high expenditures for the highway construction needs, the Government debt will be 71.5% and 75.3% of GDP respectively, while the public debt would be 74.4% and 77.9% of GDP respectively. Moreover, disbursement under other financial facilities, of up to 40 million euro annually, will be also included in the stated period.

Due to high surge of the debt in the period 2016-2018, fiscal policy to be carried out would need to be such as not to allow additional burdens and not lead to generation of additional deficit except for the deficit needed to finance capital projects aimed at generating economic growth. Investments to ensure economic growth and inflow foreign investments, as well as implementation of large projects will be particularly important in order to mitigate high level of debt and deficit. As it was already mentioned, the Law on Budget and Fiscal Responsibility defines that the public debt level should remain within the limit of 60% of GDP, while in case of deficit that limit is 3% of GDP. Bearing in mind the abovementioned, the Government of Montenegro faces a rather demanding task to bring down the level of debt and deficit within the limit defined by the Law. Taking into account that the debt will exceed the level of 60% of GDP, the Government will have the obligation, during 2016, to adopt a program for the public debt reduction in the forthcoming period, to define its policy and measures for further fiscal consolidation, borrowing, whereby it will consider that the defined measures do not endanger the economic growth or the implementation of investment plans.

Viewing the budget financing the main risk is exposure to external factors. There is a risk of Montenegro being limited a possibility to access international market, i.e. the sources of financing. In that segment, the highest risk is with the further stagnation of the global economic growths, certain financial difficulties in developing countries, as well as war conflicts in the world. Furthermore, insufficient economic recovery carries a risk, especially in the European countries, weakening of the euro, certain measures of the European Central Bank or FED or disruptions on the market due to the current developments concerning the oil prices. The Analysis of said risk with financial institutions that have participated in the Bond issue does not expect major changes that could lead to market

closure i.e. preventing Montenegro to access the market and issue bonds. This development could occur only in the event of a large-scale conflict or occurrence of a crisis of such scale that could lead to financial crisis in several European Union states.

Historical overview indicates that Montenegro managed during 2010 and 2011 to issue bonds at the international market in spite of unfavorable conditions caused by a large-scale economic and financial crisis that was happening at the time globally. Moreover, sizeable financing was secured in several years following that period, both through issue of bonds and by signing loan facilities. The most important success, in terms of obtaining interest rates, is the issue of bonds at the international market in 2015, when 500 million euro was issued with the interest rate of 3.875%, which represents a step forward in terms of the market confidence in Montenegro and implemented reforms. As for risks of the further borrowing at the market, as it was stated, interest rates trend will be affected by factors Montenegro cannot influence, thus, it is expected for interest rates to vary and increase, bearing in mind the current situation in the world.

Current risks could lead to increase of the price of borrowing, which could possible increase the costs of issuing bonds by some 1pp to 2pp, but it is unlikely that could prevent the securing of funds from the market. Likewise, in order to reduce the exposure on the international market, negotiations are being carried at in parallel with international banks for signing bilateral facilities, as well the analysis of the domestic market, as a backup-up plan in case that the market access is unable.

3.5.3 Low-growth Scenario

If a lower level economic growth occurs and revenues are reduced, taking place under the Low-growth Scenario, these changes will also affect the public debt trend. Reduction of revenues will create a need for additional borrowing in order to secure the shortfall fund to finance deficit. Likewise, the lower economic growth will also influence the GDP growth year by year, which will increase the share of public debt if compared to the forecasted baseline growth.

Table 14 Government debt trend for the period 2015-2018 – Low-growth Scenario

| Year | 2015 | 2016 | 2017 | 2018 |
|----------------------------|----------|----------|----------|----------|
| GDP | 3,660.70 | 3,747.00 | 3,953.00 | 4,139.00 |
| Domestic debt | 281.80 | 313.70 | 209.39 | 148.55 |
| Foreign debt | 1,940.10 | 2,407.40 | 2,817.70 | 3,125.80 |
| State companies | 34.60 | 50.00 | 50.00 | 50.00 |
| Total government debt | 2,256.50 | 2,771.10 | 3,077.09 | 3,324.35 |
| Total government debt/GDP | 61.64% | 73.96% | 77.84% | 80.32% |
| Local self-government debt | 140.00 | 130.00 | 120.00 | 110.00 |
| Total public debt | 2,396.50 | 2,901.10 | 3,197.09 | 3,434.35 |
| Total government debt/GDP | 65.47% | 77.42% | 80.88% | 82.98% |

3.5.4 Level of the Government Guarantees

Total government guarantees as of 30 September 2015 were 315.4 million euro or 8.62% of GDP. Out of this amount, foreign guarantees were some 306.5 million euro (8.37% of GDP), while the domestic guarantees were 8.91 million euro (0.24% of GDP).

In 2015, concluding new foreign guarantees is envisaged in the amount of 101.6 million euro, of which 40 million euro is for the loan facility between the *Crnogorski elektroprenosni*

sistem(Montenegrin Electricity Transmission System) and the European Bank For Reconstruction and Development (EBRD), for the project of construction of power cable between municipalities of Tivat and Pljevlja; for the project of the Investment-Development Fund of Montenegro with the Abu Dhabi Fund – Abu Dhabi to Montenegro Agricultural Support (ADMAS), in the amount of 50 million euro; amount of 5 million euro for facility of the Montenegrin Fund for Solidarity Housing Development for the project of construction of apartments; followed by 6.6 million euro the project of the Solidarity Housing Fund of the employees of the education sector of Montenegro – SOLIDARNO for the construction of housing units for teaching staff in the Municipality of Budva.

Out of the listed guarantees, the facility with the Abu Dhabi Fund, concluded with the Investment-Development Fund, is without a direct sovereign guarantee, while other guarantees will be issued by the end of 2015.

The issue of guarantees to municipalities of 107 million euro are envisaged by amendments and supplements to the Law on Budget for 2015. Thus the Law defines that the Government will issue guarantees to municipalities in 2015 for loan facilities in order to enable repayment of liabilities and outstanding debts, refinancing of existing credit obligations and rationalization of the administration, and so as follows: 1) for the Kolašin Municipality in the amount of 7.0 million euro; 2) for other municipalities that are users of the Equalization Fund resources in the amount of 100.0 million euro.

Bearing in mind the above stated, the Government has ensured a security instruments for these arrangements from the Equalization Fund resources, which will serve for repayment of liabilities of municipalities in case they are not able to service their liabilities on time, thus the guarantees will not be called.

For the purpose of improved sovereign guarantees management and reduction of risk, as announced, the Government of Montenegro has introduced a strict control over the further issue of sovereign guarantees. To that end, the guarantees will be issued only for infrastructure projects, as well as for loan facilities identified to contribute to economic development of the country, such as two projects mentioned earlier, as well as the projects where the assessment is that there is not risk for the guarantees to be called. As for the issuing of guarantees for the *Željeznička infrastruktura* (Railway Infrastructure), aside from the risks associated with these guarantees, having in mind the need to reconstruct the railroad, due to its conditions, it was decided to continue with the project of its reconstruction.

As regards the above mentioned, the Law on Budget for 2016, envisaged the issue of guarantees in total amount of 26.0 million euro, while there is an obligation for the collateral to be provided to the State of Montenegro

- 1) for the loan facility between the Montenegrin Electricity Transmission System (CGES) and the German Development Bank (KfW), for the project of construction of electricity infrastructure on the Luštica Peninsula, the amount of up to 20.0 million euro;
- 2) for the loan facility between the Railway Infrastructure and the European Investment Bank for projects pertaining to the reconstruction and improvement of the railway infrastructure, in the amount of up to 6.0 million euro.

3.6 Sensitivity Analysis and Comparison with the Previous Program

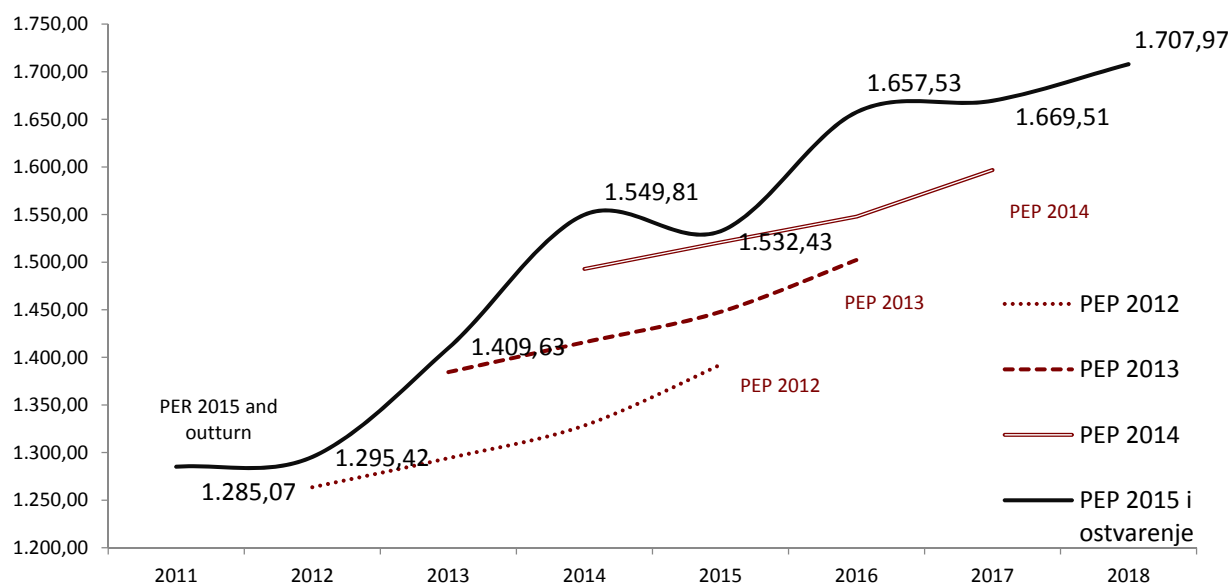
The main risks in fulfilment of fiscal projections, whether political or economic, may have positive or adverse implications on public finances. The overview of risks to fulfilment of the given fiscal projections is presented in the following table:

Table 15 Overview of fiscal risks in medium term

| | Positive | Negative |
|-----------|---|---|
| Political | <ul style="list-style-type: none"> • Invitation to NATO membership in 2015 will increase confidence of western investors and tourists, which will positively affect economy of Montenegro and better access to sources of financing; • Progress on the way to the European Union accession will condition increase of confidence of investors, more stable business environment and access to EU funds; | <ul style="list-style-type: none"> • Continuation of the crisis in the Eastern Europe may induce an adverse impulse – reduction of interest of investors from that region to make investments in our country, which has not taken place yet; • Unstable political situation and activities of some political structures have adverse impact on the international positioning of Montenegro, as well as on confidence of investors; • Due to deterioration of the refugee crisis and terrorists’ threats, and consequently endangered security situation, the Montenegrin economy may suffer consequences, in particular in the segment of collection of tourism revenues resulting from fewer tourists. |
| Economic | <ul style="list-style-type: none"> • Multiplicative effects of the highway construction and implementation of announced investments represent a risk to positive adjustment of revenue projection; • Measures and instruments of fiscal policy specified in the Analysis of specific tax system aspects, depending on their character, may have positive or adverse effect on fulfilment of projections; • Continuation of efforts to reduce grey economy and achieve results in that field, will increase tax base that may increase budgetary revenues; • Rescheduling of the tax debt to municipalities and an obligation to pay wages in gross amount will have positive effects on implementation of the projected budgetary revenues; | <ul style="list-style-type: none"> • Counterparty currency risk, which primarily refers to the currency fluctuations in Russia, Ukraine, Serbia and Azerbaijan; • Recession in Russia and Ukraine would reflect on decline in the purchasing power, and thus on reduced number of tourist arrivals from those countries, and reduction in tourism revenues; • Infrastructure weaknesses of economy; • Increasing burden of the pension system on the public finances; • Increase of the price of highway construction potentially up to 10%; • Further postponing of the commencement and/or delays in execution of investment projects may threaten the presented macro-economic scenario, and therefore fiscal projections for the medium-term period; • The amount of government debt is an adverse economic pressure on fulfilment of projections, and the increase of government debt has adverse effect on the borrowing conditions in international market; |

In relation to the revenue projection in the last year’s Program, public revenues in 2015 exceeded the projected. The most significant deviation took place with regard to the collection of contributions, due to increase in the health insurance contributions, but also due to settlement of outstanding liabilities in this segment. In addition, the collection of revenues resulting from fees has recorded an increase due to introduction of the fee for financing of the highway and national sports teams.

Chart10: Revenue analysis – execution and comparison with the previous Program



Last year's program defines also the fiscal policy objective that remained almost unchanged. In line with core conceptual provisions presented in the document Analysis of Specific Tax Policy Aspects – Reform Outlooks, adopted in December 2014, tax policies were adjusted during 2015 in line with this document. Fiscal incentives were also introduced as part of the tax policy reform, aimed at capturing value of resources and attracting new investments. Activities to combat the grey economy were intensified during the previous year, with a focus on the labor market and excisable goods market. The Commission for suppression of the grey economy continues with implementation of measures, and the core assumption was zero tolerance while complying with the unbiased and full transparency principle, with application of rigorous penalty policy.

Further implementation of activities aimed at sustainability of public finances is expected in the next period as well, in line with measures described in this chapter.

3.7 Sustainability of Public Finances

Montenegro is implementing reforms that need to ensure long-term sustainability of public finances. One of the most important factors of the fiscal consolidation is the financial sustainability of the pension system. Unfavorable demographic trends and labor market situation, and resulting accelerated growth of total number of pensioners and level of pension benefits have created the Pension and Disability Insurance Fund deficit and cause risk for sustainability of the pension system. In the period so far, Montenegro has carried out two reforms of the pension system: first systemic and parametric reform, in application since 2004, and the second parametric reform which is in application since 2011. The latter reform has moved the retirement age to 67, while the pension adjustment formulae was changed. Results of this reform will be visible in the following year due to a long transitional period of gradual increase of retirement for the old-age pension (from men until 2025 and for women until 2014). In 2016, pensions will be adjusted in line with the applicable and projected macro-economic indicators having impact on the pension benefit level (average wage and inflation).

In accordance with amendments to the Law on Pension and Disability Insurance done in 2015, an insured person whose employment in a business organization, in which the state had ownership share, was terminated as a result of a bankruptcy being opened, shall be entitled to an old-age pension with 30 years of contributing to pension insurance (men) or 25 years of contributing to pension insurance (women). Bearing in mind this, the early retirement represent one of the risks for further endangerment of the pension system.

The healthcare system has also an important role for long-term sustainability of public finances, precisely its financing. In the previous period, the high level of outstanding liabilities of the Health Insurance Fund, precisely of the public healthcare institutions, jeopardized the financial stability of the healthcare system, and consequently it placed challenges to settle these liabilities to the Budget of Montenegro. Based on this, in 2015 the Government of Montenegro has adopted the Analysis of the Healthcare System Financing in Montenegro and Master Plan for Development of Healthcare in Montenegro for the period 2015-2020. This document provides a strategic framework for strengthening and development of the healthcare system, defines priority areas for preserving and improving health and priority areas of organization and functioning of the healthcare system. Additional efforts need to be invested in the next period to improve the organization of the healthcare system and to establish financial sustainability of the health protection system in Montenegro.

The Government of Montenegro has adopted the Human Development Report – Informal Economy: Overcoming Exclusion and Marginalization, which primarily analysis causes and consequences of the informal economy, with a focus on informal labor, and gives recommendations for formalization of employment. In line with this document, recommendations were defined when implemented would result formalization of labor, and those include: education system should be inclusive, of good quality and efficient; health protection should be more accessible, of better quality and efficient; incentives for formalization within the social protection should be changed; regulatory framework should be supportive of formalization; labor legislation should be more flexible; tax policy should be in function of making preconditions for new jobs creating and gradual formalization; work of inspection authorities and enforcement of penalties should be improved.

In order to reach a long-term sustainable wages system, to increase transparency and establish balanced wages in the public sector for work on same or similar jobs, the Proposal of the Law on

Wages for Public Sector Employees is submitted to the parliamentary procedure, which has a net fiscal impact of 13 million euro. Principal measures that are intended to be achieved by this Law are:

- introduce mechanisms for wage planning during the planning of the Law on Budget based on fiscal and macro-economic parameters;
- establish principle of equality in wage calculation for all employees in the public sector;
- abolish remunerations for work in work groups, commissions and working bodies of the Government;
- abolish wage supplements and other wage increments, creating sizeable difference in the wage level and recognizing these increments;
- by unifying data on wages and introducing provisions that supplements exclude other increments, it is expected that the misuses of the wage system will be reduced;
- improve financial situation in state-owned enterprises and local self-government units.

Local self-governments are an important segment of the overall fiscal system, thus the situation and developments in finances at the local level also influence the overall fiscal sustainability and financial stability. The continued trend of stabilization of public finances of local self-government is expected in the next medium-term period, which will be reflected through reduction of the level of outstanding liabilities and rationalization of the current spending, settling liabilities from the previous period, regular servicing of statutory obligations, and rationalization in number of employees. Namely, by signing of a contract on rescheduling of debt resulting from taxes and contributions for wages of employees, the local self-government units are obliged to settle regularly liabilities arising from these grounds, as well as to rationalize the number of employees. In order to improve the fiscal discipline, at the event of new employment the municipalities are obliged to request a consent of the Ministry of Finance. Moreover, before adopting the Decision on Budget, local self-governments must obtain a positive opinion of the Ministry of Finance.

The Project “Social Card” – Social Welfare Information System, will have a long-term effect on public finances, as already stated in the previous Program. This Project creates a consolidated database on users of rights in the social welfare system, and thus is targeting better budgetary funds allocated for these purposes, it standardizes the decision making process in the process of rendering a decision about social welfare rights, reduces misuse and ensures more efficient planning of measures and programs intended for socially vulnerable categories of the society. The Project is implemented and its positive effects are expected in the forthcoming period. The medium-term budget framework also reflects amendments to the legislation governing rights in the area of social and child protection. Namely, amendments and supplements to the Law on Social and Child Protection were adopted in 2015 whereby mother having three or more children are entitle to a life-long benefit, in accordance with set criteria.

All fiscal consolidation measures introduced in the previous period, which will be in application in the next period as well, are aimed at establishing a long-term sustainability of the public finances system.

3.8 Institutional Features

Responsible fiscal policy management was and continues to be a strategic commitment of Montenegro. As a response to need for further improvement in the public finances area, in the previous period the Government of Montenegro has aligned its legislation with the EU standards and adopted strategic documents and guidelines in this field.

Core legislation governing the budget system in Montenegro is the Law on Budget and Fiscal Responsibility, which entered into force in 2014. This Law has introduced in the budget system: criteria for fiscal policy planning, medium-term budget framework, numeric fiscal rules, and other provisions aimed at improving public finances management. Development of the stronger medium-term budget framework started through defining specific sector budget ceilings for all ministries in line with the Macro-economic and Fiscal Policy Guidance. In line with the obligation stipulated under this Law, the State Audit Institution (SAI) has adopted for the first time in 2015 the Report on Assessment of Application of the Fiscal Responsibility Criteria for 2014, which makes an integral part of the SAI Annual Report on Completed Audits and Activities for the Period October 2014 – October 2015. In accordance with this Law, the Fiscal Strategy must be adopted for a period of the term of the Government, thus it is expected that the new strategy will be prepared in 2016 after parliamentary election take place, i.e. the Government is formed. Bearing in mind that according to projections it is expected that the public debt will exceed the set limit of 60% of GDP, due to implementation of capital projects, the Government will prepare in the next year a Recovery Program that will include measures for bringing down debt within the set limit within a period not exceeding five years.

The Government of Montenegro has adopted the Program of Reform of Public Finances Management for the period 2016-2020. The Reform of Public Finances Management is necessary in order to ensure fiscal sustainability and proper public finances management, in accordance with provisions of the European Union *acquis*, and the adoption of the Program is a prerequisite for drawing down funds for the direct budgetary support as part of the IPA program. Objectives of this Program are:

- advancement of the public finances system in Montenegro and readiness of Montenegro to identify, prevent, and manage fiscal risks, excessive fiscal deficits and adverse macro-economic disbalances;
- reforms should be provided in order for the public spending to be structured in such manner as to maximize the development impact on the economy and to ensure better livelihood quality for all citizens;
- alignment of regulations with the EU *acquis*.

Based on the situation analysis and identified weaknesses in various public finances management sub-sectors, the priority objectives of the Program are defined and grouped in the following areas of reform: 1) sustainable fiscal framework, planning and budgeting of the public spending; 2) budget execution; 3) development of the internal financial controls systems; 4) financial reporting and accounting; and 5) SAI capacities to meet the INTOSAI standards.

In the area covering the budgeting process, the medium-term budget framework will continue to be strengthened in order to reflect the Government's strategic objective in an adequate manner and contain fixed ceilings for all spending units, as to create an efficient system of performance measurement of budget program and to improve planning and reporting on capital projects over a medium term.

In March 2015, the Government of Montenegro has adopted the Strategy for Implementation of Accrual Accounting in the Public Sector. Main objective of the Strategy is to define core steps in order to replace cash-based accounting and financial reporting with accrual accounting, in order to ensure more effective public finances management and delivery of public service. Transition of the public sector to the accrual accounting system includes: a) change of the existing chart of accounts for users of budgetary funds; b) changes in financial reporting in the public sector; c) education and capacity building of accounting staff for the accounting system reform with focus on practical matters; d) permanent monitoring and evaluation of process of transition to the new system.

In order to increase transparency of public finances, the Strategy for Implementation of the ESA 2010 Methodology in the Public Finance Statistics of Montenegro was also adopted in 2015. ESA (European System of Accounts) is internationally comparable statistical methodology used for systematic, detailed and comprehensive presentation and measurement of economy, its components and their interdependency. Montenegro has the obligation to align its legislation, processes and capacities with the Directive 2011/85/EU governing budgetary accounting and statistical reporting, forecasts, numerical fiscal rules, medium-term budgetary framework, and clear division of competences in the statistical system. The Strategy defines the existing state, plan for transition to the ESA 2010 system, objective to be achieved by the reform of accounting and reporting, as well as proposal of measures and activities for implementation of ESA 2010. In September 2015, the Statistical Office of Montenegro has published GDP data for 2014 and revised data for the period 2010-2013, in accordance with the ESA 2010 methodology.

In order not to allow public debt to grow in excess of envisaged level and to ensure its gradual reduction, the Government has adopted the Debt Management Strategy for the period 2015-2018. This Strategy envisages the following measures:

- In order to secure part of funds for the budget financing, the funds should be obtained from issue of Government bonds on international or domestic market or via bilateral facilities, depending on the market conditions;
- Amount of issued Treasury Bills should not exceed 70 million euro at the end of 2016, and after that the amount of Bills will depend from market conditions;
- The Government deposits, in form of cash and other liquid assets, should not fall below a threshold of 20 million euro at the end of a year;
- The Central Bank should invest, on behalf of the Government of Montenegro, deposits not needed in a short-term, as cash buffer, in accordance with legislation and the Bank's guidelines;
- Should be enabled for the share of total debt with fixed interest rate to be in range of 65-75%;
- Share of debt in euro should not be below 70% of the total public debt amount;
- Guarantees should be issued only in euro;
- Debt management strategy should cover the medium-term, but should be updated annually.

The Montenegro Public Administration Reform Strategy for the period 2016-2020 will be adopted in 2016, which will provide a strategic framework for reform in this field. The Public Administration of Montenegro should be equipped to fully prepare and align national legislation framework with the *Acquis communautaire* and operate efficiently based on its full implementation within the European administrative space. The most important expected result of this commitment is certainly the creation of service-oriented public administration that will contribute to the economic stability and quality of standard of living of all citizens of Montenegro,

4 STRUCTURAL REFORM PRIORITIES 2016-2018

The ERP 2016-2018 Chapter 4 includes an overview of Montenegro reform agenda in relation to the overall macro-economic and fiscal policy priorities contained in Chapters 2 and 3. This Chapter is developed in the way that section 4.1 first presents the main obstacles to faster economic development and increased competitiveness of Montenegrin economy. Section 4.2 presents structural obstacles to increased competitiveness by areas and the stated ten areas identify 19 priority reform measures that will contribute to increased competitiveness of specific areas, as well as competitiveness of economy as a whole.

4.1 Identification of the Key Obstacles to Growth and Competitiveness (diagnostic)

Montenegro development model is still dominantly based on domestic consumption facilitated by high inflow of foreign accumulation in the form of foreign direct investments (around 16% GDP in 2015). The trends in international environment concurrently indicate that this development model is not a sufficient condition for Montenegro to accelerate its economic growth in the coming period or gradually approximate average EU per capita income. According to the EUROSTAT data, Montenegro is today at the level of 41% EU-28 average (measured by GDP (PPC) per capita).

The basic long-term economic policy objective of Montenegro is a strong economic growth accompanied by new jobs, which ultimately should result in improvement of the quality of living of citizens. In the coming period the achievement of this objective should also be based on: (i) maintaining macro-economic stability (fiscal and financial) and (ii) enhance of competitiveness. Although macro-economic stability is required for sustainable growth of economy, it will not be sufficient if no structural problems are resolved in view of contributing to increase of competitiveness and acceleration of growth. Therefore, it is necessary to decrease or fully eliminate all the obstacles preventing increase of economy competitiveness, which will facilitate faster economic growth of Montenegro.

For the purpose of accelerating economic growth, it is necessary to ensure systemic broadening of production and export base of economy. As already mentioned, it is conditioned by increase of competitiveness. According to the EC Progress Report of Montenegro 2015, Montenegrin economy is “moderately ready to face the competitive pressure within the Union. Some progress has been achieved through commencement of several infrastructure projects in the areas of infrastructure and tourism, as well as business environment enhancement... The problem of Montenegrin economy is reflected in “low competitiveness, particularly industrial and agricultural products”.

Last year’s ERP provided a detailed analysis of obstacles to faster economic development of Montenegro. Given the nature of those obstacles, it is understandable that they haven’t significantly changed until now. Those are primarily the following obstacles to increase of competitiveness and economic growth of the country: (i) relatively high share of informal economy, (ii) non-resilience and high costs of labor market, (iii) insufficient harmonization of education and skills with the labor market needs; (iv) insufficiently developed physical infrastructure; (v) insufficiently efficient state administration; (vi) limited access to finances by small and medium-sized enterprises and insufficient education and knowledge of entrepreneurs; (vii) low level of added value in production and

insufficiently diversified export; (viii) incomplete application of international business standards; (ix) insufficiently efficient enforcement of contracts, then necessity for further improvement of the overall business environment, etc. Most these obstacles are recognized in the national developmental documents, primarily in the document titled the Montenegro Development Directions 2015-2018, as well as the European Commission Report 2015 and within the consultations with OECD. Obstacles to economic growth of Montenegro are also discussed in the Doing Business Report 2016, and in the Report of the World Economic Forum 2015-2016. According to this Report, it will be particularly significant for Montenegro in view of increasing competitiveness of economy to make progress in the following areas: (i) institutions, (ii) infrastructure, (iii) health and primary education, (iv) high education and training, (v) labor market efficiency, (vi) commodity market efficiency, (vii) technological capabilities, and (viii) business and innovation sophistication.

Very clear recommendations directed at increasing competitiveness and achieving economic growth are given to Montenegro by the EU within the Ministerial dialogue in May 2015. In addition to recommendations directly related to the issue of public finances including public debt, which is discussed in chapter 3 (recommendations 1 and 2), a range of recommendations is also given in the area of structural reforms (recommendations 3 to 8) that are the subject of this chapter. As regards the recommendations from the area of structural reforms, they are as follows: recommendation no. 3 related to **implementation of the planned voluntary financial restructuring program (so called "Podgorica Approach") to address the problem of high burden of non-performing loans on bank balance sheets from a flow perspective.** In order to resolve the issue of outstanding non-performing loans, Montenegro should **improve deadlines and efficiency in enforcement of contracts.** Also, effective supervision over factoring companies should be introduced to improve transparency of the financial system; Recommendation no. 4 envisages that **labor legislation** should be amended and supplemented in order to **introduce further market flexibility.** Recommended is reinforcing of sanctions to discourage undeclared work, and to target active policies for workers at risk of losing their employments. Recommended is enhancing of labor market participation in view of ageing population; Recommendation no. 5 is related to ensuring active continuation of **education reform with a view to better aligning education and skills with labor market needs and strengthening cooperation between education and business.** Recommendation no. 6 is related to **necessity to amend transport development strategy,** ensuring alignment with regional connectivity agenda, with a particular focus on the core investment priorities (core network), and establishing a credible planning and funding mechanism in the form of a single sector pipeline. Recommendation no. 7 is related to further improvement of business environment as to ensure timely implementation of the **"regulatory guillotine" (simplification) project,** through enhancing the functioning of **"one-stop shops" at municipal level for the issuing of construction permits** and the quality of the land registry. Recommendation no. 8 is related to making further progress with a comprehensive and strategic approach in the **field of EU food safety and sanitary and phytosanitary standards** so the country would receive accreditation exporting agricultural and food products to the EU.

By combining goals and recommendations provided in the key national development documents, such as the Montenegro Development Directions 2015-2018, the EU recommendations, and taking into account analyses of other international organizations like the World Bank, World Economic Forum and OECD, in October 2015 the Government of Montenegro defined 7 priorities for the Economic Reform Program 2016-2018, directed at decreasing and if possible eliminating obstacles to increase competitiveness and accelerating economic growth. The priorities in question are directed at maintaining macro-economic stability of the country and increasing the level of competitiveness. The priorities that are generally directed at maintaining macro-economic stability are: **Fiscal sustainability; Systematic reduction of informal employment; Creation of conditions for lending growth; Strengthening**

external position of the country. Priorities dominantly directed at fostering competitiveness are: **further development of basic infrastructure; favorable investment environment; growth and development of small and medium-sized enterprises.** Development of human capacities is a priority that is not mentioned directly, but it is recognized in each of seven priorities as a precondition for their achievement.

Proposal of structural reforms in the Economic Reform Program 2016-2018 is prepared with the aim to decrease or eliminate most of the previously identified obstacles to increase competitiveness and economic growth, and therefore the achievement of the set priorities.

4.2 Priority Structural Reforms by Areas

The basic objective of this section is to present basic structural reforms that the Government envisages for the coming mid-term period. In line with the directions by the European Commission, each of eight areas is presented in a methodologically uniform way. Firstly, given is a diagnostic of the situation focused on the key obstacles to faster economic growth in a specific area. After that, follows a text about the previous process of implementing specific recommendations given to Montenegro at the Ministerial meeting in May 2015 (if such recommendations are given for the specific area), then a section the planned reforms related to such recommendations for the following period. In the further text given is also an overview of other priority reforms in that area.

At the end of the text about each of eight areas under section 4.2 presented are priority measures from that area that entered 19 most significant “priority reform measures” of this year’s Economic Reform Program. For selection of the “priority reform measures” applied were the following criteria or answers to several questions were to be given. Firstly, the measure had to be broad enough to be able to affect competitiveness of the country, and on the other side to be sufficiently “specific” so its impact can be quantified. Secondly, does/in what way does the measure contribute to implementation of the priorities set by the Government of Montenegro in the context of preparing this year’s Economic Reform Program. Thirdly, does/in what way does the measure contribute to the implementation of recommendations given to Montenegro at the Ministerial meeting in May 2015. Fourthly, the measure should be a response to some of the key obstacles to higher competitiveness and faster economic growth of Montenegro. Fifthly, is the measure prepared - in essential and financial terms – to be in the phase so its implementation could commence in 2016.

Each of the selected priority reform measures is presented in a methodologically same way and includes the following information: (i) brief measure description, (ii) envisaged timetable for implementation of the measure, (iii) financial structure and fiscal implications, and (iv) expected impact of the measure on increase of competitiveness of economy.

4.2.1 Public Finance Management

Successful public sector functioning and, successful public finance management within that framework, which is aimed at maintaining fiscal stability as a strategic commitment of the Government of Montenegro, implies significant improvement of the functioning of the budget system, managerial responsibility, public procurement, internal and external audit. This section of the ERP comprises all public policies that directly affect public finance management, save those that directly support the macro-fiscal framework which are included in Chapter 3. In this sense, within the public finance management framework, special attention is paid to: (i) carrying out public procurement procedure and application of public-private partnership, with full observance of the transparency principle and establishment of an efficient legal protection system and (ii) improvement

of discipline and transparency in use of public resources and legal disposing of public finances and state assets through internal and external control instruments.

Public policies covered by this section of the ERP are presented below.

4.2.1.1 Public procurement and public-private partnership

Diagnostic: Institutions responsible for the public procurement system are operational and established in accordance with the EU standards. Public procurement system is continually improved and harmonized with the EU regulations and principles. At the end 2015, Montenegro Public Procurement System Development Strategy 2016-2020 was passed. Amendments to the Public Procurement Law (December 2014) mostly eliminated the flaws related to efficient functioning of the public procurement system. The legislative framework treating public procurement does not include the preferential treatment clause for local participants. It strongly supports regional economic integration and competition. Although significant results have been achieved, Montenegro is facing an important challenge in terms of harmonizing public procurement regulations with the new 2014 EC directive package and their full application in practice. In addition, substantial is the issue of insufficient use of contemporary information technologies in public procurement procedures, due to the absence of suitable infrastructure and trained and competent personnel.

Montenegro is faced with the issue of lack of funds for execution of development projects. In this sense, public-private partnership has been recognized as one of the models for solving this problem. In the legal system of Montenegro there is no unified law that would regulate the issues related to public-private partnership.

Priority reforms¹⁶: In view of establishing an efficient, transparent and competitive public procurement system, as well as reducing irregularities, as stated in the European Commission Report 2015, the Montenegro Public Procurement System Development Strategy 2016-2020 will be implemented. At the same time, regulations will be harmonized with the 2014 EU Directives on public procurement, particularly in the area of concessions. Activities will be undertaken on strengthening capacities for implementation and application of public procurement system at all levels, including electronic procurement, monitoring of contracts and supervising and reporting on the public procurement procedures. Preparatory activities commenced for implementation of the project of introducing the complete public procurement electronic system, and depending on the financial potentials, activities will also be undertaken in view of strengthening administrative capacities of authorities responsible for public procurement affairs.

As regards public-private partnership, preparing of a systemic law on public-private partnership is in process, and it is to unify all the forms of public-private partnership, including concessions. Adoption of this law will create regulatory and institutional framework for identification of PPP projects, award of PPP contracts and supervision of their implementation. The Law will specify specific procedures and criteria for selection of the most favorable bidders. Also, emphasize will be on fiscal sustainability and efficiency of public service provision. An Investment Agency is envisaged to be established too, which will be in charge of all investment models, including public-private partnership. It is important to note that this Law will be harmonized with the 2014 EU Directive on Concessions. Legal and institutional regulation of public-private partnership, with sharing of risks between the public and private sectors, will affect increase of the public service quality, through inclusion of private sector and more efficient control of spending of public resources and public services.

¹⁶Montenegro had no specific recommendations from the Ministerial meeting in May 2015 in that area.

Identification of priority reform measures: One priority reform measure “Introduction of the electronic public procurement system” is established within this area.

Priority reform measure No 1: Introduction of the electronic public procurement system

Brief description of the measure: For the purpose of establishing an efficient, transparent and competitive public procurement system in Montenegro, as stated in the European Commission Report 2015, it is necessary to introduce a contemporary electronic public procurement system. With regard to this, required infrastructure will be developed, training for system users and administrators will be organized and activities undertaken on raising awareness of the electronic public procurement policy.

Envisaged timetable for implementation of the measure: Activities on implementation of this measure commenced in 2015, as a part of regular activities of the Public Procurement Administration. In the first quarter 2016 Tender procedure will commence, and it is expected to be finalized in the fourth quarter 2016. At the same time, in quarter IV the development of the electronic public procurement system will commence. Test version of the system should be completed in the third quarter 2017, including training of the employees of the Public Procurement Administration and removal of potential flaws to the system. Simultaneously with these activities, prepared will be the Plan of training and materials required for training of the system users (contracting authorities and bidders). Commencement of using the system, and training for the users of the system are expected at the beginning of 2018.

Financial structuring and fiscal implications: The project value is €1,650,000.00. The Project will be funded from IPA 2014 in the amount of €1,500,000.00, and from the Budget of Montenegro €165,000.00 (co-financing). In addition to this amount, for implementation of this measure €57,000 were spent from the Budget in 2015, and for 2016 the funds amounting to €60,000 have been allocated, which is equal to gross wages of employees with the Public Procurement Administration, who are engaged in implementation of this project. Direct impact of this measure on the reduction of budgetary expenditures will be significant when the measure becomes fully operational, but the impact is not possible to be quantified.

Expected impact of the measure on increase of competitiveness of the country: Introduction of the electronic public procurement system will increase competitiveness, shorten procedures and reduce public procurement procedure costs. Given the fact that the State directly enters the market through public procurement procedure, its behavior has great impact on the overall economic activity. Improvement of the public sector management system, i.e. public procurement system is of key importance for achieving macro-economic stability, increased competitiveness, i.e. growth and development of economy.

4.2.1.2 Public Internal Financial Control (PIFC)

Diagnostic: Procedures and rules for implementation of public internal financial control (PIFC) have been prepared, but their consistent application has not been ensured yet. In the previous period, the normative framework that regulates this area was completed through adoption of the law, enabling and other regulations. In June 2012, adopted was the Strategy on further development of public internal financial control of Montenegro (second in a row), which is implemented in line with relevant action plans. Action Plan 2016-2017 will be adopted by the end of the first quarter 2016.

The basic weaknesses related to internal financial controls are as follows: lack of managerial responsibility in state administration organizational units, financial management oriented to

compliance and mere existence of basic capacities and expertise in some internal audit units, in terms of the number of auditors and their professional competences. Risk management is an integrated element of internal control system and it needs to be further developed as to be systematically implemented in the entire public sector. Internal audit system is established in line with the requirements of the EU accession negotiating chapter 32, but the capacities for qualitative audit work still require further development. In the previous period the Ministry of Finance fostered supervision over the PIFC practice in spending units through implementation of quality controls both for internal audit rules and financial management and control rules. This analytical work should be strengthened and lessons learned incorporated in the overall procedures at the Government level.

Priority reforms¹⁷: The basic objective of further development of the internal financial control system is efficient, economic, effective and transparent public finance management at the level of individual spending units. Also, the basic risk represents non-understanding of the significance of financial management and control and internal audit, which will be mitigated through specific training of managers, employees and internal auditors. Implementation of financial management and control (FMC) varies at the level of each individual spending unit. Annual progress analysis shows significant differences among institutions. Although most institutions have FMC managers, only one third of institutions have action plans. While senior management is generally responsible for implementation of policies, financial responsibilities are rarely delegated to a level below the secretary of the institution. Also, it is necessary to strengthen the role of financial units in institutions, which would provide support to other organizational units in achieving their goals, with regard to data analyses and preparation of detailed reports. As regards the implementation of internal audits, the key issue is shortage in engaged personnel. In this context, it is necessary to accelerate additional employment and capacity strengthening.

In the coming period, special emphasis will be on fostering managerial responsibility in public sector. In this sense, it is necessary to strengthen managerial responsibility in line with the principles of delegation of responsibilities and authorizations.

4.2.1.3 External Audit

Diagnostic: Public sector external audit and establishment of the State Audit Institution make a part of the strategy of public finance reform and creation of an independent economic system of Montenegro. Legislative framework for the State Audit Institution (SAI) is harmonized with international requirements relating to its independence, authorizations and organization. The development and strengthening of the SAI is based on the Strategic Development Plan. The SAI passed methodological guidelines for audit work and quality control of audit. The basic problem in this area is related to personnel shortage, in terms of number and quality, i.e. professional skills. The SAI does not have full independence in audit planning taking into account the increased number of audits that are mandatory according to law (annual audit of financial reports of political parties).

Priority reforms¹⁸: The basic goal of reforms in this area is standardization of procedures for carrying out financial audit, regularity audit and performance audit in line with the ISSAI (international standards of supreme audit institutions). The SAI developing and strengthening are based on the Strategic Development Plan. Further activities will be focused on strengthening human resources management and improvement of professional skills of auditing personnel. Further strengthening of

¹⁷ Montenegro had no specific recommendations from the Ministerial meeting in May 2015 in that area.

¹⁸ Montenegro had no specific recommendations from the Ministerial meeting in May 2015 in that area.

audit capacities is required for implementation of various types of audit, particularly financial audit and performance audit, in line with ISSAI. Also, horizontal functions within the sector require further development. Guidelines for carrying out the audit of the budget final account also need to be prepared. Application of the audit methodology and the manual for different types of audit will ensure a sound base for coordinated program for institution and capacity building. Focus is also required in the field of strengthening communication policy with the Parliament, particularly with regard to monitoring of implementation of recommendations given in audit reports.

4.2.2 Infrastructure

4.2.2.1 Transport

Diagnostic: Good physical infrastructure that facilitates physical connectivity between the citizens living in different regions of Montenegro is a precondition for various forms of international cooperation. In addition, qualitative physical infrastructure strengthens attractiveness of Montenegro as a tourism and investment destination. Physical infrastructure weaknesses concurrently mean obstacles to faster economic growth, which actually hampers increased competitiveness and faster economic growth of Montenegro. One of the limitations that Montenegro is faced with, as an obstacle to increased competitiveness, is insufficiently developed and tied in high-quality infrastructure. Investments in transport infrastructure have long-term implications not only on development of the transport system but also on development of the entire economy. Its developmental connectivity and inter-dependency in relation to other business activities identify transport as a branch of strategic significance. Transport as a service-providing activity contributes to the growth of merchandise trade, international services, development of tourism and industry. Also, it affects the level of integration of a country not only in regional but also wider international context.

Implementation of specific recommendations given to Montenegro: Regional initiative “Berlin Process” and cooperation of the Western Balkans 6 was launched with the idea that the Western Balkan countries should be tied in a more qualitative way and thus encourage economic development and growth, primarily through infrastructural connections and incentives to investments, and also through harmonization of regulatory policies in this area. In accordance with the EU recommendations from the Ministerial meeting held in Brussels in May 2015, Montenegro commenced activities on amending the Transport Development Strategy 2008 in line with the regional Agenda (see priority measure No 2). At the latest Western Balkans 6 Summit held in Vienna on 27 August 2015, one-year intensive work with the European Commission, i.e. its Directorates was completed, which included meetings of the heads of governments, ministers of foreign affairs, ministers of economy and ministers of transport, and at that occasion the Core Transport Network in the region of the Western Balkan was confirmed, which is currently covered by extension of the three key Trans-European transport corridors to the region of the Western Balkan (Mediterranean corridor, Orient (Near East) – East Mediterranean corridor, and Rhine –Danube corridor), then the list of previously identified projects on indicative extension of the Core Trans-European Network (TEN-T) to the region of Western Balkan focusing on the period until 2020 was prepared and adopted, and action plan was adopted for implementation of “soft measures” (which is divided in two periods of implementation – 2016 and until 2020), which will contribute to elimination of market barriers in the area of transport.

Plan of reforms related to specific recommendations given to Montenegro: The established Core Transport Network through the territory of Montenegro, as of the date of this year’s Vienna Summit is: SEETO road route 4: high-way Bar-Boljare (border with the Republic of Serbia); SEETO road route 1:

Adriatic-Ionian corridor (coastal variant, i.e. fast route along the Montenegrin Coast), i.e. connection to the Republic of Croatia and Republic of Albania; SEETO rail route 4: railway line Bar-Vrbnica (border with the Republic of Serbia); SEETO rail route 2: railway line Podgorica-Tirana (connection with the Republic of Albania); port of Bar and Podgorica airport. The projects of interest for Montenegro that are included in the List of previously identified projects on indicative extension of the Core Trans-European Transport Network (TEN-T) to the region of Western Balkan will have absolute priority in the coming period, and they include the projects on the Mediterranean and Orient (Near East) – East Mediterranean corridors.

At the Vienna Western Balkans 6 Summit, the EC and Western Balkan countries agreed with the list of six investment projects for transport infrastructure which reflect main priorities and required maturity for fast implementation, which is also proposed to be included in IPA 2015 multi-beneficiary program. They include inter-modal terminal in Belgrade, two road projects (inter-connection of) B&H and Croatia, and three railway projects (inter-connection) Montenegro-Serbia, FYR Macedonia, Kosovo and Serbia, and FYR Macedonia and Serbia. The value of these projects amounts to around EUR340 million, of which grants from EU funds will amount to around EUR150 million. Within this initiative Montenegro is approved a railway project on the corridor Near East-East Mediterranean (Route 4), i.e. rail inter-connection Montenegro-Serbia, in the amount of EUR 40 million, of which EUR 20 million of the grant will be provided by the WBIF IPA 2015, and the remaining funds by the Government of Montenegro. Specifically, as a single project, within the reconstruction of the railway line Bar-Belgrade on the section passing through Montenegro, we applied for the project of replacing signaling safety devices at the station in Podgorica. The value of this part of the project is EUR 10 million, while the other part of the project is related to the reconstruction of 91 concrete bridges in the value of 30 million euro.

Plan of other priority reforms: The capital priority project whose implementation commenced with the construction of the section Smokovac-Uvač-Mateševo is the high-way Bar-Boljare that will connect Montenegro with Serbia and further with European corridors No VII and X, and then with the Central Europe (see priority measure No 3 Construction of the Bar-Boljare high-way priority section Smokovac–Mateševo below). Implementation of infrastructure related measures will be additionally contributed by construction, reconstruction, rehabilitation and periodic maintenance of the road infrastructure through the following programs: Reconstruction of regional and arterial roads in Montenegro; Resolving bottlenecks on the Montenegro transport network 2010-2016; Rehabilitation of bridges, slides and slopes on arterial and regional roads; Reconstruction and rehabilitation of critical spots; reconstruction of inter-sections; construction of third lanes; periodic maintenance of regional and arterial roads, supervision, design, expropriation, inspection and periodic resurfacing of regional and arterial roads. Capital budget 2016 allocated funds for these purposes in the amount to around EUR 35 million, while funding through loans from International Financial Institutions (EIB and EBRD), in the total amount of EUR17 million will be allocated depending on the level of completion of projects in a given year. Within the Berlin Process, Montenegro prioritized corridors and established the Core Transport Network, and decided that the coastal variant of Adriatic-Ionian High-Way, i.e. fast route along the Montenegrin Coast, so called SEETO route 1, should be a part of the Core Network, with time horizon of construction until 2030, in line with the methodology applied to the Core TEN-T in the EU. In this way priority was given to implementation of the fast route along the Montenegrin Coast, where the plan is that by 2020 conditions should be created for “maturity” of the project, its segmentation and depending on the financing potentials phased construction too, so priority measure (from 2015) that was related to the preparation of spatial-planning documents for Adriatic-Ionian High-Way (continental variant) has not been implemented. The Ministry of Transport and Maritime Affairs simultaneously commenced activities on harmonizing the Transport Development

Strategy 2008 with the previously established prioritization. These activities result from specific EU recommendations for transport, and the first step in the direction of amending the subject strategy is to ensure required financial resources. Negotiations on the foregoing are in process.

In the area of rail transport, the key measure is the continuation of rail infrastructure modernization (Priority measure No 4: Rail network modernization – section Bar-Vrbnica (border with Serbia) of the railway line Bar-Belgrade, which is detailed below).

In the area of maritime affairs, contribution to competitiveness is directed at renewal of Montenegrin trade fleet by 4 bulk carriers, and also at continuation of investments by the Port of ASAI (ex AD »Kontejnerski Terminal I Generalni Teretik« Bar) where from the signing of the concession contract until 30 April 2015 (inclusive) an investment in the total value of EUR 2,372,218 was made. According to the concession contract the Investment Program for the first three years (until the end of 2016) amounts to EUR 13,612,900, meaning that in the following year investment of EUR 11,240,682 is anticipated. Also, the concessionaire has undertaken after this period, i.e. Investment Program to make additional investment in the amount of EUR 7.631 million in the first five years after the completion of the Investment Program (until the end of 2021).

At the end 2015 and at the beginning 2016, Tender procedure for long-term award of the concession for Shipyard Bijela and Port of Kotor is planned to be carried out. The Shipyard Bijela will base its future activities on the construction and overhaul of yachts and mega-yachts, and Port of Kotor, as so far, on servicing passenger and other visiting vessels.

In the area of air transport, identified have been activities that are to contribute to long-term improvement of the level of service providing, as well as increased level of safety and security in air transport, all for the purpose of improved competitiveness of Montenegro, particularly in the area of tourism. The measures under this area are implemented in accordance with the Montenegro Airport Development Master Plan until 2030 and International Standards ICAO (International Civil Aviation Organization). In process is the implementation of the project of reconstructing the existent control tower at the Tivat airport (EUR 4 million), which will be fully financed from own funds of the Serbia and Montenegro Air Traffic Services SMATSA LLC Belgrade. Negotiations are in progress with the EBRD in view of ensuring funds required for implementation of the project of expanding and reconstructing maneuvering areas on the Tivat airport and constructing new terminal building at the Tivat airport with supporting infrastructure. In the coming period conceptual design and detailed design of the terminal building are to be produced, the most favorable contractor to be selected and works on the building to be performed. The funds required for execution of this project amount approximately to 27 million euro. Completion is anticipated by the beginning of the summer season 2018.

Identification of priority reform measures: In line with the national priorities and EC recommendations, as priority measures for elimination of obstacles to increased economic growth and competitiveness of Montenegro, three priority measures have been determined for the following period:

- Harmonization of the Transport Development Strategy with the regional Agenda
- Construction of the Bar-Boljare High-Way priority section Smokovac-Mateševo
- Rail network modernization– section Bar-Vrbnica (border with Serbia) of the railway line Bar-Belgrade.

Priority reform measure No 2: Harmonization of the Transport Development Strategy with the regional Agenda

Measure description: The priority measure is directed to harmonization of the transport development strategy with the regional agenda which is required to foster further strategic commitment of Montenegro to contribute to acceleration of the integration process and provide visible results to citizens and business entities through qualitative infrastructural connectivity, harmonization of regulatory policies, elimination of market barriers, implementation of activities of joint interest that are predominantly project-oriented.

Envisaged timetable for implementation of the measure: The Ministry of Transport and Maritime Affairs initiated correspondence with the European Bank for Reconstruction and Development with regard to providing the grant in the amount of EUR 300,000, for the purpose of updating the Transport Development Strategy (passed in 2008), which in addition to the newly created changes in the area of European integration and their reflections, would also comprise the progress made through the Berlin Process and Connectivity Agenda. Provided that the EBRD grant is obtained quickly, the measure should be completed in 2016. If the grant is not provided, then other sources of funds will be sought, including the budget, but that would affect postponing of the measure completion to 2017.

Measure financial structuring and fiscal implications: The funds required for harmonization of the Transport Development Strategy with the regional Agenda amount to around EUR 300,000. Under the mechanism of establishing and structuring the work of the National Investment Commission (May 2015), a sectoral working group was formed, and in June the process commenced for preparing a Single List of Transport Priority Infrastructure Projects, which are fully compliant to the Core Transport Network of the Western Balkan. Updated Transport Strategy will reflect this specific part too, so in the coming period, fiscal implications of the application of this strategy could be assessed more comprehensively in relation to specific projects from the list.

Expected impact of the measure on increase of competitiveness of the country: Extension of the core network corridors to the Western Balkan ensures close integration to the EU, as well as the basis for harmonization of investments in infrastructure, in the form of EU support through Western Balkans Investment Framework and Cohesion Fund under the Connecting Europe Facility.

The core network corridors, once completed, will ensure qualitative transport services to citizens and business community, through simple integration within the region and with the EU. Priority projects will assist in eliminating bottlenecks, promoting inter-operability and building non-existent cross-border ties.¹⁹

Priority reform measure No 3: Construction of the Bar-Boljare High-Way priority section Smokovac-Mateševo

Priority reform measure brief description: After the Design and Build Contract of Bar-Boljare High-Way Priority Section Smokovac-Uvač-Mateševo was concluded with the China Road and Bridge Corporation (CRBC) and the Preferential Buyer Credit Loan Agreement was concluded with the Chinese EXIM Bank in 2014, and after all the contractual and legal preconditions were fulfilled, on 11 May 2015 commenced the works and as of this date began running of the timeframe of 48 months envisaged by the Contract for completion of the Project.

Envisaged timetable for implementation of the priority reform measure: The Design and Build Contract of Bar-Boljare High-Way Priority Section Smokovac-Uvač-Mateševo (OGM 54/14) envisages the timeframe of 48 months for execution of the Project, which began running on 11 May 2015. Within

¹⁹Vienna Western Balkans Summit 2015, Annex 1, Connectivity – further elaboration

this timeframe the Contractor is bound to produce a Detailed Design, to manufacture, procure and install equipment and installations for the Bar – Boljare high-way, section Smokovac-Uvač-Mateševo, in the length of approximately 41 km. The Contractor (CRBC) will perform works in accordance with its Work Program. The schedule for disbursement of funds is more detailed in the Table in the Annex and it is produced based on the actual data under the Project implementation, within the period in which the Contractor's Work Program is expected to be adopted, and which will serve as the basis for adoption of the Payment Schedule, and subsequently the Plan for Disbursement of Funds by EXIM Bank.

Fiscal implications of the priority reform measure: Contracted design and build value amounts to €809.6 mill, of which €689.0 mill. (85% funds) will be provided from the EXIM Bank loan (repayment period 20 years, including grace period of six years, with annual interest rate of 2%), and the remaining €120.6 mill. (15% funds) and ancillary costs related to the Project execution (supervision, additional expropriation, inspection and technical examination ...) will be provided from the Budget of Montenegro. In 2015, the Contractor performed preparatory works and worked on producing the Detailed Design, and after its completion permanent works will be performed on the route, in line with the Work Program. In 2016, the completion of the major part of the Detailed Design is anticipated. In the period until the end of completion of the Project, by 2019 strong contribution by civil engineering sector to GDP growth is envisaged, encouraged by engagement of local operational capacities in the Project implementation. The Contractor is bound to realize minimum 30% of the total contracted design and build value through local sub-contractors. Also, in addition to sub-contractors, the Contractor is to engage other local legal entities in capacity of suppliers (shipping services, transport services, purchase of material and equipment, and other), which additionally contributes to GDP growth in respect of execution of this Project. Average projected GDP growth rate for 2015-2018 amounts to 3.85%. Amounts of funds shown in Table 10 in the Annex (part B.3) are preliminary estimates of funds that will be provided (disbursed) under the preferential loan funds of the Chinese EXIM Bank based on the Preferential Buyer Credit Loan Agreement concluded between the Government of Montenegro and the Chinese EXIM Bank, given that the Payment Schedule has not been agreed with the Contractor yet. The Payment Schedule is the basis for specifying the Plan for Disbursement of Funds by the EXIM Bank, as well as the basis for all macro-economic analyses.

Expected impact of the measure on increase of competitiveness of the country: Implementation of the Bar-Boljare High-Way Project will affect: better connectivity with the Pan-European corridor network and attracting merchandise and transport flows in the region, more balanced regional development, shortened travel time and saving travel time costs as a consequence of increased operating speed of vehicles, significant reduction in the number of accidents and saving costs of exploitation of vehicles and saving costs of accidents and reduction of pollution, increased accessibility to hard-to-access areas, increased mobility, significant demographic changes, changes to business market conditions and increased competitiveness of enterprises, easier access to (regional) market and reduction in dependent procurement costs, better utilization of potentials in the domain of agriculture, forestry and water management, tourism development, increased employment and change in the employment structure, better exploitation of the potentials of the Port of Bar and Container Terminal and their better connectivity with the catchment zone, direct engagement of local construction operating capacities, equipment, material and labor in the building phase which will have multiplicative effects on the overall economic growth.

Priority reform measure No 4: Rail network modernization – section Bar-Vrbnica of the railway Bar-Belgrade

Priority reform measure brief description: Railway line Vrbnica-Bar represents a part of the international railway line Belgrade-Bar, which connects the port of Bar and Montenegro with the countries of the Western Balkan and Central Europe. In the rail network of the South-East Europe (SEETO comprehensive network) it is recognized as route 4, which is also confirmed by this year's Vienna Summit of the heads of governments of the Western Balkan 6. Approved loan funds by international financial institutions EBRD and EIB and IPA and WBIF funds are intended for reconstruction and modernization of the mentioned rail route for the purpose of increased competitiveness of the railway line itself in relation to other competitive rail routes and other forms of transport as well as best use of the Port of Bar.

Envisaged timetable for implementation of the priority reform measure: The problem in implementation of this measure under the last year's economic reform program is exceeding the deadlines envisaged for completion of tender procedures and performance of works, as well as complex organizational decentralized structures of the project implementing system in Montenegro, which requires lengthy communication for aligning the procedures between the international financial institutions, implementing bodies and end beneficiaries, as well as the absence of programming for 2015. This measure will continue through the implementation of the priority projects planned for 2016 – 2018.

Fiscal implications of the priority reform measure:

The mentioned measure will be implemented in 2016-2018 through the work on the projects for the execution of which agreements have been signed and through the execution of programmed funds, which will follow the signing of agreements between the international financial institutions and state authorities.

The Table below includes a list of projects for which agreements have been signed and which will be implemented in 2016.

| No. | Project | Project contracted value | Financing source | Planned implementation period |
|-----|---|--------------------------|------------------|-------------------------------|
| 1 | Performance of works on rehabilitation of the bridge Trebaljevo | 2,952,066.00 | EIB | 2015-2016 |
| 2 | Works on urgent rehabilitation measures for 4 steel bridges | 968,435.19 | EIB | 2015-2016 |
| 3 | Rehabilitation of the bridge Morača | 886,713.47 | EIB | 2015-2016 |
| 4 | Overhaul of the railway on the section Kolašin – Kos | 5,898,315.30 | EBRD | 2015-2017 |
| 5 | Rehabilitation of 3 tunnels on the section Kos-Trebešica | 3,428,179.80 | EBRD | 2015-2018 |
| 6 | Disassembling of existent, procurement and installation of new electric traction substation Trebešica | 3,140,000.00 | IPA III | 2015-2017 |
| 7 | Inspection of 106 tunnels and development of detailed designs for priority rehabilitation | 2,500,000.00 | WBIF | 2016-2017 |

The following Table shows projects for the implementation of which signing of contracts and agreements are yet to come between the international financial institutions and state authorities with regard to the legal ground for spending financial resources and dates of their financial operating.

| No. | Project | Project contracted value | Financing source | Planned implementation period |
|-----|--|--------------------------|-----------------------|-------------------------------|
| 1 | Overhaul of the railway line on the section Kos - Trebješica | 4,140,000.00 | IPA 2014 (programmed) | 2016 -2018 |
| 2 | Rehabilitation of 12 slopes | 7,000,000.00 | IPA 2016 (programmed) | 2016 - 2018 |
| 3 | Urban-technical development of the station Bijelo Polje | 1,375,000.00 | IPA 2016 (programmed) | 2017-2018 |
| 4 | Performance of overhaul works on the railway superstructure on the section Virpazar-Sutomore / tunnel Sozina | 4,600,000.00 | IPA b component III | 2016-2017 |
| 5 | Replacement of the signalling safety system in the Podgorica station | 6,000,000.00 | EIB (new loan 20+20) | 2016-2017 |
| 6 | Rehabilitation of 5 concrete bridges | 5,000,000.00 | EIB (new loan 20+20) | 2016-2018 |

Expected impact of the measure on increase of competitiveness of the country: Implementation of the mentioned projects will increase the quality of transport services in railway traffic given the fact that significantly reduced speeds will go back to the designed, which will directly affect the reduction of passengers and goods travel time. In addition, the level of safety in rail transport operation will increase and inter-operability requirement will be fully met on the overhauled sections. Thus, increase in the speed of operation of trains, reduction in travel time of transport of goods will significantly impact increased competitiveness of railway transport. Also, improved rail network will certainly have a positive impact on the business of the port of Bar.

4.2.2.2 Energy

Diagnostic: Although the electricity market in Montenegro has been formally fully open to all buyers since 1 January 2015, the competitiveness has not yet been sufficiently developed. Insufficient connectivity of the energy system of Montenegro with the energy systems of the countries from the region and the EU has adverse impact on security in supplying buyers in Montenegro, potentials for export of available surplus electricity and participation in the regional and the EU markets. It is one of the reasons why available energy resources of Montenegro cannot be sufficiently exploited in commercial terms or contribute more to economic development of the country. In this segment of the physical infrastructure, the country encounters some other challenges too, such as insufficient investment in the existent energy capacities, losses in electricity distribution and high energy intensity. All this is pointing out the necessity for higher investments in the energy sector of Montenegro.

Priority reforms²⁰: In view of long-term energy development planning and overcoming the mentioned challenges, the Government of Montenegro in the previous period focused on two areas, as follows:

²⁰Montenegro had no specific recommendations from the Ministerial meeting in May 2015 in that area.

(1) creation of a strategic and legislative framework and (2) qualitative execution of investments in this area.

The Montenegro Energy Development Strategy until 2030 has been passed, and preparation of the Action Plan for implementation of the mentioned strategy for 2016 – 2020 is in process. At the end 2014 the Law on Efficient Use of Energy was adopted, which transposed all the new EU Directives related to energy efficiency. Adoption of most enabling regulations originating from this Law is expected by the end 2015. Proposal Law on Energy and Law on Cross-Border Exchanges in Electricity and Natural Gas have been adopted by the Government and are currently in the Parliament procedure. These two laws facilitate transposing of the Third Energy Package and the EU regulations from the area of renewable energy and security in energy supplying and thus create the precondition for full integration of Montenegrin energy market in the regional and European energy market. The Law on Mandatory Reserves of Oil Derivatives is in the preparation process.

Investments in revitalization of the current and construction of new facilities for production, transmission and distribution of energy, as well as investing in the increased energy efficiency programs and projects are the main focus of the energy in Montenegro. While some investment projects in the energy area are already in process, such as the projects of building the undersea cable with pertaining infrastructure, construction of small hydro-power plants and wind turbines and projects of increased energy efficiency, other large and for Montenegrin economy very significant projects in the area of production and transmission of energy are in different phases of preparation. Those are the projects of building Unit II of the Thermal-Power Plant Pljevlja and Ionian-Adriatic gas pipeline. Successful implementation of the Project of building the undersea cable for connecting energy systems of Montenegro and Italy with pertaining infrastructure in the country, as well as building energy inter-connection with Serbia, will create conditions for full utilization of existent and planned production facilities in the country.

Montenegro plans to deal with electricity demands in the long-term period inter alia by continuing the operation of the thermal-power complex in Pljevlja and through construction of a new unit TPP “Pljevlja“-II, using the existing coal resources in Pljevlja basin, advantages of the existing location and opportunities provided by the electricity market in the region. The main objectives, i.e. expected effects of this investment are: (i) ensuring security in supplying electricity to consumers; (ii) ensuring energy independence of the country; (iii) continuation of electricity production in thermal power complex Pljevlja; (iv) increased profitability of the current thermal-power complex in Pljevlja; (v) optimum and efficient utilization of coal reserves in Pljevlja basin (vi) resolving the key environmental problem of the Pljevlja valley during the heating season (district heating substation project with TPP as the base heating source), (vii) direct and indirect effects on the economy of the region, individual and social standard. In 2016, with regard to implementation of this investment with the total value of around €338 million, or €1.3 million per MW of installed capacity, expected is the adoption of a decision regarding the project, provision of financing, establishment of the project implementing company for TPP Pljevlja II project (SPV), contracting of project implementation (EPC contract), EIA development and evaluation, building permit obtaining and preparatory works on the location, then its construction by 2019.

So, in the coming period full attention should be paid to attracting and executing investments in the energy production facilities in the country.

Priority reform measures identification: In line with the previously stated, as the priority measure for elimination of obstacles to increased competitiveness of Montenegrin economy, defined is the

Project of connecting energy systems of Montenegro and Italy including construction of the transmission infrastructure in the country and interconnection with Serbia.

Priority reform measure No 5: Project of connecting energy systems of Montenegro and Italy including the construction of transmission infrastructure within the country and inter-connection with Serbia

Measure description: The mentioned priority measure is an investment in the construction of the transmission infrastructure in the country (SS 400/110/35 kV Lastva and 400 kV power line Lastva-Pljevlja) and construction of 400 kV inter-connection with Serbia. This measure is compatible with the project of building an under-sea cable between Montenegro and Italy, for implementation of which responsible is the Italian transmission system operator (TERNA).

Envisaged timetable for implementation of the measure: Intensive activities on the construction of the mentioned transmission infrastructure in the country were undertaken in 2015 and will continue in 2016. In addition, in 2015 financial resources were provided for implementation of the inter-connection with Serbia, and relevant preparation activities will commence in 2016.

Financial structuring and fiscal implications: The value of the part of the project that is implemented by CGES is approximately EUR127 million, while the part of the project implemented by Terna (comprises infrastructure facilities in Italy, undersea cable and the plant in Montenegro) is over EUR 800 million. Financial facility for provision of EUR127 million required for implementation of the investment envisaged the CGES to take a loan and the state to issue a guarantee. In this sense, the CGES in cooperation with the Government in 2013 signed loan agreements for its part of the project with the KfW German Development Bank (EUR25 million) and the European Bank for Reconstruction and Development (EUR 60 million). For both loans stipulated is the issuance of sovereign guarantees, but it is split in three years as follows: in 2013 - 25 million, in 2014 - 20 million and in 2015 - 40 million euro. All the mentioned guarantees are issued for the period until 2015 (inclusive). The remaining funds, amounting to 42 million euro are provided from a donation (EUR 25 million) and from own resources. Complete financial structure for implementation of the project is ensured in this way. According to the plans of the CGES, the funds envisaged for implementation of the project in 2016 amount to somewhat less than EUR 42 million, which will depend on the time schedule of the project. Investments in 2016 are related to performance of works on all three parts of the project, as follows: SS 400/110/35 kV Lastva; 400 kV power line Lastva-Pljevlja, section Lastva-Čevo; 400 kV power line Lastva-Pljevlja, section Čevo-Pljevlja.

Expected impact of the measure on increase of competitiveness of the country: Implementation of the project of connecting energy systems of Montenegro and Italy by an undersea direct current cable is envisaged to contribute to: 1) the construction of a better and stronger transmission network in Montenegro; 2) the creation of a direct connection of Montenegro with the electricity market in the EU; 3) the positioning of Montenegro as an important energy hub in the region; 4) the encouragement of investments into new electricity sources, particularly renewable energy sources. This project will contribute to increased competitiveness and represent incentive to investments in the energy sector not only of Montenegro but also the entire region. Also, this represents an extremely significant infrastructural project in Montenegro, given that its implementation will ensure significantly more reliable and stronger transmission network, a 400 kV network ring will be created which is very significant from the aspect of the system stability, Montenegro will get 20% of the transmission capacity and revenues from the cable congestion, more reliable electricity supply to the Montenegrin Coast will be ensured and the risk that transmission network will be a bottleneck for development of that part of Montenegro will be neutralized.

4.2.2.3 Municipal Utility Infrastructure

Diagnostic: Constitutionally declared as an ecological state, Montenegro is bound to pay special attention to the environmental protection and conservation. The problems in the area of utility infrastructure such as its worn-out condition, high costs of capital investments, inadequate planning and financial resources which, although limited, are spent for inadequate investments, have led to lower quality of services and higher costs of performance of this business activity. At the same these are the key obstacles to further increase of competitiveness in this area and economy as a whole. Local self-government units, their water supply and utility enterprises have an important role in this process given that they take part in the implementation of the most important infrastructure projects, related to waste water treatment, water-supply, municipal, and veterinarian, sanitary and other waste.

Priority reforms²¹: Further below presented are priority reforms planned by the Government that will contribute to removal of some of those obstacles to the development of the country identified within the diagnostic section. With regard to this, the Government of Montenegro made significant efforts to ensure technical and financial support by international financial institutions. The construction of utility infrastructure is mostly funded from the loans by international financial institutions such as the KfW Bank, the European Investment Bank, the European Bank for Reconstruction and Development, the World Bank and other, and several loan facilities were agreed with them in the previous period. A large portion of funds is provided from the EU funds and the budgets of the State and local self-governments. In the coming period continued will be the implementation of activities and projects defined by the Master Plan for Drainage of Waste Waters in the Montenegrin Coast and Cetinje Municipality and the Strategic Master Plan for Sewage and Waste Waters in the Central and Northern Region of Montenegro, adopted in 2005 to give guidelines and objectives until 2029. These documents envisage the construction of the wastewater purification plant and purification of waste waters to the required level, reconstruction and extension of the sewage network, elimination of outlets, etc. Master plans are envisaged to be implemented in phases in the total amount of €560 million for the period until 2029.

Identification of priority reform measures: Taking into account the aforementioned, the priority measure defined for elimination of obstacles to increased competitiveness within the improvement of utility infrastructure is the **construction of utility infrastructure on the Montenegrin Coast and the Historical Capital Cetinje.**

Priority reform measure No 6: Construction of utility infrastructure on the Montenegrin Coast and the Historical Capital Cetinje

Measure description: Within the mentioned priority measure envisaged is the construction of a joint waste water purification plant for the municipalities Kotor and Tivat, the construction of water-supply and sewage network in Herceg Novi Municipality as well as the construction of a sewage network in the Historical Capital Cetinje. These projects are identified as the most prepared projects and their implementation is expected in 2016.

Envisaged timetable for implementation of the measure: (1) The project of the construction of a joint waste water purification plant for the municipalities Kotor and Tivat, with capacity of 72,000 equivalent inhabitants, commenced in 2014, construction in 2015 and will continue in 2016. The completion of works is expected in June 2016. (2) The construction of water-supply and sewage

²¹Montenegro had no specific recommendations from the Ministerial meeting in May 2015 in that area.

network in Herceg Novi Municipality comprises construction of 35.3 km of water supply and sewage network, 13 pumping stations and an undersea outlet. The project commenced in 2012, and completion of works is expected in 2016. (3) Intensive activities on the construction of the sewage network in Montenegro were undertaken in 2015 and will continue in 2016.

Measure fiscal implications: (1) The total value of the construction of a joint waste water purification plant Kotor-Tivat is €10.23 million and the funds for implementation of the project are provided from the KfW Bank loan (phase IV and phase V). In 2015, for construction of this project EUR 4.8 million were spent from the KfW loan, and in 2016 it is planned that the amount of EUR 2.6 million will be spent. (2) The construction of water-supply and sewage network in Herceg Novi Municipality is funded from the KfW Bank loan in the amount of EUR 12.6 million. The share of the Government of Montenegro is EUR 2.923 million, and from the Municipality Budget the funds amounting to EUR 2.309 million are allocated. Until 2015, EUR10,296,446.48 were spent (155,750.00 KfW donation + EUR2.923 mill. Government donation + EUR7.217 mill. KfW loan). In the current 2015, EUR 2,847,923.52 were spent from the KfW loan. In 2016, expected is the expenditure in the amount of EUR 5,377,770.36 in the first two quarters which at the same time represents the completion of the project i.e. the investment according to the current assessments (the mentioned funds are the KfW loan EUR3.07 mill. and participation of the Herceg Novi Municipality from the budget EUR 2.309 mill.) (3) The value of the construction of a sewage network in the Historical Capital Cetinje is € 4,477,000, and the funds are provided from IPA 2011 and IPF MW 2008. For the part of the network that will be implemented from IPA funds, in the value of €3.2 million, the implementation will be carried out by the European Union Delegation in Montenegro. In 2016, EUR23,000 will be invested by the Historical Capital Cetinje, from IPF MW withdrawn will be EUR69,000, and from IPA 2011 EUR271,000.

The Table on fiscal implication of the priority reform measure for utility infrastructure is presented cumulatively for all the projects.

Expected impact of the measure on increase of competitiveness of the country: (1) The project of the construction of a joint waste water purification plant for the municipalities Kotor and Tivat with pertaining infrastructure is one of the most demanding regional projects the completion of which will create technical conditions for purification of waste waters of the Municipalities of Kotor and Tivat. The waste water purification plant will be installed on the territory of Tivat Municipality. In addition to the construction of the waste waters purification plant, the project includes rehabilitation and replacement of existent sewage pipes and construction of new ones. (2) The construction of water-supply and sewage network in Herceg Novi Municipality is expected to systemically improve the system for water supply and drainage of waste waters and the environmental conditions in the Boka Kotorska Bay. (3) Within the project of the construction of a sewage network in the Historical Capital Cetinje, of the total sewage network, around 17356m of sanitary and 4130m storm water network will be built. The execution of the mentioned projects in 2016 is expected to significantly improve the area of utility infrastructure, mostly on the Montenegrin Coast which will ensure better conditions for citizens and tourists.

4.2.2.4 Rural Infrastructure

Diagnostic: An important physical infrastructure segment where Montenegro, similarly to the neighboring countries, is faced with significant problems is rural infrastructure. It implies utility and road infrastructure, i.e. local roads, water supply and electricity supply, sewage, water purification and waste management. Although these problems are present in all parts of the country, they are still more distinctive in rural areas. The length of the Montenegrin road network is 6,352.8 km, of which 931.9 km are arterial roads, 850.9 km regional roads, whereas local roads are around 4,570 km long.

Insufficiently developed road network in Montenegro is a result of limiting factors that make functional connections within Montenegro difficult or limited, as well as its connections to the direct surroundings.

Priority reforms²²: In order to prevent outflow of population, exploit available natural resources for the purpose of general improvement of conditions of living for rural population and increase of their competitiveness, in Montenegro implemented is a program of improvement of road, water-supply and electricity infrastructure in rural areas of the country. Renovation and construction of rural infrastructure is primarily financed from the budget under the program “Rural Renovation and Development and Infrastructure Construction”. Specific projects are implemented in cooperation with local self-governments and population of the area to which the investment is related. The Ministry of Agriculture and Rural Development within its activities implements the measures of “Rural Renovation and Development and Infrastructure Construction” which implies road filling and cutting as well as the Water Management Projects Incentive Program, through which ensured is financial support for construction of water management facilities in rural area. The measure and Program are implemented in cooperation with local self-government, local communities as well as population of the area where the investment is located. If requested by the Ministry of Agriculture and Rural Development, municipalities submit a list of priorities in the area of rural infrastructure. Since 2014 the Ministry has supported over 50 projects through implementation of this measure and the program.

Through the Water Management Projects Incentive Program in 2015, so far 16 water supply systems have been completed in rural areas where 1,550 households have resolved the issue of water supply (in the previous three years 3,142 households in rural areas resolved the issue of water supply). By the end of the year, it is planned that another 6 water supply systems will be completed in rural areas. For 2016, 20 projects are planned for improvement of rural infrastructure (road filling and cutting) and completion of 15 water supply systems in rural areas. The funds allocated for implementation of this measure, projected by the budget of the Ministry of Agriculture and Rural Development for 2016 will amount to approximately €800,000.

Through implementation of the aforementioned, the Ministry of Agriculture and Rural Development is striving to complete the initiated projects, commence and execute new ones in the area of constructing and renovating rural infrastructure, in view of improving the quality of life in rural areas. In 2015, Montenegro became member of IFAD (International Fund for Agriculture Development). In the period 2016-2018, IFAD will include Montenegro in implementation of their projects.

Road infrastructure is one of the key assumptions for development of rural areas, given that it enhances connectivity with the market through placement of products, and therefore providing additional opportunities for generating revenues.

4.2.3 Development of Economic Sectors

4.2.3.1 Development of Agricultural Sector

Diagnostic: Gross value added in current prices in the sector of agriculture, forestry and fisheries in 2014 amounted to EUR 280.1 million, and it is by 3.7% higher in relation to 2013. Agriculture sector records higher growth in comparison to other sectors save the tourism sector where growth is also recorded. In the third quarter 2015 the number of employees with agriculture sector according to a labor force survey amounted to 19.1 thousand and is by 62% higher in relation to the same period of

²²Montenegro had no specific recommendations from the Ministerial meeting in May 2015 in that area.

the last year. In comparison to other sectors, the number of employees with the agriculture sector has a higher increasing trend in relation to the industry and services sector.

However, although growth was recorded in previous years, Montenegrin agriculture is featured by fragmented arable agricultural plots, high share of small households, low productivity, low level of modernization of production and manufacturing capacities, low level of cooperating and unfavorable age structure of producers. All these conditions primary agriculture to be insufficiently competitive, both in terms of quantity and price. Therefore, there is general shortage of larger quantities of domestic raw materials of adequate quality for continuous manufacturing industry production, which is forced to procure raw materials for most products from import. All this demonstrates that Montenegro is not even sufficiently competitive in the domestic market and that significant investments in primary sector are required so food industry would become more competitive and conditions for placement of agricultural and food products would be created through tourism offer in domestic market, as well as export of food to the EU market, which ultimately contributes to the overall economic growth. Currently, Montenegro has 2 approved facilities for export to the EU market (fisheries products) and three facilities for export of animal by-products (hides and wool).

Implementation of specific recommendations given to Montenegro: In May 2015, Montenegro was given a recommendation by the EU with regard to further development of the strategic and legislative framework for creation of preconditions to strengthen food safety system and apply phytosanitary and sanitary EU standards in order to foster competitiveness of agricultural-food sector in domestic and the EU market. In accordance with the mentioned recommendation, in view of strengthening competitiveness of domestic agricultural production and enhancement of food safety standards, phytosanitary and sanitary standards and achieving higher quality of products in 2015, Montenegro provided financial resources in support of agricultural producers and manufacturers. The support is intended for primary agricultural production and manufacturing industry through the measures of Agro-budget in the amount of around EUR 15 million, and through IPARD-like, funded from national funds and EU funds in the amount of around EUR 5.2 million.

In addition to financial support aimed at strengthening of primary and manufacturing production, in September 2015 Montenegro adopted the key law for further improvement of food production competitiveness – the Food Safety Law. The new law improved the current food safety system with clearly set responsibilities and authorities within a single system. Also, in view of strengthening administrative capacities in the food safety sector, on 20 April 2015 commenced the IPA project “Development of Food Safety and Phytosanitary Service in Montenegro” and it will last 18 months.

Plan of reforms related to specific recommendations given to Montenegro: For the purpose of implementing the specific EU recommendations, in 2015 the Government of Montenegro focused on establishing a strategic and legislative framework for creation of prerequisites for fostering the food safety system and applying phytosanitary and sanitary EU standards in order to strengthen competitiveness of agricultural-food sector in domestic and EU market. In September, the Government of Montenegro passed a Montenegro Strategy for transposing and implementing the EU Acquis for Chapter 12 – Food safety, veterinarian and phytosanitary policy including a Proposal of General Action Plan and a Proposal of Special Action Plan. Also, 9 laws from this area were adopted that are harmonized with the EU Acquis which created a condition for further harmonization with the EU food safety standards and thus it will facilitate meeting of conditions for export of food products to the EU countries. In 2016, the focus will be on implementation of legislation, fostering administrative capacities and equipping laboratories required for control and monitoring of food safety standards.

Under the Project IPA 2012 “Development of services for food safety and phytosanitary service in Montenegro” which is in progress, (until 2016) activities continued on further categorization of facilities according to the degree and type of identified inconsistencies.

Plan of other priority reforms: For the purpose of the agricultural policy reform and its harmonization with the EU Acquis, Montenegro adopted the Agriculture and Rural Areas Development Strategy including an Action Plan. One of the priorities of Montenegrin agriculture is the production of high quality food and increased number of producers who produce in line with the organic production rules. Montenegro committed to this concept primarily due to its natural features which do not allow mass production. It can be achieved by integrating agricultural producers through different quality and food safety standards, quality schemes (origin marks, geographical marks and guaranteed traditional specialty marks) and organic production. Support will continue to be allocated for introduction of quality standards, education and promotion of products. Given that land fragmentation and insufficient level of cooperating of producers is one of the basic problems for further strengthening of competitiveness, in July 2015 adopted was the Law on Cooperatives, and in the coming period for the purpose of its implementation extension and local services will be worked on to raise awareness of producers regarding the significance of cooperating. The funds for implementation of these activities are planned in national funds and international projects such as UNIDO “Strengthening competitiveness of small and medium-sized enterprises in Montenegro through cluster development” which comprises the sectors of dairy, olive growing, vineyards and fisheries.

Priority reform measures identification: In line with the recommendations for strengthening competitiveness of agricultural and food industry and introducing food safety standards for the coming period identified is the priority reform measure directed at support to investments in the primary agriculture production and manufacturing capacities.

Priority reform measure No 7: Support to investments in the primary agricultural production and manufacturing capacities in view of achieving food safety standards

Measure description: This measure supports growing agricultural cultures, increase of livestock, purchase of equipment for manufacturing, construction and reconstruction of facilities for manufacturing agricultural and fishery products for the purpose of improving food safety standards, wellbeing of animals and health of plants.

The goal is to strengthen agricultural-food sector through gradual harmonization with the EU food safety and quality standards so it would become competitive in the EU market. Priority reform measure will be financed through the measures of Agro-budget and EU funds for rural development (IPARD).

Envisaged timetable for implementation of the measure: The measure will be implemented in 2016 and 2017. The measure is divided in two sub-measures: the first one is related to “Investments in physical capital of entities dealing with food” which will be implemented through IPARD-like program, and its implementation will commence in January 2016. The second sub-measure is related to investments in primary agricultural production that will be financed from Agro-budget also from January 2016.

Financial structuring and fiscal implications: The total amount of the support is planned in the amount of EUR14.4 million of which 8.5 million will be financed from EU funds and 5.9 million from the national budget. The total amount of investment with co-financing by the beneficiary is planned in the amount of around EUR25 million (co-financing 50%).

Expected impact of the measure on increase of competitiveness of the country: The measure will contribute to increased production in the primary sector, which will ensure continuous supply of domestic raw materials to the manufacturing sector that will contribute to increased competitiveness of domestic products. Investing in the facilities for food manufacturing and meeting EU food safety standards, expansion of product assortment, investing in product marketing and introduction of new technologies will facilitate Montenegrin food producers to offer higher quality in domestic market as well as export of specific products, primarily through tourism that represents the largest potential for export of Montenegrin food products.

4.2.3.2 Industrial Sector Development

Diagnostic: The structure of Montenegrin economy in the last decade has been featured by significant changes that are primarily reflected in the increase of the share of services on account of the reduction of the share of industry. Evident is the fall of the share of industry in GDP from 17% in 2000 to 11.5% in 2014, of which the share of manufacturing industry in GDP was 3.9%. The process of large industrial enterprises restructuring contributed to preservation of steel and aluminum industry in Montenegro and creation of preconditions for contributing to creation of added value in production and increased export through enhanced technology. Due to its dominant share in manufacturing industry, the area of production of base metals and metal products determines the trends on the level of manufacturing industry as well as the entire industrial production, and export as well. Preservation of steel and aluminum industry, as well as increased production of the overall manufacturing industry contributed to the growth of industrial production of 10.9%, or 22.1%, viewed on the level of manufacturing industry, for eleven months of 2015 in relation to the comparative period 2014. However, in order for the country to continue increasing industrial production and expanding its production base and export performances in the coming period it is necessary to eliminate a range of obstacles. Low labor productivity and continuous deindustrialization, traditional sectors that keep dominant role in export, weak diversification with dominant share of products of lower processing phase, focused on small number of traditional markets, and non-utilized scientific-research potential, represent the basic structural weaknesses of Montenegrin industry i.e. obstacles to further economic growth. Additionally, the key obstacles to Montenegrin competitiveness include the insufficiently developed support to industrial modernization and access to international markets, as well as lack of investments and financial instruments available for development of enterprises. The current situation in the Montenegrin industry points out the necessity for its re-orientation towards more efficient utilization of all potentials in priority sectors, through increase of enterprise competitiveness through investments, directed at introduction of new technologies, increase of capacities and fulfilling standards and certificates.

Priority reforms²³: Proposal Montenegro Industry Policy until 2020 including an action plan, as well as the previously adopted Action Plan for the Manufacturing Industry Development Strategy 2014-2018 specified framework priorities/areas that must be worked on fast, in view of the set goals, as follows: enhancement of business and investment environment, completion of privatization and restructuring of enterprises, strengthening supply and availability of finances, positioning towards the products of higher added value, incentives to application of new technologies and innovations in production process, strengthening export performances of enterprises (clusters), strengthening human resources and aligning to labor market requirements, improvement of entrepreneurial infrastructure (business zone) as well as increased care for environmental protection and sustainable development.

²³Montenegro had no specific recommendations from the Ministerial meeting in May 2015 in that area.

Priority reform measures identification: In this area identified is a priority measure aimed at encouraging investments in manufacturing industry through implementation of the Decree on Direct Investments Incentives.

Priority reform measure No 8: Incentives to investments in industrial sector with emphasize on manufacturing industry

Measure description: In view of creating a qualitative base for enhancement of business environment and fostering competitiveness, the established Decree on Direct Investments Incentives is the continuation of activities on creating favorable business environment for domestic and foreign investors interested to invest in production. The adoption of the Decree on Direct Investments Incentives provided a base for financial incentives for attracting direct investments, particularly in the area of manufacturing industry, aimed at creating new jobs and introducing new technologies and knowledge. Taking into account performances, contribution to GDP, available resources that can be utilized in a more efficient way, the key sectors where Montenegro possesses comparative advantages with strong potentials for increased export are energy, food industry, metal and wood industry, as well as tourism, with substantial significance of civil engineering and transport, ICT and business services as sectors that provide the required support to strategic sectors. According to the mentioned Decree, the funds for encouraging investments are awarded based on a public advertisement and in accordance with pre-defined criteria which inter alia include investors' credentials, impact of the investment project on productivity of suppliers and other enterprises doing business in the same industry sector, viability of the investment project, its effects on research, development, human resources and other. In this way, in addition to encouraging faster social-economic growth, the intention is to resolve problems such as unemployment, particularly in under-developed areas of Montenegro, as well as regional disbalance.

The awarded funds are intended to finance investment projects with minimum investment value of EUR 500,000 or EUR 250,000 for investments in under-developed local self-government units including creation of minimum 20 new jobs (or 10 new jobs in under-developed local self-government units of the Northern and Central Region). In addition, for capital investments less than EUR 10 million, with minimum 50 new jobs, funds are awarded for encouraging investments in the amount of 17% of the total value of the investment project. The amount of funds awarded to the investor who meets the conditions based on the established criteria ranges from EUR 3,000 to EUR10,000 per job, and maximum up to 70% of the value of the investment.

In the procedure of the first Public advertisement in 2015 approved were 6 contracts on utilization of funds, with the total investment value of EUR21 million and employment of 293 new workers, whereas the implementation will commence in the first quarter 2016. Subsidy funds up to EUR 10,000 per job will be paid to the investor from the planned budgetary funds for 2016 in line with the planned schedule of the investment.

Envisaged timetable for implementation of the measure: In 2016, at least one public advertisement is planned to be announced for participation in the procedure of awarding funds for encouraging direct investments with emphasize on manufacturing industry, within the planned €620,000. In accordance with the expressed interest by potential investors and taking into account allocated budgetary funds, there is a possibility for several public invitations to be announced during the year. In the period 2017-2018, the activities from 2016 are planned to be continued, where further activities will be planned on the basis of effects i.e. implementation of concluded contracts on utilization of funds.

As regards the schedule of payment of funds for approved investment projects, it will be in phases, in three instalments during the implementation of the investment project, as follows: upon the conclusion of the contract, after the submission of the report on completion of more than 50% of the investment value and the last one after the full employment envisaged by the project and its final completion.

Financial structuring and fiscal implications: The funds for incentives to direct investments are provided in the Budget 2016. Considering the planned schedule, according to which at least one public advertisement will be announced in the coming period for participation in the procedure of awarding funds for encouraging direct investments, funds are allocated in the amount of €620,000, with the possibility of increase.

Expected impact of the measure on increase of competitiveness of the country: Provision of adequate incentives, i.e. subsidies to investors will directly affect increase of the contribution of the industrial sector i.e. manufacturing industry to creation of gross value added, through effects of increased employment, production and export. In addition to the mentioned, it is important to point out multiplicative effect of investments on micro level, i.e. SME sector which will have an opportunity to improve their knowledge and skills in the production and technological process, as suppliers to newly established (larger) companies. In combination with the measures directed at modernization of production, support to cluster development, aligning with the demands of international quality standards, support to innovations and introduction of new technologies, synergy effects towards further increase of competitiveness are expected.

4.2.3.3 Service Sector Development

The share of service sector in Montenegrin GDP is over 50% and around 60% in the total employment. Tourism and financial services, trade and construction services have a particularly large share in the total services. Further development of the service sector requires elimination of specific barriers to increased competitiveness both in the mentioned service activities and within ICT services, transport services, etc. It is expected that the mentioned will be contributed by the adoption of the Law on Services, in line with the Directive on Services.

4.2.3.3.1 Tourism

Diagnostic: Elimination of barriers to increased competitiveness of tourism as the largest service sector which currently significantly contributes to GDP growth (with the share of around 15%) and increased employment, will be in the focus of the Government in the following medium term. Having adopted the Tourism Development Strategy until 2020, Montenegro committed to become a high end tourist destination in the observed period. In the years following the crisis the growth of tourism sector was achieved, as well as its multiplicative effect on other tourism related sectors and increase in the overall employment. However, what appears to be a challenge is the best utilization of natural resources through investments in tourism, which would impact the growth of economy through its implementation. Also, as one of the barriers to growth considered can be the fact that tourism offer in Montenegro is not sufficient to achieve goals related to high-quality tourism destination. According to the analysis adopted by the Government of Montenegro in 2015, the key barriers to faster tourism growth in Montenegro are as follows: (i) insufficient high-quality accommodation capacity; (ii) over-seasonality; (iii) regional misbalance of the tourism offer; (iv) slow return on investment in tourism industry, etc. Therefore, improvement of tourism infrastructure and overall business environment as well as further introduction of incentives are important for increase of tourism competitiveness. According to the latest report by the World Economic Forum on competitiveness in the area of travel

and tourism, Montenegro failed to improve its position, primarily due to insufficient incentive-giving policies and conditions for travel and tourism, as well as utilization of natural and cultural resources. According to the same report, there is plenty of space for improvement of infrastructure and business environment in view of improving competitiveness of Montenegro in the area of travel and tourism.

Priority reforms²⁴: Montenegro is planning to achieve the goals set for tourism sector in the MDD 2015 – 2018 and other strategic documents, particularly Tourism Development Strategy until the end 2020 by applying different economic policy measures. The most significant include the ones related to creation of tourism and other infrastructure to serve to increased competitiveness and growth of economy. The mentioned is at the same time of significance for growth of the number of SMEs, increase of employment and reduction of regional disbalances, so it is particularly important that further improvement of tourism infrastructure includes the construction of the required infrastructure in ski centers in the North of Montenegro. In addition to the measures **directed at improved infrastructure**, particularly important for development of tourism and increase of its competitiveness is the **improvement of air-accessibility of the destination**.

Another set of measures in the area of improvement of tourism competitiveness is related to tax policy reforms, as well as other incentives in this area aimed at **resolving the issue of seasonality through opening of high-quality hotel facilities**. **Previous incentives and concessions in tourism are as follows:** completed planning documents that allow construction of 130 hotels with 4* and 5*; abolished obligation for investors to pay the fee for communal equipping for construction of 4* and 5* hotels (with exception of apart, condo and garni hotels); introduced progressive taxation rate that allows higher tax burden on hotels with 3* or less in priority zones; introduced reduction of annual tax on immovable property up to 30% for 4* hotels and up to 70% for 5* hotels; abolished obligation of payment of import VAT for delivery of goods and services for construction of 5* and 5+* hotels; adopted Decree on conversion of residential into hospitality-tourism units.

Priority reform measures identification: In line with the aforementioned, as a priority measure for elimination of barriers to increased competitiveness in tourism, and therefore overall Montenegrin economy, defined is the multi-year measure of tourism offer improvement in the North of Montenegro through construction of the required infrastructure in the ski centers, which would enable Montenegro to create its position of a unique integrated tourism destination owing to the phenomenon that a wide range of extremely diversified offer may be found in a small space through combination of different forms of offer in a single integrated one.

Priority reform measure No 9: Improvement of tourism offer in the North of Montenegro through construction of required infrastructure in ski centers

Brief description of the measure: This measure consists of several independent projects which have a common feature – establishment of infrastructural conditions for winter tourism in the North of Montenegro. Specifically, they are the following six projects, for which a brief description of activities for 2016 is provided. Continuation of activities in the ski resort **Kolašin 1600** through construction of electricity, telecommunication and hydro-technical infrastructure, access road with parking, base station and a ski lift. **Savin kuk (Žabljak)** – 21 kilometers of ski slopes are planned to be designed as well as the construction of the slopes and development of the documents for reconstruction of the road and construction of the parking. **Cmiljača (Bijelo Polje)** – review of the Detailed Design for the road section from Jasikovac to Cmiljače is in progress. In this year, project documents will be developed for substation 35/10 and base station on Cmiljača, and in 2016 envisaged is the

²⁴ Montenegro had no specific recommendations from the Ministerial meeting in May 2015 in that area.

performance of works on the mentioned projects. **Hajla (Rožaje)** – development of planning documents, investment study, as well as the continuation of works on the construction of the local road Rožaje-Štedin. **Turjak (Rožaje)** – activities are in progress on renewal of the ski lift, which is expected to become operational soon. **Vučje (Nikšić)** – developed is the design for construction of a reservoir based on which works will commence in 2016. Žarski (region Bjelasica and Komovi) – development of electricity and road infrastructure as well as preparation of project documents.

The funds envisaged by the state budget are committed in order to increase attractiveness and value of the mentioned locations and provide basic infrastructure at several locations, and ultimate goal is to attract private sector investments. At the same time, the most adequate model for best utilization of the ski centers will be considered – through private-public partnership or establishment of JSC “Skijališta Crne Gore”.

Envisaged timetable for implementation of the measure: All the mentioned projects are of multi-year character. Implementation of aforementioned activities will commence in 2016, and implementation schedule in the coming years will depend on several factors – allocated funds from the budget of the State of Montenegro, and on the other side on interest of potential private investors in projects for development of ski centers in the coming period. Projects for best utilization of these ski centers imply not only placing of wires and other infrastructure in addition to the wires, but also tourism offer, so it is difficult to envisage the time schedule of implementation.

Financial structuring and fiscal implications: The total planned expenditures from the budget of the State of Montenegro that will be available in 2016: EUR 7,749,500. The expenditures from the budget by projects - Kolašin 1600 - EUR4,659,000, Cmiljača - EUR1,298,000, Savin kuk - EUR507,500, Žarski - EUR500,000, Hajla - EUR530,000. Reservoir in Vučje /transfer of funds from 2015/ - EUR255,000.

Expected impact of the measure on increase of competitiveness of the country: the subject measure will affect systemic reduction of informal employment, SME growth and development and strengthening of the external position of the country. Also, it will affect increase of competitiveness of the Northern Region and reduction of regional differences in MNE, and generally the issue of seasonality of the tourism offer of the destination; creation of preconditions for growth of the number of SMEs; creation of new jobs and new revenues in tourism and tourism-related activities; increase in tax revenues.

4.2.3.3.2 *Financial Services*

Diagnostic: Financial sector in Montenegro is dominantly comprised of the banking system which has 14 banks, of which 11 are with majority capital from abroad. The total balance sheet sum of banks made 97% GDP at the end of October 2015, while loans made around 70% GDP. In the post-crisis period the banking sector in Montenegro has been faced with numerous internal and external challenges, and lending activity has been below the level which in the pre-crisis period was the driving force of the economic growth. Montenegrin banking sector growth until the end of 2008 was one of the highest in Europe and Central Asia, but it was followed by strong downturn of lending activity. Low lending activity of banks remained characteristic for the entire period from 2009. Impact of the crisis on economy, particularly civil engineering sector, real estate sector, and retail sector resulted in the growth of non-performing loans in the overall loan portfolio. Thus, the share of non-performing loans in the middle 2011 achieved its maximum of nearly 26%. For these reasons, banks were forced to increase their provisions for losses in respect of loans and reach for capital reserves, which resulted in recapitalization in 9 banks. The aforementioned affected increased caution of banks in approving loans to real sector, which resulted in their weak contribution to resolving the issue of insufficient

liquidity of economy and accelerating economic growth. At the same time, the share of non-performing loans (NPL) in the total loans decreased to 16.78% at the end 2014, or 13.3% in December 2015, but such share is still high. This contributed, inter alia, to the increase of banking sector lending by 6.1% at the end of November 2015 in relation to the end 2014. Still, high interest rates and high indebtedness of economy and citizens represent additional barriers to intensive growth of lending activity of banks.

Implementation of specific recommendations given to Montenegro: At the ministerial meeting held in May 2015, Montenegro was given a recommendation to implement the planned voluntary financial restructuring program (the so-called “Podgorica approach”) to address the high burden of non-performing loans on bank balance sheets from a flow perspective...” In view of reducing the share of non-performing loans in the overall banking sector loans, the Law on Voluntary Restructuring of Loans was adopted and its application commenced on 1 May 2015 with validity period of 2 years, i.e. until 1 May 2017. The mentioned law is aimed at giving incentives to recovery of debtors, i.e. users of mortgage loans having financial difficulties through restructuring of debts, preserving stability of financial system and facilitating access to new finances for the purpose of stimulating economic recovery and growth. Financial restructuring according to this Law may be applied if the debtor and creditors conclude an agreement on participation in financial restructuring, i.e. if users of mortgage loans submit an application for financial restructuring to the bank within two years from the effective date of this law.

Also, the EC recommended that effective supervision of factoring companies should be introduced to improve transparency of the financial system. In relation to that, **Work Program of the Government of Montenegro 2016 envisages that in the fourth quarter the Proposal Law on Financial Leasing, Factoring, Micro-Crediting and Credit-Guarantee Activities should be adopted**, which will regulate the legal status of all financial institutions. The adoption of this Law will regulate legal status of financial institutions which are not credit institutions, i.e. business activities will be regulated for companies that are into financial leasing, factoring companies, micro-credit financial institutions and credit-guarantee funds, in accordance with relevant EU regulations. The adoption of this regulation will additionally ensure stability of the financial system.

Plan of reforms related to specific recommendations given to Montenegro: Pursuant to the EC recommendations from the Ministerial meeting 2015 activities have been intensified on increasing the number of applications for financial restructuring. The Law on Voluntary Financial Restructuring of debts towards the financial institutions is based on the concept of voluntariness of participants to the restructuring where debtors and their creditors voluntarily take part in negotiations on debt in view of achieving a solution to mutual satisfaction. However, available data show that in the last phase of “Podgorica approach” implementation related to voluntary restructuring of loans, in spite of all the activities by the Central Bank of Montenegro there are no interested parties. Irrespective of this, the share of non-performing loans (NPL) in December 2015 decreased to 13.3% in the total loans, with anticipation that higher interest of banks in implementation of this law in 2016 would contribute to even faster reduction of the share of non-performing loans in the total loans. However, given that it is a measure with a limited timeframe, it is expected that the reduction of NPL will be also contributed by gradual growth of the overall lending activity and competition among banks.

As previously mentioned, with regard to the specific EC recommendation about introducing an effective supervision of factoring companies to improve transparency of the financial system, by the end 2016, the Government is to establish proposal Law on Voluntary Financial Restructuring of debts towards the financial institutions.

Plan of other priority reforms: As regards other priority reforms aimed at increase of competitiveness of the financial sector, they are related to enhancement of the business environment, education reforms and other reforms discussed in other chapters of the ERP, which also have direct impact on competitiveness of the financial sector.

4.2.3.3.3 *ICT Services*

Diagnostic: Under the conditions of increasing domination of information technologies further modernization of public administration is imposed as a must. Simpler communication of citizens and business entities with state administration, more efficient exercise of rights of beneficiaries of state administration services and creation of preconditions for administration to service citizens and business through establishment of G2B and G2C service were set as goals when the Law on Electronic Administration was adopted.

The option of citizens and business entities to communicate with the state and local administration through a single electronic counter (electronic administration portal) which is regulated in normative and technical terms contributes to increase of efficiency and competitiveness. For simplification and efficiency of procedures it is important to establish an IT system for exchange of data among state authorities through efficient communication among institutions (enhancement of G2G segment of electronic administration).

Plan of reforms and their impact on competitiveness: Given that in this sub-section there were no specific EC recommendations, below follows a review of activities of the Government in the mentioned sub-section aimed at improving of competitiveness and contributing to faster economic growth.

Introduction of the Single information system for electronic exchange of data creates preconditions for obtaining documents that the state administration mutually exchanges, ex officio, in electronic form. This reform that commenced in 2015 is continuing in 2016 through creation of software for exchange of data, which represents completion of the activity on establishing this System within the timeframe set in the Law on Electronic Administration. After the design of the system was completed in 2015, in the first half 2016 planned is the development of a framework of interoperability and inter-institutional connectivity, which will be followed by the development of a systemic platform and application for inter-connection and exchange of data, the completion of which is planned for the third quarter 2016. In this quarter the application will be tested and its implementation will commence, as well as the construction of infrastructure capacities.

4.2.4 Business Environment, Corporate Governance, and Reduction of Informal Economy

4.2.4.1 Improving the Business Environment

Diagnostic: One of the priorities and an important instrument of economic policy to strengthen the capacity of the Montenegrin economy is improving the business environment. Creating a favorable environment, either in order to strengthen entrepreneurial ventures or to attract new investment, contributes to the economic development of the country, and GDP growth. At the same time, the competitiveness of the economy, in international terms, determines its position in terms of attractiveness for foreign investors. In this regard, priority reforms in the coming period will focus on the areas of business registration, construction permitting, real estate registration and payment of taxes.

According to data from the last ease of business report of the World Bank, Doing Business 2016, Montenegro has moved up one place on the global ranking list, taking the 46th place out of 189 ranked countries. The most significant reforms and improvement over the previous report has been recognized for the "issuing building permits" indicators for 11 places, ranking in the 91st, and the "payment of taxes" for 33 places, ranking in the 64th place. In the previous period, further implementation of recommendations of the Regulatory Guillotine remained in the focus of the reforms.

Through the indicators included in the Doing Business Report and the areas referred to as the reform areas by the private sector, as well as the recommendations of the European Commission, activities on our agendas focused on: the real estate registration, construction permitting, enforcing contracts, resolving insolvency problems, as well as further implementation of the recommendations of the Regulatory Guillotine.

Real estate registration has been the subject of reforms in recent years through the following: since 2012, the institute of the notary has been introduced in the system, which resulted in the obligation to have contracts certified by a notary before registration in the cadaster; time limits for the response of cadastral services upon application has been reduced from 60 to 15 days; and possibility has been introduced for the notaries to submit an application for real estate registration to the cadaster on behalf of their client by official duty.

In the previous period, significant activities were carried out towards creating conditions for faster legal transactions and for fast and safe exercise and protection of rights and interests of citizens and legal entities, increasing the level of legal certainty with an emphasis on strengthening the legislative and institutional framework for contract enforcement, as well as shortening the duration of contract enforcement procedures, with a view to increasing the competitiveness of the economy.

Despite numerous reforms in the field of issuing building permits and recognized improvements in this segment, there is still room for progress in terms of regional and global competitiveness. This includes particularly the following: more effective application of "one stop shop" system, that is, the introduction of electronic issuing of building permits in order to improve business environment and shorten deadlines for administrative procedures in public service delivery.

Regulatory Guillotine reform started in 2009 as one of the pillars of the Economic Reform Agenda in Montenegro. On that occasion, of the 1,887 defined recommendations, relevant ministries accepted 1,446 recommendations to be implemented from 2012-2015. Recommendations were defined by the Action Plan and referred to the amendment or abolition of 107 laws, 301 bylaws and 237 administrative procedures.

Activities in the area of tax policy that were implemented during 2015 were primarily aimed at the adoption of a series of legal provisions to achieve harmonization with EU legislation, further improve business conditions for developing entrepreneurship, attract investments and eliminate administrative barriers, maintain fiscal stability, increase tax discipline of taxpayers. In order to continue activities in combating the informal economy: strengthen fiscal discipline, eliminate unfair competition, and raise awareness of the importance of legal business operation, the Government of Montenegro adopted the Action Plan to combat the grey economy for 2015, defining measures to control it.

In order to improve business environment at the local level, the Ministry of Finance, with partners from the United Nations Development Program Office in Montenegro, and with the support of the British Embassy in Montenegro, is implementing the project "Public Administration Tailored to the

Needs of Businesses and Citizens", modelled on the British "Red Tape Challenge" project. The main objective of the project is to initiate a broad public dialogue in order to identify and eliminate the complicated and lengthy procedures, and business barriers in public administration with a focus on the local level. The main tool for starting and conducting public dialogue is an online platform "bezbarijera.me" (no barriers), where citizens, business and academic communities, non-governmental organizations and the overall public concerned, in the period from November 2015 until the end of March 2016, can indicate problems they encounter in exercising their rights and in doing business.

Implementation of specific recommendations given to Montenegro: At a ministerial meeting in May 2015, Montenegro received a number of recommendations from the EU in the area of improving business environment. The EU recommendation of May 2015 concerning the implementation of the Regulatory Guillotine related to the provision of timely implementation of the project. Delay in the implementation of the recommendations required the adoption of the revised Action Plan in September 2013, with the implementation timeframe from 2013 to 2017. In most cases, delay in the implementation of obligations was the result of a process of harmonization of Montenegrin legislation with the EU acquis, in the sense that the relevant ministries tend to periodically gather all recommendations (Guillotine and EC) for improvement of regulations in order to avoid frequent changes in legislation, which would ultimately result in the unpredictability of the overall regulatory system. According to the last report (30 June 2015), of the total of 1,446 recommendations, 1,103 recommendations were implemented, or 76%.

The EC recommendation in the area of issuing building permits was related to strengthening the functioning of one-stop shop principle at the municipal level for construction permits. In this regard, the regulatory framework is in the process of amendment for further improvement of the one-stop shop principle, as well as creation of prerequisites for the smooth implementation of the electronic construction permitting, the conversion of planning documents into the vector form and the establishment of a geo-portal with applicable planning documents. In 2015, the Rulebook on the content and manner of keeping the Central Registry of Planning Documents was adopted, and the Central Registry of Planning Documents was set up, in which all applicable planning documents have been entered, one part scanned and the other part in vector form, to be used for the establishment of the geo-portal.

The EC recommendation for contract enforcement related to the improvement of timeframes and efficiency in the contract enforcement. In this regard, the Law on Amendments to the Law on Enforcement and Security was adopted (May 2015), stipulating normative changes in terms of functional competence to decide on legal remedies against decisions of public bailiffs, providing that objection against a decision reached on the basis of executive title is decided by a single judge, while acting upon objection against a decision adopted on the basis of authentic documents remains the responsibility of a panel of three judges. Another important amendment concerns the obligation of the organization for enforced collection to maintain a register of accounts of individuals under the unique identification number, and innovation in the order of collection against the account balances of the legal entity or entrepreneur. Furthermore, enforcement against the judgment debtor's funds on accounts with commercial banks has been specified, in the sense that enforcement against that account excludes the salaries and pensions. Also, in the enforcement upon the real property, the lower limit of the real estate selling price is limited. In the Doing Business 2016 report, Montenegro is ranked 43rd, confirming last year's position. Compared to the Doing Business 2014, Montenegro used to rank 135th. When it comes to the time limits in the contract enforcement, the number of days in

Montenegro is significantly higher in comparison with the countries of Europe and Central Asia, as well as OECD countries, while the quality of court proceedings is at a higher level.

In the previous period, 29 public bailiffs were appointed, out of 31 foreseen. Bailiffs have started operating on 7 April 2014, but not all 29 public bailiffs started on the specified date because a number of them were appointed later.

The EC recommendation in the area of real estate registration related to the increase of quality of cadaster. In this regard, the implementation of standards introduced by the Law on State Survey and Cadaster of July 2015 is planned in the coming period. In addition to the tendency to continue to perform the modernization of cadastral services in the form of capacity building, increasing the efficiency and introducing new software solutions, a new set of measures is planned for the next period. The aim is to increase efficiency in service provision to investors and citizens, and to strengthen competitiveness in terms of Montenegro's ranking in the areas addressed by the Doing Business Report of the World Bank. In Doing Business 2016, Montenegro is ranked 79th, which is a decline of two places compared to the DB 2015. This indicator represents the third area in which Montenegro was ranked the worst, after the indicators for obtaining electricity and obtaining a construction permit. Compared to the countries of Europe and Central Asia, as well as OECD countries, Montenegro is ranked lower in the sub-indicators that treat the number of procedures, the cost and duration of the process, as well as in the quality of work of the cadaster.

Plan of priority reforms: The plan of priority reforms: For efficient issuance of building permits it is planned to continue reforms in the field of building construction through legislative amendments, as follows: (i) the adoption of the Law on Spatial Planning and Building Construction, which will define e-business at the level of spatial planning and construction of buildings, (ii) the adoption of bylaws for e-business, and (iii) the upgrade of existing information systems to support e-business.

Furthermore, the Government of Montenegro is continuously working on providing technical assistance and support to public bailiffs, with the aim of strengthening public enforcement activities, strengthening the Association bodies and increasing the quality and professionalism of their work. It also performs continuous surveillance of the work of bailiffs. Evaluation of public bailiffs is expected in late 2015, through the production of an analysis of efficiency of functioning of the enforcement system, including the work of bailiffs and the impact of the reform on the productivity of courts.

For improvements in the field of real estate registration, the implementation of the Law on State Survey and Real Estate Cadaster of July 2015 is planned in the coming period, including: the obligation of the Real Estate Administration to publish on its website not only the number of applications and the time of submission, but also the data from the applications and thereby to increase legal certainty and make the entire procedure before the administrative body transparent; the taxpayer is required to file a tax return and pay the real estate tax, and in this respect the proposed deadline of 15 days is harmonized with the time limits prescribed by other laws regulating similar areas; further strengthening of the IT capacity of the Real Estate Administration, aimed at establishing its obligation to allow other state agencies, local governments, legal persons performing activities of public interest and notaries access to geodetic-cadastral information system and to retrieve data from the system, for the purpose of performing activities within their jurisdiction.

The implementation of the remaining 343 recommendations from the Regulatory Guillotine is foreseen by the end of 2017.

Taxation policy in the future will be in conformity with the basic principles of tax policy in Montenegro, aiming to further improve the competitiveness of the tax system, which includes

competitive and flat tax rates, an effective administration and procedures and good tax payers' culture, which will ultimately promote Montenegro as an attractive investment destination. In the coming period, implementation of activities related to the harmonization of tax and customs legislation with the European Union law and practice (*acquis*) will be continued, as well as the activities aimed at entering into agreements on avoiding double taxation, which will create a favorable environment for attracting foreign investment and further stimulate the economic and financial relations between the contracting states. In order to continue the fight against grey economy, the Government will also continue with the adoption of new action plans in the coming period (2016-2018).

Identification of priority reform measures: In accordance with the above stated the following priority reform measures have been identified for this area:

- Implementation of outstanding recommendations from the Regulatory Guillotine,
- Improving the process of issuing construction permits through upgrade of existing ICT solutions,
- Introduce issuing of electronic fiscal invoices for tax cash registers in order to suppress informal economy,
- Cadaster to render decisions in line with deadlines envisaged under the Law on State Surveying and Immovable Property Cadaster.

Priority measure No 10: Implementation of outstanding recommendations from the Regulatory Guillotine

Measure description: Measures envisaged by the regulatory reform – the Regulatory “Guillotine” refer to limiting or reducing deadlines for the state authorities to render decisions upon requests of parties; eliminating procedure of submitting documents that can be obtained *ex officio*, as well as authenticated copies of documents; eliminating or reducing some fees; more precisely defining processes, procedures and criteria that natural and legal person must fulfil in order to obtain some permits and licenses from the state authorities; as well as the need to repeal some legislation due to them being outdated as they define procedures no longer in application.

Envisaged timetable for implementation of the measure: The timetable for implementation of the measure is defined in the Action Plan for Implementation of the Regulatory Guillotine, obliging the line ministries to implement recommendations by the end of 2017. According to the latest adopted Information on Implementation of Recommendations from the Regulatory Guillotine, it was stated that in the period since the Action Plan was adopted (May 2012) until Q2 2015 1,103 recommendations were implemented out of 1,446 accepted recommendations, or the implementation rate is 76.3%. Implementation of remaining 343 recommendations is defined in the following manner: 204 recommendations until the end of 2015, 128 recommendations during 2016 and 11 recommendations during 2017.

Financing structuring and fiscal implications: There are no direct fiscal implications in terms of additional costs for realization of this measure, since the measure will be implemented with existing administrative capacities in the country and it does not envisage any sizeable investments for its implementation.

Expected impact of the measure on competitiveness increase of the country:Realization of the foreseen recommendations is aimed at creating an efficient administration, clear procedures with short and transparent deadlines for acting upon requests of parties by the state authorities, which will ultimately affect strengthening of competitive advantages of Montenegro by creating better conditions for investments.

Priority reform measure No 11: Improving the process of issuing construction permits through upgrade of existing ICT solutions

Measure description: Improving the process of issuing construction permits through upgrade of existing ICT systems, which will integrate all information on space, precisely that will enable easier implementation of investments in space, as well as the construction of municipal, energy, transport and other infrastructure. This measure is of administrative nature.

Realization of this measure will improve the process of issuing construction permits using the “one-stop shop” principle at both the State and local level. The manner of issuing construction permits using the “one-stop shop” principle is implemented in practice but in such manner as that the administrative authorities are communicating among them and exchanging documents via letters, which is taking quite a lot of time and this is the reason why their electronic connectivity within the state administration is required. It should be taken into consideration that the process of issuing construction permits is decentralized competence (some 95% of construction permits are issued at the local level, while only around 5% at the State level); this is why the measure of improving the process of issuing construction permits through upgrade of existing ICT solutions is proposed. Upgrade of existing ICT solutions includes upgrade of the ICT system at the state level, but which will also connect 23 local authorities competent for spatial development and construction of structures, local-level authorities in charge of environmental protection, 23 local-level enterprises that are managing water-supply and sewerage system infrastructure, the Administration for Inspection Affairs, the Water Administration, the Administration for Protection of Cultural Monuments, all regional offices and the central office of the Real Estate Administration, all regional office and the central office of EPCG, PE Maritime Domain, PE National Parks of Montenegro, the Environmental Protection Agency, the Air Traffic Safety Agency, the Agency for Telecommunications, the Transport Directorate.

This measure was also proposed in the 2015 Economic Reform Program through adoption of amendments and supplements to the Law on Spatial Development and Construction of Structures, but as it was assessed by the Ministry of Sustainable Development and Tourism that the priority is to adopt a new law and to consider overall subject-matter of planning and construction of structures, the adoption of this law is planned for 2016.

Envisaged timetable for implementation of the measure: In the forthcoming period, precisely in 2016, the following activities are planned: (i) adoption of the Law on Spatial Development and Construction of Structures, which will define electronic operation for the field of spatial development and construction of structures, (ii) adoption of secondary legislation for electronic operation, and (iii) upgrade of existing ICT systems which will support electronic operation. If all the above mentioned is taken into account, full application of the system of electronic issuing of construction permits is expected by the end of 2017.

Financing structuring and fiscal implications: Funds for implementation of this measure are planned in the Law on Budget for 2016 in the amount of 150,000 euro.

Expected impact of the measure on competitiveness increase of the country: This measure will have impact on simplification of administrative procedures in the field of delivery of public services, and it

will directly have effect on improving the business environment as an important element for improving the competitiveness.

Priority reform measure No 12: Cadaster to render decisions in line with deadlines envisaged under the Law on State Surveying and Immovable Property Cadaster

Measure description: Amendments to the Law on State Surveying and Immovable Property Cadaster from July 2015 introduced a principle of data currency, in addition to already existing principles, which increases the timeliness of work of administration authorities by very fact of keeping current the data records on registered rights on immovable property and submitted requests for changes of such data.

In addition to earlier changes to the Law concerning shortening of deadlines for rendering decisions, as well as other measures undertaken to improve procedure of registration of immovable property in the cadaster through notary services actions, which was aimed as to increase efficiency in this segment of the business environment. The Real Estate Administration will monitor implementation of legislative provisions, in the forthcoming period, through quarterly reports on acting of the cadaster office. Thus the realization of requests from companies and citizens, as well as efficiency of the cadaster could be monitored and if needed improved.

Envisaged timetable for implementation of the measure: Special focus will be directed towards acting in line with legislative procedure using the uniform principles and acting within deadlines, in the segment of creating more favorable business conditions during 2016, all aimed to achieve higher efficiency in work of cadastral offices. While taking into account reduction of deadline to 15 days, due to different application resulting from scale of work in regional cadastral office, compliance with statutory deadlines needs to be monitored in the forthcoming period until 2017. After the submitted report on work of cadastral offices is implemented, the procedure for registering immovable property in the cadaster, as well as legal security of holders of rights on immovable property, will be at the higher level. The Council for Improving the Business Environment, Regulatory and Structural Reforms will discuss the report, which will create room for detailed presentation of the procedure of registering immovable property in the cadaster and compliance with deadlines set forth by the Law in all cadastral offices.

Financing structuring and fiscal implications of the measure: There are no direct fiscal implications in terms of additional costs for realization of this measure, since the measure will be implemented with existing administrative capacities in the country, and it does not envisage any sizeable investments for its implementation.

Expected impact of the measure on competitiveness increase of the country: Implementation of the proposed measure, along with the set of measures continuously implemented in the segment of strengthening human resources and ICT capacities of cadastral offices, will contribute to improving the quality, efficiency and accessibility of the cadaster's public services. It will also strengthen the business environment in this segment, which will ultimately improve competitiveness of Montenegro, especially in the area of improving ranking in global reports such as the Doing Business Report.

Priority reform measure No 13: Introduce issuing of electronic fiscal invoices in order to reduce informal economy

Measure description: Fight against the grey economy, coordinated by the Commission for Suppressing the Grey Economy, is based on the core principles: unbiased, transparency and zero tolerance for grey economy. In order to eliminate unfair competition and to strengthen competitiveness of

enterprises operating in the formal zone, the Commission will continue in the following period to implement measure to fight the grey economy through constructive discussion of all involved entities and to review effects of proposed measures at the highest level. Intensive and strong media campaign will continue at the national level, having as the objective to strengthen the fiscal discipline of all taxpayers aimed at motivating citizens and companies to behave responsibly by strengthening awareness of negative phenomenon of the grey economy which is affecting citizens as direct budget users and the companies which are exposed to unfair competition due to the grey economy.

The conclusion adopted by the Government of Montenegro this year was to consider the possibility to introduce issuing of electronic fiscal invoices, as one of the measures to suppress the informal economy, which would provide information on trade in goods and service in real time. The Ministry of Finance's working group has prepared the *Information on Possibility of introducing Issuing of Electronic Fiscal Invoices in Montenegro*. The establishment of the multi-sectoral working team is envisaged for implementation of this project, which will work in parallel on implementation of technical solution and to develop relevant legislation (a law and rulebook). By introducing the issuing of electronic fiscal invoices, which was planned in 2016, a major advancement would be made in terms of control of recording transactions paid in cash.

Existing system of issuing of fiscal invoices via tax cash registers in Montenegro is hardware-based system (fiscal cash registers), while the objective is to introduce software-based (electronic) system of issuing fiscal invoices which is based on introduction of control of issuing invoices. This model of issuing fiscal invoices requires use of software adapted to the process of issuing fiscal invoices and the obligation for invoices to be issue via electronic payment devices, which must enable use of the software support for electronic signing of invoices. Internet connection is used for electronic data sharing with the Tax Administration.

Existing model of issuing fiscal invoices in use in Montenegro is complex and outdated in terms of business processes and procedures. The Tax Administration does not have information on trade in goods and services in real time, thus does not perform comparative analysis with data presented in tax returns and comparative analysis of taxation of trade for a given taxpayer. Thus, the existing system does not enable implementation of good quality reporting system and risk analysis.

Process of issuing electronic fiscal invoices, which is planned to be introduced, commences at the time of issuing an invoice. Before printing, the obligor of issuing fiscal invoice signs digitally the invoice and sends it via internet to the Tax Administration (invoice is stored in the database of the Tax Administration and not on the cash register control rolls). The Tax Administration verifies whether all stipulated elements of an invoice are submitted and whether it is signed with an appropriate digital certificate. If all these requirements are met a unique invoice identifier (JIR) is issued, which is sent to the obligor, JIR is linked with the number of the invoice and invoice is printed. This process takes place within 2 seconds.

This model enables the buyer and inspector to verify in real time, based on JIR, each issued invoice via SMS or the Tax Administration portal.

Implementation of an electronic (software) system of issuing fiscal invoices should lead to higher collection of tax revenues, reduction of informal economy and tax evasion, more efficient and higher quality mechanism of inspection oversight during recording of transactions (changes in the manner of oversight, a good quality reporting system, risk analysis, comparative analysis of trade and data from tax returns, on-line oversight), and optimization of the Tax Administration resources.

Envisaged timetable for implementation of the measure: During 2016, the multi-sectoral working team will work on implementation of technical solutions (procurement of software and required hardware equipment) and development of appropriate legislation (a law and rulebook). The project of implementing the issuing of electronic fiscal invoices will take place in 2017.

Financing structuring and fiscal implications: There are no direct fiscal implications in terms of additional costs for realization of this measure, since the measure will be implemented with existing administrative capacities in the country. When we are talking about impact on the revenue side, it is expected that introducing the issuing of electronic fiscal invoices will increase the revenues of the budget of Montenegro in 2018 by 11 million euro.

Funds required in 2016 for adapting the information system of the Tax Administration, which includes procurement of software and required hardware equipment, are estimated to around half a million euro.

Expected impact of the measure on competitiveness increase of the country: Introducing the issuing of electronic fiscal invoices for tax cash registers will contribute significantly to increase of competitiveness of the Montenegrin economy. Competitive economy assumes introduction of the high degree of tax discipline, whereby this project would provide sizeable contribution.

4.2.4.2 Development of Small and Medium-sized Enterprises

Diagnostic: It is understood that the sector of small and medium-sized enterprises is a foundation for economic development and improvement of competitiveness of Montenegro, which could sizably contribute to GDP, exportation and overall employment. In spite of the fact that the business environment for SME development is improving from year to year, their development continues to be restricted by administrative and regulatory barriers such as obtaining licenses, paying taxes, registering immovable property, but also economic barriers such as difficult access to financing, collection of receivables, high costs of labor, limited availability of business services for SMEs, etc.

The analysis of achieved results and recommendations for further development of the SME sector is provided as part of the assessment of implementation of the Small Business Act (SBA) in the report the SME Policy Index. Even though Montenegro recorded progress, according to preliminary results for 2015, in the segment dealing with alignment of the policy for development of small and medium-sized enterprises for all 10 defined dimensions, the access to financing and delivery of business services continue to represent barriers for growth and development of SMEs.

Obstacles are evident in the aspect of access to financing for SMEs, both on the side of supply and on the side of demand, and they pertain to insufficient adequacy and appropriateness of financial products for various categories, few alternatives for sources of financing, as well as insufficient readiness of SMEs for their absorption.

Priority reforms²⁵: In order for the SME sector to grow and develop in the forthcoming period, it is necessary to ensure more adequate, accessible and innovative access to financing if compared to the supply in 2015. In 2015 (as of 24 December 2015), the Investment-Development Fund (IDF) has invested 115.58 million euro in form of short-term and long-term loans and through factoring, which is the amount higher by 44.47% if compared to the amount of 80 million euro planned for 2015, or by 62.33% higher if compared to the funds placed in 2014 (71.2 million euro). Number of approved loans totals to 254 in the amount of 64.36 million euro, whereby the majority are for the sector of tourism

²⁵ There were no specific recommendations from the Ministerial meeting in May 2015 in this field for Montenegro.

(43.74%), food production and processing (32.69%), service sector (18.81%), agricultural production (3.30%), and have planned opening of 1,882 new jobs. In the segment of factoring, 40 facilities were approved in the amount of 51.22 million euro of collected receivables which has resulted in preserved 2,762 existing jobs through maintained liquidity of SMEs. Support provided to the SME sector also included special target groups (youth, women in business, agricultural producers, and business start-ups), resolving the problem of illiquidity, etc. The European Investment Bank (EIB) has approved a new loan facility to IDF in the amount of 70 million euro, and the Contract for the first installment of 40 million euro was signed in March 2015. At the end of 2015 IDF became the member of ENIF – Enterprise Innovation Fund as part of the WB EDIF Program. In 2015, Crnogorska komercijalna bank (CKB) used approved 7.9 million euro for lending to SMEs as part of the agreement with the European Investment Fund (Guarantee instrument of WB EDIF²⁶ program).

In the forthcoming period, the improved access to financing for SMEs will be provided through implementation of updated lending schemes through and with the guarantees of commercial banks, as well as through direct lending and implementation of factoring facilities, which will be implemented by IDF. Envisaged reforms also include innovation in the segment of introducing equity financing under the ENIF Fund and lending-guarantee facility under the COSME²⁷ program.

Delivery of business services (information, advisory, training, business connectivity) will be improved through work of the newly established Regional Business Center and Incubator in Berane (IPA 2011 Project) and activities of the Enterprise Europe Network – EEN Montenegro²⁸.

Identification of priority reform measures: One priority reform measure is identified in this area, specifically in the area of improving financial support to the sector of small and medium-sized enterprises.

Priority reform measure No 14: Improving financial support to the sector of small and medium-sized enterprises

Measure description: In order to remove obstacles to SME development in the segment of access to financing, in 2016 the reform measure will be aimed at updating the existing financial instruments and creating new, in accordance with SMEs needs, focusing on both investments and liquidity of enterprises, while supporting more uniform regional development. IDF will update the existing lending scheme with new lending lines, such as micro loans, lending to SMEs operating in ICT sector, no-interest lending to university students for business start-ups, and combination of non-financial and financial support for business start-ups. A special reform segment pertains to introduction of a new financial instrument for financing equity capital for start-up innovative enterprises and enterprises in development phase engaged in innovation activity under the ENIF fund, and implementation of instrument for loan guarantees of financial institutions as part of the COSME program.

The objective of the reform is ensure better conditions for access to financing in terms of more favorable lending terms and to introduce new financial instruments, and thus so as to widen the range of users, primarily business start-ups, innovative SMEs, existing SMEs in order to increase their growth and improve liquidity, etc.

Envisaged timetable for implementation of the measure: Measures for improving the financial support to the SME sector development will be implemented in the period 2016–2018. Financial support will be implemented continuously during the year, based on the open calls issued in January 2016.

²⁶ Western Balkans Enterprise Development and Innovation Facility

²⁷ EU Program for Competitiveness of Small and Medium-sized Enterprises 2014-2020

²⁸ Project Enterprise Europe Network Montenegro as part of COSME 2014-2020

Financing structuring and fiscal implications: To implement the financial support for SME sector, in 2016 IDF will provide 100 million euro. Majority of funds will be provided based on the signed financial agreement with EIB, repayment of funds from previous IDF placements, and planned signing of agreements with the World Bank, the Council of Europe Development Bank, and the European Investment Fund. CKB will continue with implementation of the COSME program for instruments of the credit guarantees in the value of 30 million euro for the period of 3 years, which was signed in July 2015.

Expected impact of the measure on competitiveness increase: Diversification of financial supply for SMEs will enable meeting of the demand also for riskier SME categories (business start-ups), but will also improve operation of innovative SMEs through investments in equity capital. This will also contribute to increase in the number of newly established SMEs, opening of jobs, increased share in GDP, as well as improvement in competitiveness at the level of enterprises and international competitiveness of Montenegro.

4.2.4.3 Privatization

Diagnostic: Activities in the area of privatization in 2015 were implemented in accordance with the Decision on the Privatization Plan for 2015, which was adopted in March 2015. Out of 12 planned tenders under the Privatization Plan for 2015, tenders for 5 business organizations were carried out. In that respect, total proceeds from realization of this Plan were 13,493,806 euro. Following tenders for sale of the share capital were implemented: Institut "dr Simo Milošević", Montenegro defense industry" d.o.o – Podgorica, Poliex AD – Berane; sale and lease of property of the Hotel Park complex in Bijela; and sale and lease of the part of the property of "Gornji Ibar" from Rožaje. Companies and assets that are yet to be privatized in line with the Plan via open call are: *Novi duvanski kombinat AD Podgorica* - privatization and/or recapitalization (buying, production, and trade in tobacco and tobacco products), *AD "Montecargo" Podgorica* (railway transport), *"Montenegro airlines" AD Podgorica* (air traffic and airliners), *HG "Budvanska rivijera" AD Budva* (hotel and similar accommodation), *HTP "Ulcinjaska rivijera" AD Ulcinj* (hotel and similar accommodation), *"Institut za crnu metalurgije" AD, Nikšić* (technical testing and analysis), and *Montepranzo - bokaprodukt AD – Tivat* (mixed agricultural production).

Activities to sign a contract for sale of 215,954 shares of the *Institut za fizikalnu medicinu, rehabilitaciju i reumatologiju „Dr Simo Milošević” AD – Igalo* are underway, where the purchase-sale prices is 10,025,306 euro and minimum contracted investments 50,000,000 euro.

Moreover, activities to conclude a contract for sale of shares of/stock in the *"Montenegro defense industry" d.o.o – Podgorica* were carried out, with purchase-sale price of 680,000 euro and contracted investments of 500,000 euro, and with the *Poliex AD, Berane* where the purchase-sale price is 138,500 euro and contracted investments 400,000 euro. Purchase and sale contracts and property lease contracts were signed for the Hotel Park complex in Bijela, with purchase-sale price of 2,250,000 euro and minimum contracted investment of 6,500,00 euro and for the part of property of the company *"Gornji Ibar"* from Rožaje, with purchase-sale price of 400,000 euro and contracted investment of 5,360,000 euro. The tender commission for privations was not successful in agreeing the contract on purchase and sale of shares or recapitalization of the *Novi duvanski kombinat AD Podgorica* and the tender was announced as unsuccessful. New tender procedure is open for this business organization, as well as for the sale of the remaining part of the property of the company *"Gornji Ibar"* from Rožaje.

Under the competence of the Council for Privatization and Capital Projects the following tenders were opened in 2015 for capitalize on tourism sites: Site Pećine, between Njivice and mouth of the Sutorina River in Herceg Novi; construction of the base camp in the mountain center "Kolašin 1600"; "Donja Arza" in the Herceg Novi Municipality; Eco-lodge in Vranjina; and site of the former military recreation center Mediterranean in Žabljak. Tender documentation is being prepared for site "Buljarica" in the municipalities of Bar and Budva.

A Contract on financing and design of the priority section of the Bar-Boljare Highway was concluded (priority section Smokovac-Matešev) and the activities to create prerequisites for the construction of the 2nd block of the Thermo Power-plant Pljevlja are in the final stage

Priority reforms²⁹: The Government has adopted the Privatization Plan for 2016 based on the proposal of the Council for Privatization and Capital Projects. It is expected that the realization of this Plan will end in privatization of remaining not privatized business organizations, as well as in capitalizing on tourism sites. Based on the experience from previous years, it is expected that unsuccessful tenders will be transferred from the present plan into the new privatization plan, which will be focused on projects for which the planning documents were adopted and property relations resolved.

In this respect, the core objective of privatization in 2016 will be to increase competitiveness and efficiency in functioning of companies, to spur foreign investments and entrepreneurship in all sectors, and to improve standard of living.

In order to continue with activities concerning privatization of remaining not privatized business organizations, as well as to put to good use tourism sites, the Government of Montenegro will continue in the future period (in 2017 and 2018) to adopt decisions on the Privatization Plan.

4.2.5 Absorption of Technology and Innovation

Diagnostic: Innovations as one of the main drivers of economic growth are gaining a rather important place in all types of economic activities of Montenegro and are being deemed as basis for economic transformation and modernization of the country. In order to achieve the desired results, Montenegro has recognized a need to create a well interconnected system of innovation where investing in human resources, their knowledge and skills, combined with developed infrastructure for innovation, contributes to high level of creativity which yields specific results in terms of increasing productivity, expanding the production base and creating new sources of competitive advantages. Montenegro continues to have very few enterprises that are basing their activities on innovation, knowledge and modern technologies, which has negative effect on the level or productivity and competitiveness of the country. On the other hand, the present cooperation of enterprises with scientific and research institutions is still in an initial phase, thus it has not yet produced significant results in the field of innovation. Moreover, access to financing and inadequate model of business support to enterprises do not meet development needs of enterprises and creating new economic activities.

Priority reforms³⁰: A special attention will be directed towards creating framework requirements that will be inductive for the innovation and knowledge transfer process, in the forthcoming period, as well as for strengthening of links between scientific and research institutions and real economy sector. Establishing an adequate institutional framework that will enable spur on innovations and facilitate absorption of technology is the most important step, which on one hand assumes

²⁹ There were no specific recommendations from the Ministerial meeting in May 2015 in this field for Montenegro.

³⁰ There were no specific recommendations from the Ministerial meeting in May 2015 in this field for Montenegro.

incentivizing scientific excellence in all fields where Montenegro has the highest scientific and economic potential, while on the other hand triggers entrepreneurial potential based on innovation that can have direct effect on competitiveness of the economy. In the context of incentives for entrepreneurial potential based on innovation, the institutional framework will be realized by establishing the first Scientific and Technological Park in Montenegro (2014-2020), which is designed as a networked structure that will be headquartered in Podgorica with three decentralized units – impulse centers in Nikšić, Bar, and Pljevlja, which will create a strong link with local and regional business centers, incubators, clusters, and voucher schemes and it will enable commercialization of innovative ideas into new products and services, which could be placed on the market. Due to complicated procedures of transfer of ownership, technical preparations for projects commencement, as well as the public procurement procedures (four tenders), construction works on reconstruction and refurbishment of the Military Club in Nikšić for accommodation of the Innovation-Entrepreneurship Center “Technopolis”, one of three so called impulse centers, have started with some delay if compared to the initially planned, precisely at the end of July 2015 and completion of works is expected in Q2 of 2016. During 2015, extensive activities were also carried out to provide premises for accommodation of the Scientific and Technological Park – central unit in Podgorica, and preparatory activities were carried out as well required for preparation for the Conceptual Design and Main Design.

Through the program of competitive grants for sub-projects for research and development (2014-2017) applied and development research are incentivized, which require cooperation with partners from abroad and from the real economy sector in order to be completed, all in order to create commercial innovations. Focus is on strengthening good quality and sustainable partnerships showing potential to integrate research into dominant economic drivers in Montenegro and to grow out into future centers of excellence.

In order to trigger changes and provide incentives to innovations in small and medium-sized enterprise, a program of support to innovation in small and medium-sized enterprises in manufacturing industry was designed with the aim of enabling enterprises to access knowledge and experience required for them to become innovative and strengthen their competitiveness and productivity. At the same time, enterprises are invited to establish new links with specialized consulting firms, scientific and research institutions, centers of excellence, scientific and technological parks, innovation-entrepreneurship centers, and business incubators, which should provide impetus for transfer of knowledge and innovativeness.

Establishing new institutional framework and strengthening existing innovation potential through realization of the support programmer have pointed out to the need to create a legal and strategic framework for the area of innovative activities. The Law on Innovative Economic Activity in Montenegro governs the area of innovative economic activity in Montenegro, in such manner as to enable innovation to become a pillar of development of dynamic and relevant environment for the development of science and research. On the other hand, an increasing importance of innovation has a growing impact on directions for formulating policies of Montenegro, thus this segment is included in all relevant strategies and programs. To that end, the preparation and adoption of the Innovation Strategy with the Action Plan in 2016 will define a single framework for the innovation policy and give guidance for the future development with special emphasis on priority development sectors in order to spur the economic growth.

Identification of priority reform measures: Due to delay in realization of construction of the innovation-entrepreneurship center “Technopolis” in Nikšić, which was proposed in the previous

Economic Reform Program – explanation provided in the text above – this reform measure remains a priority even in this-year’s document.

Priority reform measure No 15: Construction of the Innovation-Entrepreneurship Center “Tehnopolis” in Nikšić

Measure description: In accordance with the implementation schedule of the Strategic Plan for introducing the Science and Technology Park (STP) in Montenegro (2012), establishment of the first Innovation-entrepreneurship Centre “Tehnopolis” in Nikšić commenced in 2014, which was started with work on 11 September 2014, as of the day of registration in the Central Registry of Business Entities (CRPS), in temporary business premises in Nikšić provided by the Nikšić Municipality. The Main design envisages that the activity of the “Tehnopolis” is to be carried out in the business premises of the reconstructed Military Club in Nikšić. This building will accommodate office space for up to 20 micro and small enterprises, and 3 laboratories: biochemical laboratory, industrial design laboratory, and ICT laboratory (ICT data center).

Envisaged timetable for implementation of the measure: Bearing in mind that works on reconstruction and refurbishment of the Military Club in Nikšić were late to start, precisely started in July 2015, the implementation of this measure was rescheduled for 2016. Completion of works is expected in Q2 of 2016, after that the premises will be equipped with furniture and part of the equipment, such as computer equipment and other small office equipment. After that, residents will move in, based on procedures and models for support of future start-up projects and entrepreneurs, where the “Tehnopolis” is already working intensively. Training of employees in the “Tehnopolis”, specification of required equipment for laboratories and procurement of equipment for laboratories is planned from IPA II funds as part of the sector “Competitiveness and Innovation”, which will be implemented in the period 2016-2018.

Financial structuring and fiscal implications: The Law on Budget of Montenegro for 2015 has planned financing of reconstruction of the Military Club in Nikšić building for accommodation of the “Tehnopolis” in the Capital budget in total amount of 929,000.00 euro, of which approx 100,000 was used, while the amount of 63,620.00 euro was used for work of the “Tehnopolis”. The Law on Budget of Montenegro for 2016 planned in the Capital budget funds for completion of works for reconstruction of the building of Military Club in Nikšić for accommodation of the “Tehnopolis” in the amount of 805,000.00 euro. Operation of the “Tehnopolis” in 2016 will be financed with 67,186.00 euro. As part of the IPA II sector “Competitiveness and Innovation”, publishing of the Terms of Reference for technical assistance for training of employees in the “Tehnopolis” in the amount of 30,000.00 euro was planned in 2016, as well as technical assistance for preparation of detailed specification for equipment in the laboratories of the “Tehnopolis” in the amount of 40,000.00 euro, while the activities will be continued in 2018 under the same program, in the form of procurement of equipment for laboratories in the “Tehnopolis” in the amount of approx 1,000,000.00 euro.

Expected impact of the measure on competitiveness increase of the country: “Tehnopolis” will have multiple positive effects on competitiveness of the economy of Montenegro, since it will become the most important development center in Nikšić that will support creation and attract new small and medium-sized enterprises, consolidation of existing enterprises, it will open new possibilities for cooperation of scientific and research institutions with business entities, and in such manner will enable innovative environment inductive for creation of new products and services and opening of new jobs.

4.2.6 Trade Integration

Diagnostic: Montenegrin economy is facing a problem of external economic disbalance over a longer period of time, which is reflected primarily through high deficit in the current account of the balance of payments, which based on estimate for 2015 is around 12.6% of GDP. This is the highest balance of payments deficit in the Western Balkans region. Key reason for high deficit in the current account of the balance of payments is import dependency of the Montenegrin economy, and on the other hand low level of import coverage by export of goods. Reasons for insufficient export of goods from Montenegro are multiple and mainly related to the low level of added value in production, low quality of products due to absence of alignment of production with international quality standards, narrow production base, precisely insufficiently diversified export, which ultimately has impact on insufficient growth rates. The process of trade and overall economic integration is one of the ways to strengthen the external position of the country, but with application of international agreements on free trade, the key element that could contribute to expansion of the export base of the economy, precisely to the growth of export, is the increase of competitiveness of Montenegrin products intended for sale in country and abroad.

Implementation of specific recommendations given to Montenegro and plans for their implementation:

At the ministerial meeting held in May 2015, suggestion was given to Montenegro to “make further progress with a comprehensive and strategic approach in the field of EU food safety and sanitary and phytosanitary standards in order to receive accreditation for exporting agricultural and food products to the EU. Efforts in this direction should commence with those products where preparations are advanced and where Montenegro sees the biggest export potential.” Implementation of this recommendation and plans in this field were discussed under the segment on agriculture, and priority reform measure for that field was presented there (Measure No 7). Having in mind that in 2015 an increased interest was present to introduce standards in other sectors of economy, in particular in manufacturing industry, tourism and trade, the continuation of the program is planned in 2016, which is aimed at strengthening regional and local competitiveness through alignment of economic entities with requirements of international operating standards.

Other priority reforms: In addition to the above mentioned set of measures pertaining to **alignment with international quality standards requirements**, second set of measures relating to **trade facilitation** has important effect on eliminating trade barriers, precisely on increasing competitiveness and economic growth, which was also recognized at the international level. Proposal of the Law on Ratification of the Trade Facilitation Agreement is currently in the parliamentary procedure in Montenegro. Chief benefits from implementation of this Agreement are simplification of the customs procedures, increase of transparency and reduction of transaction costs. Namely, it is expected that application of the Agreement at international level will reduce costs between members of the World Trade Organization by 10%-15%, which should ultimately support growth of the global economy and opening of new jobs. Furthermore, it is expected that the exportation will be increased, for developing countries by 10% and for developed countries by 4.5%. Implementation of the Trade Facilitation Agreement in Montenegro will encourage connectivity of information of all inspection services performing border-related activities, simplify customs procedures, increase transparency and reduce transaction costs, and by doing so improve the competitiveness of enterprises and the entire economy.

In addition to the above stated, in 2015 parties to the CEFTA have commenced negotiations to sign *Framework Agreement on Simplification of Border Procedures, Electronic Data Sharing and Mutual Recognition of the Program of Authorized Economic Entities, based on the WTO Trade Facilitation*

Agreement. Once the Framework Agreement enters into force procedures for importation and exportation will be largely aligned and simplified, and the average customs release of goods will be shortened as well, which are some of the key problems identified by representatives of the business sector. It is expected that the negotiations will be completed by mid-2016.

Identification of priority reform measures: Based on the previously stated, the priority reforms measures from 2015 are to continue in 2016, as measures applicable to the development of sectors of industry, tourism and trade, and resultantly to export increase. The measure in question is: “Increasing competitiveness of business organizations through harmonization with the requirements of international quality standards”.

Priority reform measure No 16: Increasing competitiveness of business organizations through harmonization with the requirements of international quality standards

Measure description: It is crucial for Montenegro to strengthen export capacities and ensure better integration of the economy into global production chains and common EU market, thus to reduce vulnerability to shocks. Harmonization with the requirements of international standards and improving the quality of products and services are having major contribution in this process. Within that context, in 2014 the Government has initiated a special program of support to small and medium-sized enterprises – “Program to Increase Regional and Local Competitiveness through harmonization with International Business Standards”, as an important measure to advance competitiveness SMEs, which was implemented in 2015. Having in mind the pronounced interest of enterprises in the areas of manufacturing industry, tourism and trade for introduction of international business standards, continuation of the Government’s support to these activities is planned for 2016. More specifically it is envisaged to issue at least one open call as part of the mentioned multi-year Program of Increasing competitiveness of business organizations through harmonization with the requirements of international quality standards (HACCP, ISO 9000, ISO 14001; HACCAP, OHSAS, etc.). The Program contains the following components of support: (i) support to SMEs through refund of costs for accreditation of bodies for assessing the level compliance; and (ii) support to SMEs for refund of costs of implementation of standards/certification/re-certification.

Envisaged timetable for implementation of the measure: The public call under the Program is planned for Q2 of 2016, in order to make evaluation and enable payout of funds to business organization that meet requirements until the end of 2016.

Fiscal implications of the measure: The Budget for 2016 has envisaged 100,000 euro for implementation of this measure. In accordance with the state aid rules, the maximum refund amount for qualified costs is 5,000 euro or up to 70% of the investments to enterprises that meet the criteria set forth in the public call.

Expected impact of the measure to on competitiveness increase of the country: It is expected that higher number of SMEs from the manufacturing industry, tourism and trade will make investments to introduce standards in order to increase competitiveness of their products and services and thus contributing to an increased competitiveness of the Montenegrin export and the entire economy.

4.2.7 Employment and Labor Market

4.2.7.1 Labor Market

Diagnosis: Despite the recovery trend that continued in 2015, the existing situation in the labor market of Montenegro is caused by the structural changes in the economic structure that developed

from the industry sector to the service sector, as well as the impact of the long-lasting economic crisis that ultimately affected the labor market. It is characterized by a relatively slow increase in employment rate, which was 45.9% for the population 15+ in the end of the third quarter of 2015, and caused a relatively low activity rate of 55.0% for the same population group. Besides, a particularly negative characteristic of the labor market is the long-term unemployment. According to the Labor Force Survey (LFS), the share of long-term unemployed in the total unemployment was 77.9% in the third quarter of 2015, while the long-term unemployment rate was 12.8% in the same period. However, a key challenge in the labor market remains a structural mismatch between supply and demand in the labor market. As part of this challenge, it should be emphasized that this mismatch is most visible among youth, especially university graduates.

Furthermore, when it comes to comprehensive regulation and functioning of the labor market, it should be noted that in the previous period, flexibility in the labor market has increased, as supported by the results of the relevant *Doing business* survey. However, there is an obvious need for further improvement of this segment, through further reform of the labor legislation.

Implementation of specific recommendations: In order to increase the competitiveness of the economy, with regard to employment and the labor market, at the Ministerial meeting in May 2015, Montenegro received the following recommendation: "To amend the labor legislation in order to introduce further market flexibility. To intensify the sanctions to discourage undeclared work. To improve channeling of active policies for workers at risk of losing their jobs and to strengthen participation of the older population in the labor market."

In accordance with this recommendation of the Ministerial Meeting in May 2015, and generally in order to eliminate the mentioned key obstacle to increasing flexibility in the labor market, and to combat the gray economy and address structural unemployment, which are important for the increase in the competitiveness of the economy, there are ongoing activities aimed at further increasing labor market flexibility and the implementation of active employment policy measures.

In order to eliminate the identified challenges in the labor market, and to create conditions for further flexibility in the labor market, activities have started to amend the labor legislation. Namely, the working group for drafting the new Labor Law, comprised of representatives of the Government, the social partners and the civil society, is working on agreeing specific solutions in order to meet this objective, while active employment policy measures are continuously implemented, as targeted actions to remove the obstacles in the labor market. So, representatives of the Government, in cooperation with the social partners and the civil sector, are preparing the new Labor Law, and its adoption is foreseen in 2017. In 2016, the focus of the working group will be to comply with labor standards and directives in this field. In addition to further harmonization with the EU *acquis* and international standards, the focus of the new Act will be to review decisions related to employment contracts, both open-end and limited term ones. There will also be an analysis of the possibilities for more favorable treatment of specific categories of physical and legal entities, as well as the possibilities to simplify the procedures related to redundancies, in terms of informing particular legal entities and taking specific action to reduce the risk of loss of employment to the lowest possible number of workers.

In addition to drafting the new Labor Law, aimed at increasing flexibility in the labor market, active employment policy measures are also implemented, focused on the unemployed and employers, and aimed at better matching supply and demand in the labor market. These measures are implemented through the programs of education and training, public works, programs for the less employable categories of the unemployed, stimulating entrepreneurship and employment mediation. A particular

focus is given to those target groups that represent the biggest challenge in the existing circumstances, and those are the long-term unemployed, youth and women.

Reforms plan related to specific recommendations given to Montenegro:The labor market is undergoing reform through various interventions in order to remove obstacles to economic growth and development. A special place in the reform measures of the Government in 2016 is given to the active employment policy measures, as well as to encouraging the formalization of informal employment through carefully designed combination of incentives, preventive measures and sanctions. Besides, as previously indicated, activities are underway to improve labor legislation, social dialogue, occupational health and safety, harmonization with European regulations in the area of employment policy and social policy.

4.2.7.2 Education:

Diagnostic: Montenegro restructured its economy in the previous period and as a result certain qualifications were no longer needed, while some new qualifications were high in demand. Data of the Employment Agency of Montenegro shows that there is a structural disbalance between supply and demand, which manifests itself in two main forms: in the market there is demand for labor force with certain qualifications, which are lacking in the market; and in the labor market there is supply of labor force with certain qualifications, but the demand for those. There is also the attitude of employers about the imbalance of skills and knowledge that students acquire in the educational system with those required by the labor market. This period is characterized by the growing interest of students for enrolment in programs that belong to the social sciences and the declining interest for enrolment in programs that are in demand in the labor market. One of the biggest challenges in the labor market in Montenegro is youth unemployment. The share of youth in the total number of unemployed at the end of 2014 stood at 20.87% , which is 0.4% more compared to the same period in 2013 (20:49%). As for the population aged 15-30, the share was 39.7% in 2014 and 39.8% in 2013. Study on labor market needs in the field of higher education, adopted by the Government in 2014, showed that most employers (95%) believe that in Montenegro there is a discrepancy between the number of people with high education in certain occupations and the need for these occupations, while a negligible percentage of employers (4%) believes that the number of people who are educated for certain professions is adequate having in mind the number of vacancies in these occupations.

Existing cooperation between the labor market and educational institutions involves participation in advisory bodies and working groups, without active participation of employers in the organization and realization of practical education for students. Education system lacks relevant labor market information about the need for qualifications, which would eventually result in better connection between the labor market and education, through better educational offer. It is necessary to create conditions for learning by doing, at the workplace, which will enable students to develop the necessary skills and competencies, and allow for the promotion of entrepreneurship.

In 2013, the share of Montenegrin citizens of the age group 25-64 years who participated in lifelong learning programs was 3.10%, which clearly indicates the need for further work on strengthening of lifelong learning, both in terms of promotion as well as practical application, in order to increase the participation of adults in lifelong learning programs. In support of lifelong learning, the educational programs of vocational education should be more modularized and based on learning outcomes, which will allow adults without qualifications, or with qualifications for which there is no demand in the labor market, to obtain a specific professional qualification, to gradually acquire qualifications, while evaluating previously acquired knowledge, thus improving their position in the labor market.

Implementation of specific recommendations: In order to increase the competitiveness of the economy, at the Ministerial meeting in May 2015 Montenegro received a recommendation: "to actively continue educational reform in order to better align education and skills with labor market needs and to strengthen the cooperation between education and the economy". Educational institutions are already reviewing the existing programs, writing learning outcomes, analyzing the structure of studies, all with the aim to improve the quality of education and to develop competitive labor force. Through the work of the sectoral committees and the Qualifications Council, employers are given the possibility to express their needs and contribute to the development of appropriate qualifications in demand in the labor market. Aware of the importance of improving the quality of education and connection with the labor market, through several sets of reform measures, the Government of Montenegro aims to contribute to ensuring a higher degree of harmonization between education and labor market needs. Within one group of measures, The program of professional training of university graduates is implemented as part of one group of measures, as a multi-year program that was developed within the priority reform measure in the 2015 PER. This measure will continue in 2016, and the 2016 budget allocated EUR 8.5 million for this purpose. In the framework of the program for 2016, the right to a nine-month vocational training was acquired by 3,452 users. In addition, the Ministry of Education will, inter alia, through the IPA IV Human Resources Development, Operational Program 2012-2013, provide funds for implementation of other measures that should ensure better harmonization between education and the labor market needs. In accordance with the Law on Higher Education, at least once in five years higher education institutions are obliged to conduct labor market research by surveying graduates, employers' associations, businesses and entrepreneurs on the applicability of acquired knowledge, skills and competencies that are essential to the labor market. Through the activities of the project, labor market research tools will be developed and the research will be undertaken, in order to determine which skills and qualifications are missing in the labor market. An analysis of existing qualifications and programs will also be undertaken. Educational programs will be developed based on the results of these analyses. A very important segment of the project is to improve the capacity of sectoral committees. Working with teachers in all phases of the project will enable the improvement of their knowledge in the area of defining learning outcomes, use of modern methods of teaching and learning in the implementation of the program, checking students' achievements, etc. A special segment is career orientation. After the development of appropriate programs, training of school teams will be conducted to support students in career development.

Within the project "Higher Education and Research for Innovation and Competitiveness", funded from a World Bank loan, the feasibility study for establishment of a career monitoring system for university graduates (Tracer Study) and IT support in career monitoring was developed, through the specially created questionnaire for graduates. The data obtained by surveying graduates will result in a feedback that is very important for the creation of enrolment policy in terms of its better harmonization with the actual needs of the labor market.

Reforms plan related to specific recommendations: The government will continue to implement priority reforms related to the specific EU recommendations in this area, which is also in line with the national priorities of the country, all with the aim to increase competitiveness. In the future it is necessary to: plan an admission policy based on the data regarding the demand in the labor market, improve the quality and efficiency of education relevant to the labor market; provide equal opportunities to achieve a qualification in order to ensure employability and social inclusion, and develop further lifelong learning and mobility, and strengthen the cooperation between educational institutions and employers.

In order to harmonize the enrolment policy with the needs of the labor market it is necessary to strengthen the career guidance and counselling service, starting from primary school; plan the number of admissions through the cooperation between educational institutions, local communities, associations of employers, and relevant ministries. Better forecasting of the demand for skills and qualifications is essential for the education system to respond quickly and appropriately to the needs of individuals from various target groups, employers and the labor market.

In order to further improve the quality of higher education and to ensure better alignment of enrolment policy with the needs of the labor market, the Government Activity Program projects drafting of the Strategy for the development of higher education for the period 2016-2020 in the second quarter of 2016.

For the quality improvements it is of particular importance to strengthen the quality assurance mechanisms through internal and external evaluation of institutions. A significant contribution and inputs for improving the situation in the higher education institutions came from the external evaluation carried out in 2014. The external evaluation of the higher education institutions resulted in individual reports for specific institutions, already available to the public, and an integrated report on the quality of the higher education system in Montenegro.

Reforms plan related to specific recommendations: There is one priority reform measure defined in this field and it relates to the development of *qualifications* based on learning outcomes and in line with the labor market needs.

Priority reform measure no. 17: Development of qualifications based on learning outcomes in accordance with the needs of the labor market

Measure description: Correlation between education and the labor market - faster and more efficient response of the education system to the changing demands of the labor market and creation of conditions for every individual to acquire skills and competences necessary for personal and professional development and employability, represents the target set in all strategic documents in the field of education. Realization of this objective implies involvement of the social partners and the division of responsibilities in the planning, organization and implementation of education. Appropriate educational policy is based on the relevant information on the needs of the labor market and society as a whole. With this in mind, it is necessary to carry out an analysis of existing qualifications, look into the need for modernization in cooperation with the relevant sectoral committees, in order to obtain the required qualifications. New or modified qualifications, defined based on the learning outcomes, need to respond to the recommendations identified through the aforementioned analysis. Based on these outcomes, employers will have good information on the acquired knowledge, skills and competences of the qualification holders. Further capacity building of the sectoral committees and professional development of teachers in schools and higher education institutions will ensure the quality and applicability of the knowledge of those who are obtaining it.

Envisaged timetable for implementation of the measure: Implementation of activities related to the development of qualification and programs based on learning outcomes, as well as capacity building of the human resources are planned to start in January 2016 and to end in July 2017.

Training of sectoral committees on writing learning outcomes will take place in 2016, as well as the analysis of existing and creation/ improvement of the methodology, models and instruments for labor market research, which are necessary to harmonize the supply of different types of qualifications with the labor market needs. The research on the missing skills and qualifications in the labor market will be carried out research, together with the analysis of existing qualifications in the field of vocational

education in order to establish the need for their modernization and/or development of new ones. Efforts will be focused on occupational standards, qualification standards, examination catalogues to test the previously acquired knowledge and curricula. The plan is to finalize the curricula, modularized, assessed in terms of credits, and based on learning outcomes. Their implementation will start in the academic year 2017/2018. Improvement of teachers' competencies will take place continuously during course of the project.

In accordance with the recommendations given in the external review report, higher education institutions are already working on curriculum innovation and the development of learning outcomes for all study programs. The deadline for completion of the learning outcomes at the University is May 2016. Through the planned IPA project, and awaiting the new external evaluation, analysis of the existing programs in the field of higher education will be conducted with an emphasis on programs in science, technology, engineering and mathematics - STEM³¹ project will have a direct impact on teachers and researchers by enabling them to improve their skills in areas relevant to innovation, entrepreneurship, creativity, commercialization of scientific results, and access to the EU funds. The new labor market needs analysis will be conducted in 2016 at all levels of education.

Financial structuring and fiscal implications: Funds in the amount of EUR 1,204,609.40 were provided through IPA IV instrument and will be divided as follows: EUR 804,609.40 for pre-university education and EUR 400,000.00 for university education. The state budget is to allocate 15% of these funds, which is EUR 180,691.42. Apart from the IPA instrument, the aforementioned activities will also be financed from the state budget, funds of the individual institutions and the World Bank loan.

Expected impact of the measure on competitiveness increase: Reform measure will provide for a better link between education and the labor market through decision-making on the needs for qualifications on the basis of relevant information from the labor market, development of qualifications based on learning outcomes, compliance with procedures and quality assurance mechanisms in the process of developing and acquiring qualifications, availability of qualifications and information important for career development, international comparability of qualifications, improvement of teacher knowledge, which will all together contribute to the increase of the labor force competitiveness and greater employability.

4.2.8 Encouraging Social Inclusion, Fight against Poverty and Promotion of Equal Opportunities

Diagnostic: The issue of lack of social inclusion, fight against poverty and insufficient promotion of equal opportunities represents one of the obstacles to the increased competitiveness of the economy. Insufficient promotion of equal opportunities for women and men and failure to address fully the issue of inequality is one of the indicators of the aforementioned. In the area of social protection, special emphasis is given to the development of services. Key obstacles to the development of social and child welfare may be an insufficient number of licensed providers of social services. The existing pension system represents also one of the obstacles to the increase in competitiveness, but that issue is elaborated in chapter 3.

Implementation of specific recommendations to Montenegro: One of the specific recommendations of the European Commission, which partly relates to this chapter is "considering additional reforms to achieve long-term sustainability of the budget, such as the introduction of further restrictions on early retirement and analysis of options for individual participation in the age-pension system on a mandatory basis, as well as the implementation of the common public sector wage policy in the

³¹Science, Technology, Engineering, and Mathematics

context of the rationalization and modernization of the public sector". Legal provisions that temporarily allowed the retirement under more favorable conditions have ceased to be valid in 2015. There was an analysis conducted regarding the financial effects of the special retirement conditions that were in force in the pension system of Montenegro in recent years.

Priority reforms³²: There were no specific EC recommendations in the chapter on social inclusion, poverty reduction and promotion of equal opportunities, except in the area of early retirement (which is analyzed in Chapter III of PER from a fiscal point of view). Further reform of the pension system will include review of the legal conditions that allow for early retirement. Future reforms in this area will be aimed at preventing early exit from the labor market and early retirement. When it comes to other reform priorities, the project "Social Card - Social Welfare Information System" is currently underway, in support of the reform of the social protection system. In phase I the project has achieved its objectives and significantly improved the institutional-organizational, technical-IT and HR capacities of the social welfare centers. The second phase of the project started in 2015 and it will last until the end of 2017. By the end of 2017 the plan is to implement projects that will allow easier access to the labor market for persons with disabilities and members of the RAE population, and these projects are related to the training of employees of the Employment Agency and the social welfare centers, vocational training programs, social inclusion and employment of persons with disabilities.

In addition, the development of social welfare services will remove obstacles to development in this area, relating to the protection of children, adults and the elderly with disabilities and other categories of vulnerable persons. In the future, the priority is the development of social and child protection services at the local level in accordance with the plans of the local self-governments. **The second phase of the project** "Integrated social welfare information system (IISSS), includes the following components: monitoring and further development of Phase I; development of an IT system for social and child welfare institutions; interoperability; capacity building (institutional, technical, HR). Deadline for the implementation of Phase II is September 2017, and the total value of the project is EUR 935,000.00. The social welfare system created the preconditions for the promotion of social inclusion of persons to participate actively in the labor market and in society. Financial assistance from the social welfare system is provided to ensure the existence of persons until they get involved in the labor market. There are ongoing projects for inclusion in the labor market, literacy and training of harder to employ persons. Based on a service contract training will be organized for the employees of the Employment Agency and the social welfare centers, in order to support hard-to-employ persons, primarily persons with disabilities and members of the RAE population. On the basis of the contract on approval of grants, support will be provided for vocational training projects, social inclusion programs and projects for the employment of persons with disabilities.

Priority reforms in the health sector are aimed at increasing the quality of health care and opportunities for citizens to obtain health care in a faster and easier way, as well as to achieve significant financial savings through the increase in efficiency. In order to upgrade the health care system it is necessary to continue with the reform, through the following: the measure of ongoing training of medical personnel at all levels of health care; implementation of measures for redistribution of working hours; rationalization of expenses related to temporary incapacity to work; introduction of more restrictive lists of medicines and inclusion of a higher number of generic drugs; allocation of a certain percentage of concession fees and excise tax for the health system; reduction in hospital capacity, change of their planned use that will contribute to the rational use of hospital

³² Montenegro did not receive specific recommendations in this area at the Ministerial meeting in May 2015. Recommendations in the area of retirement benefits and the pension system are elaborated in chapter 3.

capacity and more efficient hospital care; transfer of technical tasks to the specialized agencies through public-private partnership; continuation of activities in terms of standardization and accreditation of health institutions; further elaboration and establishment of an integrated information system; continuation of activities on the introduction of payment by diagnostic groups - DRG, in order to put emphasis on achieving a higher level of competitiveness in the health system and their improvement of occupational medicine in Montenegro. The health care system of Montenegro developed the so-called health information system (HIS), which is centralized and includes most of the institutions in the public health system in Montenegro, as follows: 18 outpatient facilities, 7 general hospitals, 45 pharmacies within the Public Institution "Montefarm" Pharmacy, Institute for Emergency Medical Services (19 organizational units in municipalities), Institute for Blood Transfusion (with 9 organizational units in municipalities), the Health Insurance Fund (with 21 organizational units in municipalities), the Public Health Institute, the Agency for medications and medical devices, as well as one part of the institutions in the private sector that have a contract with the Fund on the provision of services to the persons insured by this Fund, as follows: 173 dental facilities, 110 private pharmacies.

It is necessary to upgrade the system in terms of introduction of an advanced - flexible reporting system, development of advanced reporting technologies and services, which is important in terms of increasing competitiveness. Implementation of the Strategy will help in overcoming weaknesses in the existing computer and communication infrastructure, and improve the quality of data and the reporting system.

The strategy of an integrated health information system of Montenegro will represent the regulatory framework for further development and functional – IT integration of the entire health system of Montenegro. Implementation of the Strategy of integrated health information system began in July 2015, with completion due by 2018; its financing requires EUR 630,000 in 2016 and EUR 520,000 in 2017. It is expected that the improvement of the health information system will contribute to improving the quality of life of the citizens, and it is also important for the development of the tourism sector, due to an increase in the quality of health care services provided to tourists, and similar.

When it comes to priority reforms in the area of preschool education, the analysis of the number of children by educational groups and limited space/ premises in which to perform educational work based on the curricula, showed that there is a need to build the facilities in Podgorica, in the zones of Stari Aerodrom, Blok VI, Zagoric, as well as in the City Municipality Tuzi, and the municipalities of Bar, Pljevlja and Ulcinj. In these municipalities it is also necessary to reconstruct the existing facilities. The priority of the Government of Montenegro, defined in the strategic documents, is to increase the coverage of children with preschool education and upbringing. The aim is that by 2020, 95 % of children ranging from 3 years old to primary school age is covered by early upbringing and education. Through credit arrangement with the Council of Europe Development Bank, the Government of Montenegro launched the project of building facilities in Pljevlja, Ulcinj, Bar and Podgorica (including Tuzi).

Identification of priority reform measures: Based on the aforementioned, the identified reform measures in this area are as follows:

Project that will allow hard-to-employ people to access more easily the labor market, construction of preschool facilities in order to increase coverage of children with preschool upbringing and education.

Priority reform measure no. 18: Implementation of service contracts and grant schemes in order to improve HR capacities and increase employability, as well as access to the labor market for hard-to-employ persons

Measure description: Reform measure is comprised of two components related to the implementation of service contracts and grant schemes. The aim of the first component is implementation of two service contracts. The first one – “Active labor market measures for employability” will primarily support training of staff in the Ministry of Labor and Social Welfare and the Employment Agency of Montenegro (including local offices of the Agency at the municipal level) in the area of development, assessment, management, monitoring and evaluation of active labor market measures, as well as to prepare project ideas and develop projects at the local level. Under this project there will also be an analysis conducted of the existing situation in the labor market in Montenegro and the needs of employers for qualified labor force, as well as the analysis of the existing active policies and measures in the labor market in Montenegro, and support to the development of a new set of active measures. Finally, attention will be given to the development of new methods of work of the Employment Agency with employers and the unemployed in order to ensure focus (targeting) of active labor market measures and sufficient number of workers with quality training. The other service contract “Cooperation between the Employment Agency of Montenegro and the centers for social work” will include an analysis of the current situation in the area of social inclusion, primarily in the local employment offices and centers for social work, including the analysis of business opportunities and capacity for activation and support to the most vulnerable groups in the labor market; it involves implementation of numerous joint training programs for the local employment offices, centers for social work and representatives of the social partners with the aim to include vulnerable groups in the labor market and to develop a detailed cooperation agreement between the Employment Agency and the centers for social work. This agreement involves also the implementation of an informative campaign for the most vulnerable groups (persons with disability and persons belonging to RAE population) regarding new and advanced methods of work of the Employment Agency and the centers for social work.

The aim of the second component of this reform measure is to implement to grant schemes, that is, to implement the grant contract. The first grant scheme will be aimed at supporting projects that will increase employability of the unemployed, youth and women through education and capacity building programs, and respond to the employers’ needs for labor. Through the grant approval to selected projects the plan is to train minimum 1500 unemployed persons, and employ 25% of the total number of those who participated in the project, i.e. in the training programs, who acquired new skills and knowledge. The second grant scheme will support projects related to professional rehabilitation and employment of persons with disability, as well as literacy programs, training programs for occupations that are acceptable in the labor market and projects for employment of the RAE population.

Envisaged timetable for implementation of the measure: Preparatory activities for implementation of this reform measure were finalized by the end of 2015, while the implementation is supposed to take place in the course of 2016 and 2017, and the details are provided in the table.

Financial structuring and fiscal implications: the amount of EUR 3,612,531.00 is planned for the implementation of this reform measure in the period 2015 - 2017. Out of this amount, co-financing from the state budget will amount to EUR 541,881.07, while the non-budgetary sources of finance, more specifically IPA funds, amount to EUR 3,070,650.80 euro. Financing structure by years is given in table 10 of the Annex.

Expected impact of the measure on competitiveness increase:The impact of this measure on economic development and competitiveness of Montenegro can be viewed from two angles. First, the training of employees in relevant institutions and evaluation of the existing manner of work and policy implementation, thereby strengthening the institutional capacity and improving policies. Second, grant awarding results in direct investment in the employability of the most vulnerable categories and human resource development in general, thus responding to the changes in the labor market, which ultimately leads to the increased levels of productivity. Besides, it is expected that the implementation of this measure will result in the increased participation of the “vulnerable” categories of persons in the labor market, which will further result in the increase of production of goods and services, as well as competitiveness in general.

Priority measure no. 19: Construction of pre-school institutions in order to increase the coverage of children with preschool education and upbringing

Description:In order to ensure development of the overall potential of children of preschool age in Montenegro, through their inclusion in preschool education based on increased, it is necessary, inter alia, to build new kindergartens and reconstruct the existing ones.

Implementation of this measure will take place through the Project “Construction of 7 new preschool institutions and renovation of the existing preschool infrastructure”, financed through the CEB (Council of Europe Development Bank) loan. This project involves construction of four new buildings in the following communities in Podgorica: Stari Aerodrom, Zagoric, Blok VI and in the city municipality of Tuzi, and one new building in each of the following municipalities: Pljevlja, Bar and Ulcinj. There are also plans to reconstruct the existing buildings in Podgorica, Pljevlja and Ulcinj.

Timetable for implementation of the measure: Construction of preschool facilities (kindergartens) in the communities Stari Aerodrom and Zagoric in Podgorica should start in the first quarter of 2016 and it should be finalized in one year. Construction of the building in the communities Stari Aerodrom and Zagoric in Podgorica, and the one in Bar should start in the first quarter of 2016. Construction of the new buildings in the community Block VI in Podgorica and in Pljevlja should begin in the second quarter of 2017. Construction of the buildings in Tuzi and Ulcinj is to begin in the first quarter of 2017. The deadline for completion of all works is twelve months from the commencement of works. Reconstruction of the existing facilities in these municipalities will be carried out in 2017.

Fiscal implications: Framework loan agreement in the amount of EUR 10,000,000.00 (without VAT), which was signed by the State of Montenegro and the Council of Europe Development Bank (CEB), on 6 January 2014, provided the funding to construct seven preschool institutions and reconstruct part of the existing buildings in the territory of Montenegro. Value added tax (VAT) in the amount of EUR 225,000.00 is provided from the state budget. Total funds for implementation of this measure in 2016 amount to EUR 4.89 million, of which 4.8 million euro is the CEB loan and EUR 91,200 is secured from the state budget.

Impact of the measure on competitiveness: Involvement of children in pre-school education has a crucial impact on the development of their abilities, their overall growth, personality development, as well as socio - economic impact on the society as a whole. Investing in early learning has a much greater effect than later investments in life. According to OECD, which conducts the Pisa research, attending pre-school education is connected with the subsequent success of students. Students who have attended pre-school education for more than one year were on average better than students who have not attended it. The difference was 54 points, which corresponds to one and a half year of formal education.

4.3 Summary Overview of Reform Priorities

This sub-chapter provides a brief overview priority reform measures responding to reduction or elimination of diagnosed obstacles to competitiveness and growth in ten reform areas defined by the EC Guidance. Furthermore, the priority reform measures are also proposed based on suggestion from EU documents in the manner which is presented in the following table.

Table 16 Overview of implementation of recommendations or parts of EU recommendations embedded in the priority reform measures of Montenegro

| Title of the priority reform measures in ERP 2016-2018 within reform areas | Specific EU recommendations of the ministerial meeting from May 2015 |
|---|--|
| Area 1: Public Finance Management Priority reform measure No 1: Introduction of the electronic public procurement system | |
| Area 2: Infrastructure | |
| Sub-area 2.1: Transport Priority reform measure No 2: Harmonization of the Transport Development Strategy with the regional Agenda Priority reform measure No 3: Harmonization of the Transport Development Strategy with the regional Agenda Priority measure No 4: Rail network modernization – section Bar-Vrbnica of the railway Bar-Belgrade | Recommendation No 6: Strengthen the transport development strategy ensuring alignment with the regional agenda on connectivity, with a particular focus on the core investment priorities (core network), and establish a credible planning and funding mechanism in the form of a single sector pipeline. |
| Sub-area 2.2: Energy Priority reform measure No 5: Project of connecting energy systems of Montenegro and Italy including the construction of transmission infrastructure within the country and inter-connection with Serbia | |
| Sub-area 2.3 Municipal Utility Infrastructure Priority reform measure No 6: Improving the municipal utility infrastructure | |
| Area 3: Development of Economic Sectors | |
| Sub-area 3 .1: Development of Agricultural Sector Priority reform measure No 7: Support to investments in the primary agricultural production and manufacturing capacities in view of achieving food safety standards | Recommendation No 8: Make further progress with a comprehensive and strategic approach in the field of EU food safety and sanitary and phytosanitary standards to receive accreditation for exporting agricultural and food products to the EU. Efforts in this direction should commence with those products where preparations are advanced and where Montenegro sees the biggest export potential. |
| Sub-area 3.2: Industrial Sector Development Priority reform measure No 8: Incentives to investments in industrial sector with emphasize on manufacturing industry | |
| Sub-area 3.3: Service Sector Development Priority reform measure No 9: Improvement of tourism offer in the North of Montenegro through construction of required infrastructure in ski centers | Recommendation No 3: Implement the planned voluntary financial restructuring program (the so-called "Podgorica approach") to address the high burden of non-performing loans on bank balance sheets from a flow perspective. In order to address the NPL stock issue, improve deadlines and efficiency of contract enforcement. Introduce effective supervision of factoring companies to improve the transparency of the financial system. |
| Area 4: Business Environment, Corporate Governance, and Reduction of Informal Economy Priority measure No 10: Implementation of outstanding recommendations from the Regulatory "Guillotine" Priority measure No 11: Improving the process of issuing construction permits through upgrade of existing ICT solutions Priority reform measure No 12: Cadaster to render decisions in line with deadlines envisaged under the Law on State Surveying and Immovable Property Cadaster Priority reform measure No 13: Introduce issuing of electronic fiscal invoices in order to reduce informal economy Priority reform measure No 14: Improving financial support to the | Recommendation No 7: "Further improve the business environment by ensuring the timely implementation of the so-called "regulatory guillotine" (simplification) project, enhancing the functioning of one-stop shops at municipal level for the issuing of construction permits and the quality of the land registry". Recommendation No 3: Implement the planned voluntary financial restructuring program (the so-called "Podgorica approach") to address the high burden of non-performing loans on bank balance sheets from a flow perspective. In order to address the NPL stock issue, improve deadlines and efficiency of contract enforcement. Introduce effective supervision of factoring companies to improve the transparency of the financial system. |

| | |
|--|---|
| sector of small and medium-sized enterprises | |
| Area 5: Absorption of Technology and Innovation Priority reform measure No 15: Construction of the Innovation-Entrepreneurship Center “Tehnopolis” in Nikšić | |
| Area 6: Trade Integration Priority reform measure No 16: Increasing competitiveness of business organizations through harmonization with the requirements of international quality standards | Recommendation No 8: “Make further progress with a comprehensive and strategic approach in the field of EU food safety and sanitary and phytosanitary standards in order to receive accreditation for exporting agricultural and food products to the EU. Efforts in this direction should commence with those products where preparations are advanced and where Montenegro sees the biggest export potential.” |
| Area 7: Employment and Labor Market Priority reform measure No 17: Development of qualifications based on learning outcomes in accordance with the needs of the labor market | Recommendation No 4: “Amend labor legislation in order to introduce further market flexibility. Reinforce sanctions to discourage undeclared work. Better target active policies for workers at risk of losing their employments and enhance labor market participation in view of an ageing population.” Recommendation No 5: “Actively continue education reform with a view to better aligning education and skills with labor market needs, and strengthening cooperation between education and business.” |
| Area 8: Encouraging Social Inclusion, Fight against Poverty and Promotion of Equal Opportunities Priority reform measure No 18: Implementation of service contracts and grant schemes in order to improve HR capacities and increase employability, as well as access to the labor market for hard-to-employ persons Priority reform measure No 19: Construction of pre-school institutions in order to increase the coverage of children with preschool education and upbringing | |

5 FISCAL IMPLICATIONS OF PRIORITY STRUCTURAL REFORMS

The Table 16 presents an overview of quantified fiscal effects of 19 structural reforms presented in details in sub-chapter 4. In accordance with the EC Guidance, this sub-chapter presents total direct effects of implementation of the priority structural reforms on budgetary revenues and expenditures in 2016, as well as indicative estimates of those effects from implementation of measures in 2017 and 2018. As far as the budgetary expenditures are concerned, the implementation of specific structural reforms is accompanied with certain increase in expenditures, resulting from preparation and implementation of specific reforms. Increase in budgetary expenditures caused by structural reforms/measures is presented in Table 10 of the Annex is marked with sign minus (-) for each priority reform measure, and if the reform is causing an increase in revenues then it is marked with sign plus (+).

Starting from Table No 10 of the Annex, which contains direct fiscal implication for each of the 19 priority structural reforms, the following table (part of this chapter) presents a summary overview of direct effects of all 19 priority reform measures to budgetary expenditures and revenues. This table contains data on total non-budgetary financing of all priority reform measures i.e. financing from loans, EU funds, etc.

As presented in the following table, it is estimated that the net fiscal effect for 2016 of envisaged priority reform measures will be –62.36 million euro. The most sizeable increase in budgetary expenditures in the area of structural reforms will be the cost for construction of the priority highway section Smokovac-Mateševo, and the increase in expenditures for implementation of new economic policy measures in the area of sectoral policies, employment and social inclusion represents a relatively important item.

Structural reforms/measures also have impact on the revenue side of the budget and so most often through increase of revenue, as for example in case of introduction of issuing of electronic fiscal invoices aimed at suppressing the informal economy. Increase of budgetary revenues resulting from structural reforms/measures are indicated in the table with sign plus (+). Since the increase in budgetary expenditures will surpass by far the increase in revenues, it is understandable that Montenegro will record a net negative effect of structural reforms on the budget. Such net negative effect is estimated to amount -62.36 million euro in 2016, - 42.5 million euro in 2017 and – 9.3 million euro in 2018. Finally, it should be emphasized that only direct fiscal effects are taken into account, while indirect effects, i.e. those reflected through impact of increase/reduction of economic activity on some fiscal categories are not covered here.

Aside from direct impact of priority reform measures on revenues and expenditures of the budget, the total non-budgetary financing of measures in 2016 amounts to 370.39 million euro, of which 17.07 million euro is through IPA funds, while the remainder is from loans. Indicative estimate of non-budgetary financing of priority structural reforms in 2017 and 2018 is around 223.04 million euro and 85.52 million euro respectively.

If we were to observe financing from loans as direct budgetary effect, since the loans are recorded as part of the budget, then the net direct impact of structural reforms on the budget would be -415.7 million euro in 2016.

Table 17 Summary of fiscal implications of 19 priority reform measures envisaged in chapter 4 for 2016-2018

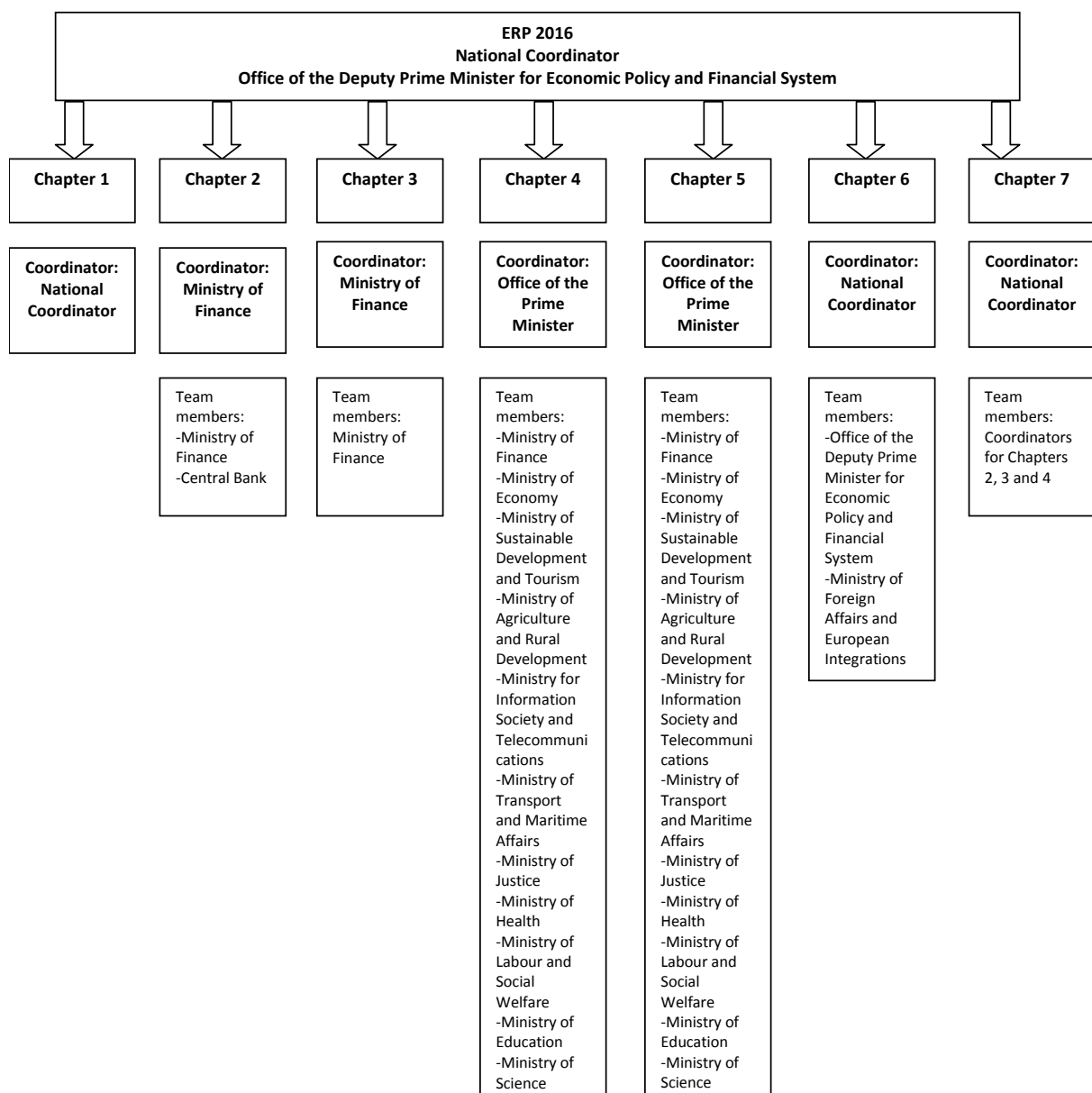
| | 2015 | 2016 | 2017 | 2018 |
|--|------|---------------|-----------------------------|-------------|
| B. Net direct impact on the Budget (if any)(in euro) | | -62,359,580.6 | -42,506,627.9 ³³ | -9,294,750 |
| B.1 Direct impact on budgetary revenues (in euro) | | / | / | +11,000,000 |
| B.2 Direct impact on budgetary expenditures (in euro) | | -62,359,580,6 | -42,506,627,9 | -20,294,750 |
| B.3 Possible non-budgetary financing ³⁴ (in euro) | | 370,388,477 | 223,037,283 | 85,522,250 |
| - B.3.1 of which designed for the IPA financing including WBIF (in euro) | | 17,706,477 | 14,804,783 | 6,066,000 |

³³Estimate of fiscal implications does not include all priority reform measures that will be implemented in 2017 and 2018, thus the data on total impact on budgetary revenues and expenditures could be treated as minimum impact.

³⁴Loans, IPA funds

6 INSTITUTIONAL ISSUES AND STAKEHOLDERS INVOLVEMENT

Process of preparing the Montenegro Economic Reform Program commenced with adoption, by the Government, of the Decision on establishment of the team for preparation of the Economic Reform Program (ERP). By doing so the Government has adopted the Decision establishing the Working team for preparation of the 2016 ERP. The diagram to follow shows the National coordination for ERP, coordination of chapters and institutions which were represented in preparation of the 2016 ERP:



A need for public consultations results not only from the obligation set in the Guidance by the European Commission, but also from the consensus of the Government's bodies that the quality of the document will depend on input of stakeholders to the final document.

First presentation of the 2016 ERP to the public was on 13 December 2015 as part of the regular annual meeting of the high Government officials with businessmen organized by the Chamber of Economy of Montenegro. The Deputy Prime Minister for Economic Policy and Financial System has presented the objectives, focus and instruments of the economic policy for the period 2016-2018, importance of structural reforms for aspiration to increase competitiveness of the Montenegrin economy, and forecast of core macro-economic indicators.

Once completed, the first draft of the 2016 ERP was available on the website of the Government for comments and suggestions in the period 18-24 December. No comments or suggestions were presented as a result of electronic presentation of ERP.

A round table titled the “ERP 2016” was organized as part of the public consultations where the concept and detailed extracts of the document were presented by the National Coordinator and coordinators for chapters 2, 3 and 4. Representatives of the following institutions were invited to take part at the round table by directly emailing invitation with marked link for the complete document:

- Parliament (Committee for economy finance, and budget),
- Central Bank of Montenegro,
- Local self-governments (Union of Municipalities),
- State Audit Institution,
- MONSTAT,
- Trade union organizations (Association of Free Trade Unions),
- Business associations (Chamber of Economy of Montenegro, Union of Employers, Montenegro Business Alliance),
- Civil sector (MANS, Institute Alternativa, Institute for Strategic Studies and Prognosis),
- UNDP,
- Office of the World Bank in Podgorica,
- Association of bankers,
- EU Delegation to Montenegro.

As a result of discussions and presentation of the ERP the comments were presented by representatives of the Chamber of Economy of Montenegro, who have supported structural reforms and measures in line with the improvement of the business environment.

Representative of the Association of Free Trade Unions commented that measures for flexible labor market should be excluded and redirected towards flexi-security.

After public consultation, MERP 2016 was discussed twice at Government Commissions and once at Government session when it was adopted on 21st January 2016. Changes made on request of European Commission (table in Chapter 1) were adopted through changes of Government conclusions on 11 February 2016.

With efforts of the Working team to involve the parliamentary committees, local self-government, civil sector, as well as all relevant associations and international institutions, the result of public discussions about the document expressed support for comprehensiveness and consistency of the 2016 ERP, or lack of basis for critical approach to the content of the most important economic document in the country.

7 SUMMARY DATA

Table 1a: Macroeconomic prospects

| Percentages unless otherwise indicated | ESA Code | Year 2014 | Year 2014 | Year 2015 | Year 2016 | Year 2017 | Year 2018 |
|---|----------|----------------|----------------|--------------|--------------|--------------|--------------|
| | | Level (bn EUR) | Rate of change | | | | |
| 1. Real GDP at market prices | B1*g | 3,316 | 1,8 | 4,3 | 4,1 | 4,0 | 3,0 |
| 2. Current GDP at market prices | B1*g | 3,363 | 2,8 | 5,9 | 5,7 | 6,1 | 5,1 |
| Components of real GDP | | | | | | | |
| 3. Private consumption expenditure | P3 | 2,674 | 2,9 | 2,7 | 1,5 | 2,3 | 1,8 |
| 4. Government consumption expenditure | P3 | 0,680 | 1,4 | 0,0 | 1,0 | 1,5 | 1,5 |
| 5. Gross fixed capital formation | P51 | 0,696 | -2,5 | 13,6 | 18,8 | 5,3 | -1,6 |
| 6. Changes in inventories and net acquisition of valuables (% of GDP) | P52+P53 | : | : | -100,0 | : | : | : |
| 7. Exports of goods and services | P6 | 1,371 | -0,7 | 7,5 | 1,3 | 3,4 | 0,9 |
| 8. Imports of goods and services | P7 | 2,099 | 1,6 | 3,7 | 2,8 | 1,1 | -2,5 |
| Contribution to real GDP growth | | | | | | | |
| 9. Final domestic demand | | 4,0 | 2,1 | 4,7 | 5,3 | 3,3 | 1,2 |
| 10. Change in inventories and net acquisition of valuables | P52+P53 | : | 1,0 | : | : | : | : |
| 11. External balance of goods/services | B11 | -0,7 | -1,3 | 0,8 | -1,2 | 0,7 | 1,8 |

Table 1b: Price developments

| Percentage changes, annual averages | ESA Code | Year | Year | Year | Year | Year |
|---|----------|------|------|------|------|------|
| | | 2014 | 2015 | 2016 | 2017 | 2018 |
| 1. GDP deflator | | 0,2 | 1,5 | 1,5 | 2,0 | 2,0 |
| 2. Private consumption deflator | | -1,0 | 1,5 | 1,5 | 2,0 | 2,0 |
| 3. HICP | | -6,4 | : | : | : | : |
| 4. National CPI change | | -3,3 | 4,6 | 0,0 | 0,5 | 0,0 |
| 5. Public consumption deflator | | 0,9 | 1,5 | 1,5 | 2,0 | 2,0 |
| 6. Investment deflator | | -0,6 | 1,5 | 1,5 | 2,0 | 2,0 |
| 7. Export price deflator (goods & services) | | 0,6 | 1,5 | 1,5 | 2,0 | 2,0 |
| 8. Import price deflator (goods & services) | | -1,1 | 1,5 | 1,5 | 2,0 | 2,0 |

Table 1c: Labour markets developments

| | ESA Code | Year | Year | Year | Year | Year | Year |
|---|----------|-------|----------------------|-------|-------|-------|-------|
| | | 2014 | 2014 | 2015 | 2016 | 2017 | 2018 |
| | | Level | Level/Rate of change | | | | |
| 1. Population (thousands) | | | 622,3 | 623,1 | 623,9 | 624,8 | 625,6 |
| 2. Population (growth rate in %) | | | 0,2 | 0,1 | 0,1 | 0,1 | 0,1 |
| 3. Working-age population (persons)[1] | | | : | : | : | : | : |
| 4. Participation rate | | | : | : | : | : | : |
| 5. Employment, persons [2] | | | 209,5 | 212,0 | 213,9 | 215,7 | 216,7 |
| 6. Employment, hours worked[3] | | | : | : | : | : | : |
| 7. Employment (growth rate in %) | | | 1,2 | 1,2 | 0,9 | 0,8 | 0,5 |
| 8. Public sector employment (persons) | | | : | : | : | : | : |
| 9. Public sector employment (growth in %) | | | : | : | : | : | : |
| 10. Unemployment rate [4] | | | : | : | : | : | : |
| 11. Labour productivity, persons[5] | | 16,3 | 0,1 | 4,0 | 3,2 | 3,2 | 2,5 |
| 12. Labour productivity, hours worked[6] | | | : | : | : | : | : |
| 13. Compensation of employees | D1 | 2,0 | 0,8 | 1,5 | 2,9 | 2,8 | 2,5 |

Table 1d: Sectoral balances

| Percentages of GDP | ESA code | Year | Year | Year | Year | Year |
|--|-----------------|-------|-------|-------|-------|-------|
| | | 2014 | 2015 | 2016 | 2017 | 2018 |
| 1. Net lending/borrowing vis-à-vis the rest of the world | B.9 | : | : | : | : | : |
| <i>of which:</i> | | | | | | |
| - Balance of goods and services | | -20,7 | -20,4 | -19,1 | -18,1 | -17,1 |
| - Balance of primary incomes and transfers | | 20,7 | 20,4 | 19,1 | 18,1 | 17,1 |
| - Capital account | | : | : | : | : | : |
| 2. Net lending/borrowing of the private sector | B.9/ EDP B.9 | : | : | : | : | : |
| 3. Net lending/borrowing of general government | | : | : | : | : | : |
| 4. Statistical discrepancy | | : | : | : | : | : |

Table 1e: GDP, investment and gross value added

| | ESA Code | Year | Year | Year | Year | Year |
|---|----------|-------|------|------|------|------|
| | | 2014 | 2015 | 2016 | 2017 | 2018 |
| GDP and investment | | | | | | |
| GDP level at current market prices (in domestic currency) | B1g | 3,4 | 3,7 | 3,9 | 4,1 | 4,3 |
| Investment ratio (% of GDP) | | 19,2 | 20,7 | 23,6 | 23,9 | 22,9 |
| Growth of Gross Value Added, percentage changes at constant prices | | | | | | |
| 1. Agriculture | | 3,9 | 4,4 | 4,0 | 3,5 | 3,5 |
| 2. Industry (excluding construction) | | 3,6 | 1,1 | 4,8 | 3,4 | 2,0 |
| 3. Construction | | -21,2 | 7,1 | 22,0 | 17,0 | 2,0 |
| 4. Services | | 1,6 | 4,9 | 3,2 | 3,3 | 3,2 |

Table 1f: External sector developments

| Billion Euro unless otherwise indicated | | Year 2014 | Year 2015 | Year 2016 | Year 2017 | Year 2018 |
|--|---------------|--------------|--------------|--------------|--------------|--------------|
| 1. Current account balance(% of GDP) | % of GDP | -17,8 | -18,8 | -19,1 | -17,1 | -15,1 |
| 2. Export of goods | Bn NCU or EUR | 0,4 | 0,3 | 0,4 | 0,4 | 0,4 |
| 3. Import of goods | Bn NCU or EUR | 1,7 | 1,8 | 1,9 | 1,9 | 1,9 |
| 4. Trade balance | Bn NCU or EUR | -1,3 | -1,5 | -1,5 | -1,5 | -1,5 |
| 5. Export of services | Bn NCU or EUR | 1,0 | 1,2 | 1,2 | 1,3 | 1,3 |
| 6. Import of services | Bn NCU or EUR | 0,3 | 0,4 | 0,4 | 0,5 | 0,4 |
| 7. Service balance | Bn NCU or EUR | 0,7 | 0,8 | 0,8 | 0,8 | 0,9 |
| 8. Net interest payments from abroad | Bn NCU or EUR | : | : | : | : | : |
| 9. Other net factor income from abroad | Bn NCU or EUR | : | : | : | : | : |
| 10. Current transfers | Bn NCU or EUR | : | : | : | : | : |
| 11. <i>Of which</i> from EU | Bn NCU or EUR | : | : | : | : | : |
| 12. Current account balance | Bn NCU or EUR | -0,6 | -0,7 | -0,7 | -0,7 | -0,7 |
| 13. Capital and financial account | Bn NCU or EUR | : | : | : | : | : |
| 14. Foreign direct investment | Bn NCU or EUR | : | : | : | : | : |
| 15. Foreign reserves | Bn NCU or EUR | : | : | : | : | : |
| 16. Foreign debt | Bn NCU or EUR | : | : | : | : | : |
| 17. <i>Of which</i> : public | Bn NCU or EUR | : | : | : | : | : |
| 18. <i>O/w</i> : foreign currency denominated | Bn NCU or EUR | : | : | : | : | : |
| 19. <i>O/w</i> : repayments due | Bn NCU or EUR | : | : | : | : | : |
| 20. Exchange rate vis-à-vis EUR (end-year) | NCU/EUR | 1,0 | 1,0 | 1,0 | 1,0 | 1,0 |
| 21. Exchange rate vis-à-vis EUR (annual average) | NCU/EUR | 1,0 | 1,0 | 1,0 | 1,0 | 1,0 |

Table 1g: Sustainability indicators

| | Dimension | Year 2011 | Year 2012 | Year 2013 | Year 2014 | Year 2015 |
|--|-----------|--------------|--------------|--------------|--------------|--------------|
| 1. Current Account Balance | % of GDP | -17,7 | -18,4 | -19,2 | -17,8 | -18,8 |
| 2. Net International Investment Position | % of GDP | : | : | : | : | : |
| 3. Export market shares | %, yoy | : | : | : | : | : |
| 4. Real Effective Exchange Rate [1] | %, yoy | 3,1 | 3,2 | 1,2 | 3,7 | 2,0 |
| 5. Nominal Unit Labour Costs | %, yoy | -5,2 | 4,9 | -1,1 | 0,1 | -4,1 |
| 6. Private sector credit flow | % of GDP | : | : | : | : | : |
| 7. Private sector debt | % of GDP | : | : | : | : | : |
| 8. General Government Debt | % of GDP | : | : | : | : | : |

Table 2b: General government budgetary prospects

MONTENEGRO

| | ESA code | Year | Year | Year | Year | Year |
|--|---------------------------|---------|---------|---------|---------|---------|
| | | 2014 | 2015 | 2016 | 2017 | 2018 |
| bn NCU | | | | | | |
| Net lending (B9) by sub-sectors | | | | | | |
| 1. General government | S13 | -107.5 | -239.7 | -235.3 | -251.0 | -120.8 |
| 2. Central government | S1311 | 1460.8 | 1618.6 | 1732.4 | 1755.8 | 1660.8 |
| 3. State government | S1312 | : | : | : | : | : |
| 4. Local government | S1313 | 196.5 | 153.5 | 160.4 | 164.7 | 168.0 |
| 5. Social security funds | S1314 | : | : | : | : | : |
| General government (S13) | | | | | | |
| 6. Total revenue | TR | 1549.8 | 1,532.4 | 1,657.5 | 1,669.5 | 1,708.0 |
| 7. Total expenditure[1] | TE | 1,657.3 | 1,772.1 | 1,892.8 | 1,920.5 | 1,828.8 |
| 8. Net borrowing/lending | EDP.B9 | -107.5 | -239.7 | -235.3 | -251.0 | -120.8 |
| 9. Interest expenditure | EDP.D41 incl. FISIM | 78.9 | 81.9 | 80.6 | 100.7 | 100.9 |
| 10. Primary balance[2] | | -28.6 | -157.8 | -154.7 | -150.3 | -20.0 |
| 11. One-off and other temporary measures [3] | | : | : | : | : | : |
| Components of revenues | | | | | | |
| 12. Total taxes (12 = 12a+12b+12c) | | 873.0 | 842.0 | 888.8 | 930.1 | 956.8 |
| 12a. Taxes on production and imports | D2 | 676.3 | 654.2 | 694.2 | 728.1 | 749.5 |
| 12b. Current taxes on income and wealth | D5 | 181.8 | 171.8 | 178.3 | 185.4 | 190.3 |
| 12c. Capital taxes | D91 | 14.9 | 16.0 | 16.3 | 16.6 | 17.0 |
| 13. Social contributions | D61 | 444.3 | 455.4 | 483.2 | 489.1 | 501.4 |
| 14. Property income | D4 | 71.1 | 72.0 | 73.9 | 74.9 | 76.4 |
| 15. Other (15 = 16-(12+13+14)) [4] | | 161.4 | 163.0 | 211.6 | 175.4 | 173.4 |
| 16 = 6. Total revenue | TR | 1549.8 | 1532.4 | 1657.5 | 1669.5 | 1708.0 |
| p.m.: Tax burden (D2+D5+D61+D91-D995) [5] | | 1,317.3 | 1,297.4 | 1,372.0 | 1,419.2 | 1,458.2 |
| Selected components of expenditures | | | | | | |
| 16. Collective consumption | P32 | : | : | : | : | : |
| 17. Total social transfers | D62 + D63 | 492.8 | 499.8 | 534.4 | 544.9 | 560.3 |
| 17a. Social transfers in kind | P31 = D63 | : | : | : | : | : |
| 17b. Social transfers other than in kind | D62 | 492.8 | 499.8 | 534.4 | 544.9 | 560.3 |
| 18 = 9. Interest expenditure (incl. FISIM) | EDP.D41 + FISIM | 78.9 | 81.9 | 80.6 | 100.7 | 100.9 |
| 19. Subsidies | D3 | 18.8 | 22.0 | 21.0 | 21.5 | 21.5 |
| 20. Gross fixed capital formation | P51 | 183.4 | 306.0 | 420.0 | 417.1 | 304.6 |
| 21. Other (21 = 22-(16+17+18+19+20)) [6] | | 883.4 | 862.4 | 836.8 | 836.3 | 841.5 |
| 22. Total expenditures | TE [1] | 1657.3 | 1772.1 | 1892.8 | 1920.5 | 1828.8 |
| p.m. compensation of employees | D1 | : | : | : | : | : |

Table 5: Cyclical developments

| % of GDP | ESA Code | Year 2014 | Year 2015 | Year 2016 | Year 2017 | Year 2018 |
|--|----------|--------------|--------------|--------------|--------------|--------------|
| 1. Real GDP growth (% , yoy) | B1g | 1,8 | 4,3 | 4,1 | 4,0 | 3,0 |
| 2. Net lending of general government | EDP.B.9 | : | : | : | : | : |
| 3. Interest expenditure | EDP.D.41 | : | : | : | : | : |
| 4. One-off and other temporary measures [1] | | : | : | : | : | : |
| 5. Potential GDP growth (% , yoy) | | : | 2,2 | 3,1 | 3,2 | 3,2 |
| Contributions: | | | | | | |
| - labour | | : | : | : | : | : |
| - capital | | : | : | : | : | : |
| - total factor productivity | | : | : | : | : | : |
| 6. Output gap | | : | -1,5 | -0,4 | 0,5 | 1,2 |
| 7. Cyclical budgetary component | | : | 2,0 | -5,3 | -4,9 | -5,4 |
| 8. Cyclically-adjusted balance (2-7) | | : | | | | |
| 9. Cyclically-adjusted primary balance (8+3) | | : | : | : | : | : |
| 10. Structural balance (8-4) | | : | : | : | : | : |

Table 6: Divergence from previous programme

| | Year 2014 | Year 2015 | Year 2016 | Year 2017 | Year 2018 |
|---|--------------|--------------|--------------|--------------|--------------|
| 1. GDP growth (% , yoy) | | | | | |
| Previous programme | 2,0 | 3,5 | 3,8 | 4,0 | 4,0 |
| Latest update | 1,8 | 4,3 | 4,1 | 4,0 | 3,0 |
| Difference (percentage points) | -0,2 | 0,8 | 0,3 | 0,0 | -1,0 |
| 2. General government net lending (% of GDP) | | | | | |
| Previous programme | : | : | : | : | : |
| Latest update | : | : | : | : | : |
| Difference | : | : | : | : | : |
| 3. General government gross debt (% of GDP) | | | | | |
| Previous programme | : | : | : | : | : |
| Latest update | : | : | : | : | : |
| Difference | : | : | : | : | : |

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

| | | Year | Year | Year | Year | Year |
|------------------------------------|----------------|------|-------|-------|-------|------|
| | Dimension | 2014 | 2015 | 2016 | 2017 | 2018 |
| Short-term interest rate | Annual average | 0,3 | 0 | -0,2 | -0,2 | : |
| Long-term interest rate | Annual average | 1,6 | 0,5 | 0,7 | 0,9 | : |
| USD/EUR exchange rate | Annual average | 1,33 | 1,12 | 1,12 | 1,12 | 1,16 |
| Nominal effective exchange rate | Annual average | 98,4 | 101,5 | 101,8 | 102,3 | : |
| Exchange rate vis-à-vis the EUR | Annual average | 1 | 1 | 1 | 1 | 1 |
| Global GDP growth, excluding EU | Annual average | 3,7 | 3,3 | 3,9 | 4,2 | : |
| EU GDP growth | Annual average | 1,4 | 1,9 | 2 | 2,1 | : |
| Growth of relevant foreign markets | Annual average | -0,5 | -0,3 | 0,7 | 1,7 | : |
| World import volumes, excluding EU | Annual average | 2,9 | 1 | 3,6 | 4,8 | : |
| Oil prices (Brent, USD/barrel) | Annual average | 99,7 | 54,8 | 54,2 | 58,8 | : |

Table 10: Matrix of commitments under a policy

| Policy description | 2015 | 2016 | 2017 | 2018 |
|--|--|----------------|----------------|----------------|
| <i>Priority reform measure No 1: Introduction of the electronic public procurement system</i> | | | | |
| A. Reform duration* | x | X | X | x |
| B. Net direct impact on the budget (if any) (in euro) | -57,000 | -60,000 | -100,000 | -65,000 |
| B.1 Direct impact on the budgetary revenue (in euro) | | | | |
| B.2 Direct impact on the budgetary expenditures (in euro) | -57,000 | -60,000 | -100,000 | -65,000 |
| B.3 Possible non-budgetary financing (in euro) | | | 909,000 | 591,000 |
| - B.3.1 of which allocated financing from IPA, including WBIF (in euro) | | | 909,000 | 591,000 |
| <i>Priority reform measure No 2: Harmonisation of the Transport Development Strategy with the regional Agenda</i> | | | | |
| A. Reform duration* | | | | |
| B. Net direct impact on the budget (if any) (in euro) | | | | |
| B.1 Direct impact on the budgetary revenue (in euro) | | | | |
| B.2 Direct impact on the budgetary expenditures (in euro) | | | | |
| B.3 Possible non-budgetary financing (in euro) | | 300,000 | | |
| - B.3.1 of which allocated financing from IPA, including WBIF (in euro) | | | | |
| <i>Priority reform measure No 3: Harmonisation of the Transport Development Strategy with the regional Agenda</i> | | | | |
| A. Reform duration* | X | X | x | x |
| B. Net direct impact on the budget (if any) (in euro) | -36,000,000.00 | -43,542,000.00 | -42,080,750.00 | -20,210,750.00 |
| B.1 Direct impact on the budgetary revenue (in euro) | In the observed period, being the Project implementation period, the observed measure cannot have direct impact on budgetary revenues. This impact will take place in the period of exploitation, after it is implemented. | | | |
| B.2 Direct impact on the budgetary expenditures (in euro) | -36,000,000.00 | -43,542,000.00 | -42,080,750.00 | -20,210,750.00 |
| B.3 Possible non-budgetary financing (in euro) | 170,000,000.00 | 204,000,000.00 | 201,386,300.00 | 77,456,250.00 |

| | | | | |
|---|-------------------------|---------------|---------------|--------------|
| - B.3.1 of which allocated financing from IPA, including WBIF (in euro) | | | | |
| <i>Priority measure No 4: Rail network modernisation – section Bar-Vrbnica of the railway Bar-Belgrade³⁵</i> | | | | |
| A. Reform duration* | X | X | X | x |
| B. Net direct impact on the budget (if any) (in euro) | | | | |
| B.1 Direct impact on the budgetary revenue (in euro) | | | | |
| B.2 Direct impact on the budgetary expenditures (in euro) | | | | |
| B.3 Possible non-budgetary financing (in euro) | | 14,100,500,00 | 15,244,700.00 | 9,275,000.00 |
| - B.3.1 of which allocated financing from IPA, including WBIF (in euro) | | 6,258,500.00 | 8,398,500.00 | 5,475,000.00 |
| <i>Priority reform measure No 5: Project of connecting energy systems of Montenegro and Italy including the construction of transmission infrastructure within the country and inter-connection with Serbia³⁶</i> | | | | |
| A. Reform duration* | X | X | X | |
| B. Net direct impact on the budget (if any) (in euro) | | | | |
| B.1 Direct impact on the budgetary revenue (in euro) | | | | |
| B.2 Direct impact on the budgetary expenditures (in euro) | -40,000,000 (guarantee) | | | |
| B.3 Possible non-budgetary financing (in euro) | 25,000,000 | | | |
| - B.3.1 of which allocated financing from IPA, including WBIF (in euro) | 25,000,000 | | | |
| <i>Priority reform measure No 6: Construction of utility infrastructure on the Montenegrin Coast and the Historical Capital Cetinje</i> | | | | |
| Construction of the sewerage network for the Historical Capital Cetinje | | | | |
| A. Reform duration* | x | x | | |
| B. Net direct impact on the budget (if any) (in euro) | | -2,332,000 | | |
| B.1 Direct impact on the budgetary revenue (in euro) | | | | |
| B.2 Direct impact on the budgetary expenditures (in euro) | | -2,332,000 | | |

³⁵ Total contracted value (or value that is yet to be contracted) for implementation of all projects under this priority reform measure in the period 2015-2018, is 47.016 million euro of which 38.62 million euro is for the period 2016-2018.

³⁶ All loans for this project were secured in 2013, 60 million from EBRD and 25 million from KfW. The state guarantees will be issued for the entire amount for both loans, and so as follows: in 2013 – 25 mil, 2014-20mil, 2015-40mil. The only remaining for 2015 is a guarantee of 40 million euro. The only burden in that year is exactly that guarantee of 40 million euro. Moreover, in the observed the only thing that could be presented is the expected grant of 25 million from WBIF. No other sources of financing cannot be stated for this period.

| | | | | |
|---|------------|--|---|---|
| B.3 Possible non-budgetary financing (in euro) | | 6,010,000 | | |
| - B.3.1 of which allocated financing from IPA, including WBIF (in euro) | | 340,000 (271,000 euro IPA 2011, 69,000 euro IPF MW) | | |
| <i>Priority reform measure No 7: Support to investments in the primary agricultural production and manufacturing capacities in view of achieving food safety standards</i> | | | | |
| A. Reform duration* | X | X | X | X |
| B. Net direct impact on the budget (if any) (in euro) | - | -5,900,000 | - | - |
| B.1 Direct impact on the budgetary revenue (in euro) | - | - | - | - |
| B.2 Direct impact on the budgetary expenditures (in euro) | | -5,900,000 | | |
| B.3 Possible non-budgetary financing (in euro) | | 8,500,000 | | |
| - B.3.1 of which allocated financing from IPA, including WBIF (in euro) | | 8,500,000 | | |
| <i>Priority reform measure No 8: Incentives to investments in industrial sector with emphasise on manufacturing industry</i> | | | | |
| A. Reform duration* | x | x | X | x |
| B. Net direct impact on the budget (if any) (in euro) | | -620,000 | | |
| B.1 Direct impact on the budgetary revenue (in euro) | | | | |
| B.2 Direct impact on the budgetary expenditures (in euro) | | -620,000 | | |
| B.3 Possible non-budgetary financing (in euro) | | | | |
| - B.3.1 of which allocated financing from IPA, including WBIF (in euro) | | | | |
| <i>Priority reform measure No 9: Improvement of tourism offer in the North of Montenegro through construction of required infrastructure in ski centres</i> | | | | |
| A. Reform duration* | X | X | X | X |
| B. Net direct impact on the budget (if any) (in euro) | -4,255,822 | -7,749,500 | | |
| B.1 Direct impact on the budgetary revenue (in euro) | | | | |
| B.2 Direct impact on the budgetary expenditures (in euro) | -4,255,822 | -7,749,500 | | |
| B.3 Possible non-budgetary financing (in euro) | | | | |

| | | | | |
|---|---|----------|---|---|
| - B.3.1 of which allocated financing from IPA, including WBIF (in euro) | | | | |
| <u>Priority measure No 10: Implementation of outstanding recommendations from the Regulatory Guillotine</u> | | | | |
| A. Reform duration* | X | X | X | X |
| B. Net direct impact on the budget (if any) (in euro) | 0 | 0 | 0 | 0 |
| B.1 Direct impact on the budgetary revenue (in euro) | 0 | 0 | 0 | 0 |
| B.2 Direct impact on the budgetary expenditures (in euro) | 0 | 0 | 0 | 0 |
| B.3 Possible non-budgetary financing (in euro) | 0 | 0 | 0 | 0 |
| - B.3.1 of which allocated financing from IPA, including WBIF (in euro) | | | | |
| <u>Priority measure No 11: Improving the process of issuing construction permits through upgrade of existing ICT solutions</u> | | | | |
| A. Reform duration* | | X | X | |
| B. Net direct impact on the budget (if any) (in euro) | | -150,000 | | |
| B.1 Direct impact on the budgetary revenue (in euro) | | | | |
| B.2 Direct impact on the budgetary expenditures (in euro) | | -150,000 | | |
| B.3 Possible non-budgetary financing (in euro) | | | | |
| - B.3.1 of which allocated financing from IPA, including WBIF (in euro) | | | | |
| <u>Priority reform measure No 12: Cadastre to render decisions in line with deadlines envisaged under the Law on State Surveying and Immovable Property Cadastre</u> | | | | |
| A. Reform duration* | x | x | x | x |
| B. Net direct impact on the budget (if any) (in euro) | 0 | 0 | 0 | 0 |
| B.1 Direct impact on the budgetary revenue (in euro) | 0 | 0 | 0 | 0 |
| B.2 Direct impact on the budgetary expenditures (in euro) | 0 | 0 | 0 | 0 |
| B.3 Possible non-budgetary financing (in euro) | 0 | 0 | 0 | 0 |
| - B.3.1 of which allocated financing from IPA, including WBIF (in euro) | | | | |
| <u>Priority reform measure No 13: Introduce issuing of electronic fiscal invoices in order to reduce informal economy</u> | | | | |

| | | | | |
|--|-------------|---------------------------|---|--------------|
| A. Reform duration* | | x | x | x |
| B. Net direct impact on the budget (if any) (in euro) | | - 500,000 | | + 11,000,000 |
| B.1 Direct impact on the budgetary revenue (in euro) | | | | + 11,000,000 |
| B.2 Direct impact on the budgetary expenditures (in euro) | | - 500,000 | | |
| B.3 Possible non-budgetary financing (in euro) | | | | |
| - B.3.1 of which allocated financing from IPA, including WBIF (in euro) | | | | |
| <i>Priority reform measure No 14: Improving financial support to the sector of small and medium-sized enterprises</i> | | | | |
| A. Reform duration* | x | x | x | x |
| B. Net direct impact on the budget (if any) (in euro) | | | | |
| B.1 Direct impact on the budgetary revenue (in euro) | | | | |
| B.2 Direct impact on the budgetary expenditures (in euro) | | | | |
| B.3 Possible non-budgetary financing (in euro) | 115,580,000 | 130,000,000 ³⁷ | | |
| - B.3.1 of which allocated financing from IPA, including WBIF (in euro) | | | | |
| <i>Priority reform measure No 15: Construction of the Innovation-Entrepreneurship Center "Tehnopolis" in Nikšić</i> | | | | |
| A. Reform duration* | x | x | x | x |
| B. Net direct impact on the budget (if any) (in euro) | -163,620 | -872,186 | | |
| B.1 Direct impact on the budgetary revenue (in euro) | | | | |
| B.2 Direct impact on the budgetary expenditures (in euro) | -163,620 | -872,186 | | |
| B.3 Possible non-budgetary financing (in euro) | | 70,000 | | 1,000,000 |
| - B.3.1 of which allocated financing from IPA, including WBIF (in euro) | | | | |
| <i>Priority reform measure No 16: Increasing competitiveness of business organisations through harmonisation with the requirements of international quality standards</i> | | | | |
| A. Reform duration* | x | x | | |

³⁷Planned 30 mil euro for CKB COSME facility for 3 years

| | | | | |
|---|------------|--------------|-------------|------------|
| B. Net direct impact on the budget (if any) (in euro) | -81,900 | -100,000 | | |
| B.1 Direct impact on the budgetary revenue (in euro) | | | | |
| B.2 Direct impact on the budgetary expenditures (in euro) | -81,900 | -100,000 | | |
| B.3 Possible non-budgetary financing (in euro) | | | | |
| - B.3.1 of which allocated financing from IPA, including WBIF (in euro) | | | | |
| <i>Priority reform measure No 17: Development of qualifications based on learning outcomes in accordance with the needs of the labour market</i> | | | | |
| A. Reform duration* | | x | x | |
| B. Net direct impact on the budget (if any) (in euro) | | - 99,380.28 | -81,311.14 | |
| B.1 Direct impact on the budgetary revenue (in euro) | | | | |
| B.2 Direct impact on the budgetary expenditures (in euro) | | - 99,380.28 | -81,311.14 | |
| B.3 Possible non-budgetary financing (in euro) | | | | |
| - B.3.1 of which allocated financing from IPA, including WBIF (in euro) | | 662,535.17 | 542,074.23 | |
| <i>Priority measure No 18: Implementation of service contracts and grant schemes in order to improve HR capacities and increase employability, as well as access to the labour market for hard-to-employ persons</i> | | | | |
| A. Reform duration* | X | x | X | |
| B. Net direct impact on the budget (if any) (in euro) | -30,000.12 | -343,314.31 | -168,566.76 | |
| B.1 Direct impact on the budgetary revenue (in euro) | | | | |
| B.2 Direct impact on the budgetary expenditures (in euro) | -30,000.12 | -343,314.31 | -168,566.76 | |
| B.3 Possible non-budgetary financing (in euro) | 169,999.88 | 1,945,442.14 | 955,208.78 | |
| - B.3.1 of which allocated financing from IPA, including WBIF (in euro) | 169,999.88 | 1,945,442.14 | 955,208.78 | |
| <i>Priority measure No 19: Construction of pre-school institutions in order to increase the coverage of children with preschool education and upbringing</i> | | | | |
| A. Reform duration* | | | | |
| B. Net direct impact on the budget (if any) (in euro) | -38,000.00 | -91,200.00 | -76,000.00 | -19,000.00 |
| B.1 Direct impact on the budgetary revenue (in euro) | | | | |

| | | | | |
|---|------------|---------------|-----------------------------|--------------|
| B.2 Direct impact on the budgetary expenditures (in euro) | -38,000.00 | -91,200.00 | -76,000.00 | -19,000.00 |
| B.3 Possible non-budgetary financing (in euro) | 200,000.00 | 4,800,000.00 | 4,000,000.00 | 1,000,000.00 |
| - B.3.1 of which allocated financing from IPA, including WBIF (in euro) | | | | |
| <i>Total net budgetary impact</i> | | | | |
| Total impact on budgetary revenues | | / | / | +11,000,000 |
| Total impact on budgetary expenditures (in euro) | | -62,359,580,6 | -42,506,627,9 ³⁸ | -20,294,750 |

³⁸ Fiscal implications estimate does not include all priority reform measures that will be implemented in 2017 and 2018, thus the data on total impact on budgetary revenues and expenditures could be deemed as minimum impact.

Table 11: Timetable of structural reform measures

Priority reform measure No 1: Introduction of the electronic public procurement system

| Q1 2016 | Q2 2016 | Q3 2016 | Q4 2016 |
|--|--------------------|--------------------|--|
| Initiating tender procedure | Tender procedure | Tender procedure | <ul style="list-style-type: none"> • Contract • Start of the Project implementation |
| Q1 2017 | Q2 2017 | Q3 2017 | Q4 2017 |
| System development | System development | System development | Training for the use of the system for employees of the Public Procurement Administration and making operational fully functioning prototype of the system |
| Q1 2018 | Q2 2018 | Q3 2018 | Q4 2018 |
| Start of using the system Training for use of electronic system for contracting authorities and bidders | Training continued | Training continued | Training continued |

Priority reform measure No 2: Harmonisation of the Transport Development Strategy with the regional Agenda

| Q1 2016 | Q2 2016 | Q3 2016 | Q4 2016 |
|--------------------------------------|----------------------------------|----------------------------------|----------------------------------|
| Securing funds to amend the Strategy | Activities to amend the Strategy | Activities to amend the Strategy | Activities to amend the Strategy |
| Q1 2017 | Q2 2017 | Q3 2017 | Q4 2017 |
| | | | |
| Q1 2018 | Q2 2018 | Q3 2018 | Q4 2018 |
| | | | |

Priority reform measure No 3: Harmonisation of the Transport Development Strategy with the regional Agenda

| Q1 2016 | Q2 2016 | Q3 2016 | Q4 2016 |
|---------|---------|---------|---------|
| X | X | X | X |
| Q1 2017 | Q2 2017 | Q3 2017 | Q4 2017 |
| X | X | X | X |
| Q1 2018 | Q2 2018 | Q3 2018 | Q4 2018 |
| X | X | X | X |

Priority reform measure No 4: Rail network modernisation – section Bar-Vrbnica of the railway Bar-Belgrade

| Q1 2016 | Q2 2016 | Q3 2016 | Q4 2016 |
|---------|---------|---------|---------|
| X | X | X | X |
| Q1 2017 | Q2 2017 | Q3 2017 | Q4 2017 |
| X | X | X | X |
| Q1 2018 | Q2 2018 | Q3 2018 | Q4 2018 |
| X | X | X | X |

Priority reform measure No 5: Project of connecting energy systems of Montenegro and Italy including the construction of transmission infrastructure within the country and inter-connection with Serbia

| Q1 2016 | Q2 2016 | Q3 2016 | Q4 2016 |
|---|---|--|--|
| Execution of works for: <ul style="list-style-type: none"> • Substation 400/110/35 kV Lastva – 3,500,000 e • 400 kV overhead power line Lastva-Pljevlja, section Lastva-Čevo - 3,000,000e • 400 kV overhead power line Lastva-Pljevlja, section Čevo-Pljevlja – 1,000,000e • preparatory activities for segment of interconnection with Serbia, | Execution of works for: <ul style="list-style-type: none"> • Substation 400/110/35 kV Lastva – 7,300,000 e • 400 kV overhead power line Lastva-Pljevlja, section Lastva-Čevo – 4,000,000 e • 400 kV overhead power line Lastva-Pljevlja, section Čevo-Pljevlja – 5,400,000 e • preparatory activities for segment of interconnection with Serbia, | Execution of works for: <ul style="list-style-type: none"> • Substation 400/110/35 kV Lastva – 1,500,000 e • 400kV overhead power line Lastva-Pljevlja, section Lastva-Čevo – 3,000,000e • 400 kV overhead power line Lastva-Pljevlja, section Čevo-Pljevlja – 5,000,000e • preparatory activities for segment of interconnection with Serbia, | Execution of works for: <ul style="list-style-type: none"> • Substation 400/110/35 kV Lastva – 1,420,000 e • 400kV overhead power line Lastva-Pljevlja, section Lastva-Čevo – 1,840,000e • 400 kV overhead power line Lastva-Pljevlja, section Čevo-Pljevlja – 5,000,000e • preparatory activities for segment of interconnection with Serbia, |
| Q1 2017 | Q2 2017 | Q3 2017 | Q4 2017 |
| Works completed for all infrastructure facilities * Time schedule for execution of works for interconnection with Serbia will be subject of an agreement with the Transmission System Operator of the Republic of Serbia and is still not agreed | | | |
| Q1 2018 | Q2 2018 | Q3 2018 | Q4 2018 |
| | | | |

Priority reform measure No 6: Improving the municipal utility infrastructure

| Q1 2016 | Q2 2016 | Q3 2016 | Q4 2016 |
|--|--|--|---------|
| <ul style="list-style-type: none"> • Completion of access road and electricity supply for Facilities for treatment of waste waters in Kotor and Tivat • Completion of works is expected for laying of coastal sewerage collector in Bijela, Đenovići, Zelenika and Meljine, total length of 1300m, distribution water supply system in these settlements – length 900m, as well as laying of discharge pipeline for pumping stations – length 550m. Furthermore, construction of the pumping station Đenovići is planned, as well as completion of works for 6 pumping stations. Handover and putting into operation is planned at the beginning of year for the priority section from Forte Mare to the Facilities for treatment of wastewaters. • Completion of works for both segments of the sewerage network in the Historical Capital Cetinje is planned. | <ul style="list-style-type: none"> • Wet and dry tests are planned for Facilities for treatment of waste waters in Kotor Tivat • Completion of works is expected for testing of pipelines, completion of works for assembling of electrical equipment and machinery in the pumping station, their testing and putting into operation. Completion of asphalt paving of streets and promenade on the Riviera is expected, as well as of remaining part or approx 150m of the 5 Danica promenade. Stone slabs are planned to be put back and repaved with slabs for the 5 Danica promenade from Forte Mare to Savine. Handover and putting into operation is planned before tourism season for the new sewerage system. | <ul style="list-style-type: none"> • Planned putting into operation of Facilities for treatment of waste waters Kotor/Tivat | |
| Q1 2017 | Q2 2017 | Q3 2017 | Q4 2017 |
| | | | |
| Q1 2018 | Q2 2018 | Q3 2018 | Q4 2018 |
| | | | |

Priority reform measure No 7: Support to investments in the primary agricultural production and manufacturing capacities in view of achieving food safety standards

| Q1 2016 | Q2 2016 | Q3 2016 | Q4 2016 |
|--|--|-----------------------------------|--|
| Announcing public call, IPARD LIKE II, Agro-budget measure | Signing contracts with users of IPARD LIKE II, | Implementation, | Implementation, Issuing public call for PARD measure 1 |
| Q1 2017 | Q2 2017 | Q3 2017 | Q4 2017 |
| Implementation of IPARD measure 1 | Implementation of IPARD measure 1 | Implementation of IPARD measure 1 | Implementation of IPARD measure 1 |
| Q1 2018 | Q2 2018 | Q3 2018 | Q4 2018 |
| Not available | Not available | Not available | Not available |

Priority reform measure No 8: Incentives to investments in industrial sector with emphasise on manufacturing industry

| Q1 2016 | Q2 2016 | Q3 2016 | Q4 2016 |
|--|---|---|---|
| - Announcing public call - Pay-out of the first instalment to users of subsidies from the first public call | - Procedure for evaluating validity of received applications - contracts signing | - Pay-out of the first instalment to users of subsidies from the second public call | Preparation of documentation for announcing new public call |
| Q1 2017 | Q2 2017 | Q3 2017 | Q4 2017 |
| n/a | n/a | n/a | n/a |
| Q1 2018 | Q2 2018 | Q3 2018 | Q4 2018 |
| n/a | n/a | n/a | n/a |

Priority reform measure No 9: Improvement of tourism offer in the North of Montenegro through construction of required infrastructure in ski centres

| Q1 2016 | Q2 2016 | Q3 2016 | Q4 2016 |
|---|---|--|---|
| <p>Kolašin 1650 and Cmiljača construction of electricity supply, telecommunication, and hydro technical infrastructure, access road with parking, base station and ski lift.</p> <p>Savin kuk – deigns and construction of new ski slopes, as well as development of project documentation for road reconstruction and construction of the parking lot.</p> <p>Žarski i Hajla - planned activities include preparing a competition, conceptual design, studies, main designs and execution or works for access road Mojkovac-Vragodo-Vrioca-Žarski katun, base station, water supply and electricity supply infrastructure.</p> <p>Reservoir lake in Vučje – resolving outstanding issues with the Nikšić Municipality;</p> | <p>Kolašin 1650 and Cmiljača construction of electricity supply, telecommunication, and hydro technical infrastructure, access road with parking, base station and ski lift;</p> <p>Savin kuk – deigns and construction of new ski slopes, as well as development of project documentation for road reconstruction and construction of the parking lot;</p> <p>Žarski i HAjla - planned activities include preparing a competition, conceptual design, studies, main designs and execution or works for access roads, base station, water supply and electricity supply infrastructure.</p> <p>Commencing activities in Vučje</p> | <p>Kolašin 1650 and Cmiljača construction of electricity supply, telecommunication, and hydro technical infrastructure, access road with parking, base station and ski lift;</p> <p>Savin kuk – deigns and construction of new ski slopes, as well as development of project documentation for road reconstruction and construction of the parking lot</p> <p>Žarski i Hajla - planned activities include preparing a competition, conceptual design, studies, main designs and execution or works for access roads, base station, water supply and electricity supply infrastructure.</p> <p>Implementation of activities in Vučje;</p> | <p>Kolašin 1650 and Cmiljača construction of electricity supply, telecommunication, and hydro technical infrastructure, access road with parking, base station and ski lift;</p> <p>Savin kuk – deigns and construction of new ski slopes, as well as development of project documentation for road reconstruction and construction of the parking lot;</p> <p>Žarski i Hajla - planned activities include preparing a competition, conceptual design, studies, main designs and execution or works for access roads, base station, water supply and electricity supply infrastructure.</p> <p>Implementation of activities in Vučje;</p> |
| Q1 2017 | Q2 2017 | Q3 2017 | Q4 2017 |
| No precise plan is developed, and its development will depend on timing for implementation of activities in 2016 | No precise plan is developed, and its development will depend on timing for implementation of activities in 2016 | No precise plan is developed, and its development will depend on timing for implementation of activities in 2016 | No precise plan is developed, and its development will depend on timing for implementation of activities in 2016 |
| Q1 2018 | Q2 2018 | Q3 2018 | Q4 2018 |
| No precise plan is developed, and its development will depend on timing for implementation of in the previous period | No precise plan is developed, and its development will depend on timing for implementation of in the previous period | No precise plan is developed, and its development will depend on timing for implementation of in the previous period | No precise plan is developed, and its development will depend on timing for implementation of in the previous period |

Priority measure No 10: Implementation of outstanding recommendations from the Regulatory Guillotine

| Q1 2016 | Q2 2016 | Q3 2016 | Q4 2016 |
|---|---|---|---|
| Implementation of the Regulatory Guillotine recommendations | Implementation of the Regulatory Guillotine recommendations | Implementation of the Regulatory Guillotine recommendations | Implementation of the Regulatory Guillotine recommendations |

| | | | |
|--|---|--|--|
| <p>Implementation of the voluntary financial restructuring</p> <p>Implementation of the project “Administration fit for citizens and business”</p> <p>Implementation of measures from the Law on State Surveying and Immovable Property Cadastre</p> | <p>Implementation of the voluntary financial restructuring</p> <p>Implementation of measures from the Law on State Surveying and Immovable Property Cadastre</p> | <p>Implementation of the voluntary financial restructuring</p> <p>Implementation of measures from the Law on State Surveying and Immovable Property Cadastre</p> | <p>Implementation of the voluntary financial restructuring</p> <p>Adoption of the Law on financial leasing, factoring, micro-lending, credit-guarantee business</p> <p>Implementation of measures from the Law on State Surveying and Immovable Property Cadastre</p> <p>Development of the Analysis of efficiency of functioning of the enforcement system</p> <p>Adoption of the Law on Spatial Development and Construction of Structures, which will define electronic operation for the spatial development and construction of structures area</p> |
| Q1 2017 | Q2 2017 | Q3 2017 | Q4 2017 |
| <p>Implementation of the Regulatory Guillotine recommendations</p> <p>Implementation of the voluntary financial restructuring</p> <p>Implementation of measures from the Law on State Surveying and Immovable Property Cadastre</p> | <p>Implementation of the Regulatory Guillotine recommendations</p> <p>Implementation of the voluntary financial restructuring</p> <p>Implementation of measures from the Law on State Surveying and Immovable Property Cadastre</p> <p>Adoption of secondary legislation for electronic operation (issuing of construction permits)</p> | <p>Implementation of the Regulatory Guillotine recommendations</p> <p>Implementation of measures from the Law on State Surveying and Immovable Property Cadastre</p> | <p>Implementation of the Regulatory Guillotine recommendations</p> <p>Implementation of measures from the Law on State Surveying and Immovable Property Cadastre</p> <p>Development of the Analysis of efficiency of functioning of the enforcement system</p> <p>Upgrade of existing ICT system to support electronic operations (issuing of construction permits)</p> |
| Q1 2018 | Q2 2018 | Q3 2018 | Q4 2018 |
| <p>Implementation of measures from the Law on State Surveying and Immovable Property Cadastre</p> | <p>Implementation of measures from the Law on State Surveying and Immovable Property Cadastre</p> | <p>Implementation of measures from the Law on State Surveying and Immovable Property Cadastre</p> | <p>Implementation of measures from the Law on State Surveying and Immovable Property Cadastre</p> <p>Development of the Analysis of efficiency of functioning of the enforcement system</p> |

Priority measure No 11: Improving the process of issuing construction permits through upgrade of existing ICT solutions

| Q1 2016 | Q2 2016 | Q3 2016 | Q4 2016 |
|---------|--|---------|---|
| | | | Adoption of the Law on Spatial Development and Construction of Structures, which will define electronic operation for the spatial development and construction of structures area |
| Q1 2017 | Q2 2017 | Q3 2017 | Q4 2017 |
| | Adoption of secondary legislation for electronic operation | | Upgrade of existing ICT system to support electronic operations |
| Q1 2018 | Q2 2018 | Q3 2018 | Q4 2018 |
| | | | |

Priority measure No 12: Cadastre to render decisions in line with deadlines envisaged under the Law on State Surveying and Immovable Property Cadastre

| Q1 2016 | Q2 2016 | Q3 2016 | Q4 2016 |
|---|---|---|---|
| Acting in accordance with statutory procedure applying uniform principles and deadlines | Acting in accordance with statutory procedure applying uniform principles and deadlines | Acting in accordance with statutory procedure applying uniform principles and deadlines | Acting in accordance with statutory procedure applying uniform principles and deadlines |
| Q1 2017 | Q2 2017 | Q3 2017 | Q4 2017 |
| Acting in accordance with statutory procedure applying uniform principles and deadlines | Acting in accordance with statutory procedure applying uniform principles and deadlines | Acting in accordance with statutory procedure applying uniform principles and deadlines | Acting in accordance with statutory procedure applying uniform principles and deadlines |
| Q1 2018 | Q2 2018 | Q3 2018 | Q4 2018 |
| Acting in accordance with statutory procedure applying uniform principles and deadlines | Acting in accordance with statutory procedure applying uniform principles and deadlines | Acting in accordance with statutory procedure applying uniform principles and deadlines | Acting in accordance with statutory procedure applying uniform principles and deadlines |

Priority reform measure No 13: Introduce issuing of electronic fiscal invoices in order to reduce informal economy

| Q1 2016 | Q2 2016 | Q3 2016 | Q4 2016 |
|---|---|---|---|
| Development of the Project Introduce issuing of electronic fiscal invoices | Development of the Project Introduce issuing of electronic fiscal invoices | Development of the Project Introduce issuing of electronic fiscal invoices | Development of the Project Introduce issuing of electronic fiscal invoices |
| Q1 2017 | Q2 2017 | Q3 2017 | Q4 2017 |
| Implementation of the Project Introduce issuing of electronic fiscal invoices " | Implementation of the Project Introduce issuing of electronic fiscal invoices " | Implementation of the Project Introduce issuing of electronic fiscal invoices " | Implementation of the Project Introduce issuing of electronic fiscal invoices " |
| Q1 2018 | Q2 2018 | Q3 2018 | Q4 2018 |
| Implementation of the Project Introduce issuing of electronic fiscal invoices " | | | |

Priority reform measure No 14: Improving financial support to the sector of small and medium-sized enterprises

| Q1 2016 | Q2 2016 | Q3 2016 | Q4 2016 |
|---|--|--|--|
| Announcing public call for realisation of loan and factoring facilities | Application for, evaluation and selection of loan and factoring applications | Application for, evaluation and selection of loan and factoring applications | Application for, evaluation and selection of loan and factoring applications |
| Q1 2017 | Q2 2017 | Q3 2017 | Q4 2017 |
| | | | |
| Q1 2018 | Q2 2018 | Q3 2018 | Q4 2018 |
| | | | |

Priority reform measure No 15: Construction of the Innovation-Entrepreneurship Center "Tehnopolis" in Nikšić

| Q1 2016 | Q2 2016 | Q3 2016 | Q4 2016 |
|--|---|---|---|
| Upgrade of buildings and works for hydro and electricity installations | Completion of works for reconstruction refurbishment of the Military Club in Nikšić where the Tehnopolis will be accommodated. Publishing ToR as part of IPA II for training and equipment | Tender procedures for equipping buildings with furniture and other equipment; Competition for selection of residents | Activities for moving in residents of Tehnopolis Signing of contract for services for training and equipment of Tehnopolis |
| Q1 2017 | Q2 2017 | Q3 2017 | Q4 2017 |
| Training | | Tender procedure for procurement of equipment for laboratories in Tehnopolis | |
| Q1 2018 | Q2 2018 | Q3 2018 | Q4 2018 |
| procurement of equipment for laboratories in Tehnopolis | | | |

Priority reform measure No 16: Increasing competitiveness of business organisations through harmonisation with the requirements of international quality standards

| Q1 2016 | Q2 2016 | Q3 2016 | Q4 2016 |
|---------|--|--|--|
| | Public call (minimum 1) for program of increasing regional and local competitiveness through alignment with requirements of international business standards | Evaluating applications and signing contracts for the program of increasing regional and local competitiveness through alignment with requirements of international business standards | Evaluation and payout under public calls |
| Q1 2017 | Q2 2017 | Q3 2017 | Q4 2017 |
| | | | |
| Q1 2018 | Q2 2018 | Q3 2018 | Q4 2018 |
| | | | |

Priority reform measure No 17: Development of qualifications based on learning outcomes in accordance with the needs of the labour market

| Q1 2016 | Q2 2016 | Q3 2016 | Q4 2016 |
|--|---|--|--|
| <p>X Development of tools for labour market surveys Analysis of existing qualifications Analysis of the existing curricula in the field STEM sciences; Preparation of the report and detailed plan of activities</p> | <p>X Labour market survey; Improving capacity of sectoral commissions Improving the model of professional development of teachers Development of at least 20 standards for vocations and 10 standards for qualifications Defining key issues/areas for revising the existing STEM program; Developing draft of at least 5 new or updated study programs.</p> | <p>X Improving capacity of sectoral commissions; Training of teachers Development of at least 20 standards for vocations and at least 10 standards for qualifications Implementing training of professors at STEM faculties for development of curricula, including analysis and labour market forecasts; Training about innovative and multidisciplinary teaching methods and transferable skills (innovation, creativity, entrepreneurship) Commercial knowledge and protection of intellectual property.</p> | <p>X Training of teachers; Develop at least 10 modular curricula based on education outcomes Preparation of relevant guidance and methodological manuals.</p> |
| Q1 2017 | Q2 2017 | Q3 2017 | Q4 2017 |
| <p>X Training of teachers; Develop at least 10 modular curricula based on education outcomes; Develop mechanism for carrier guidance Preparation for accreditation and licensing of updated STEM programs.</p> | <p>X Training of teachers; Implementation of the carrier guidance mechanism Implementation of updated STEM programs.</p> | | |
| Q1 2018 | Q2 2018 | Q3 2018 | Q4 2018 |
| | | | |

Priority reform measure No 18: Implementation of service contracts and grant schemes in order to improve HR capacities and increase employability, as well as access to the labour market for hard-to-employ persons

| Q1 2016 | Q2 2016 | Q3 2016 | Q4 2016 |
|--|--|--|---|
| <p>Develop analysis on the current state in the area of social inclusion, in terms of including vulnerable groups in the labour market</p> | <p>Develop report on implemented analysis and recommendations for improving the cooperation between the Employment Office and social welfare centres</p> | <p>Implement joint training of the Employment Office and social welfare centres for work with hard-to-employ persons Signing contracts for awarding grants for implementation of the project of</p> | <p>Develop Agreement on cooperation between the Employment Office and social welfare centres – defining roles and method of cooperation for inclusion of hard-to-employ persons in the labour market Implementation of the project of professional</p> |

| | | | |
|---|--|--|---|
| | | professional development and employment of disabled persons and members of RE population Start of implementation of the project of professional development and employment of disabled persons and members of RE population | development and employment of disabled persons and members of RE population Provision of technical support to users of grants in implementation of the project of professional development and employment of disabled persons and members of RE population |
| Q1 2017 | Q2 2017 | Q3 2017 | Q4 2017 |
| Implement public awareness campaign on possibilities for inclusion of vulnerable groups (primarily disabled persons and members of RE population) in the labour market Implementation of the project of professional development and employment of disabled persons and members of RE population Provision of technical support to users of grants in implementation of the project of professional development and employment of disabled persons and members of RE population | Provision of technical support to users of grants in implementation of the project of professional development and employment of disabled persons and members of RE population Implementation of the project of professional development and employment of disabled persons and members of RE population Update database of the Employment Office on persons who have participated in professional development projects and employment through award of grants | Implementation of the project of professional development and employment of disabled persons and members of RE population and completion of all contracts for award of grants | |
| Q1 2018 | Q2 2018 | Q3 2018 | Q4 2018 |
| | | | |

Priority measure No 19: *Construction of pre-school institutions in order to increase the coverage of children with preschool education and upbringing*

| Q1 2016 | Q2 2016 | Q3 2016 | Q4 2016 |
|---|--|--|--|
| Kindergarten Zagorič, Podgorica - Signing contract for execution of works | Kindergarten Zagorič, Podgorica - Construction of the building | Kindergarten Zagorič, Podgorica - Construction of the building | Kindergarten Zagorič, Podgorica - Construction of the building |
| Kindergarten Stari Aerodrom, Podgorica - Signing contract for execution of works | Kindergarten Stari Aerodrom, Podgorica - Construction of the building | Kindergarten Stari Aerodrom, Podgorica - Construction of the building | Kindergarten Stari Aerodrom, Podgorica - Construction of the building |
| Kindergarten Bar - Signing contract for execution of works | Kindergarten Bar - Construction of the building | Kindergarten Bar - Construction of the building | Kindergarten Bar - Construction of the building |

| | | | |
|--|---|--|--|
| Kindergarten Blok VI, Podgorica - Development of the Main design | Kindergarten Blok VI, Podgorica - Tender procedure for selection of contractor for works | Kindergarten Blok VI, Podgorica - Tender procedure for selection of contractor for works | Kindergarten Blok VI, Podgorica - Construction of the building |
| Kindergarten Pljevlja - Development of the Main design | Kindergarten Pljevlja - Tender procedure for selection of contractor for works | Kindergarten Pljevlja - Tender procedure for selection of contractor for works | Kindergarten Pljevlja - Construction of the building |
| Kindergarten Tuzi - Tender procedure for development of the Main design | Kindergarten Tuzi - Development of the Main design | Kindergarten Tuzi - Tender procedure for selection of contractor for works | Kindergarten Tuzi - Tender procedure for selection of contractor for works |
| Kindergarten Ulcinj - Tender procedure for development of the Main design | Kindergarten Ulcinj - Development of the Main design | Kindergarten Ulcinj - Tender procedure for selection of contractor for works | Kindergarten Ulcinj - Tender procedure for selection of contractor for works |
| Tender procedure for development of the Main design for reconstruction of existing buildings in Podgorica, Ulcinj and Pljevlja | - Development of the Main design for reconstruction of existing buildings in Podgorica, Ulcinj and Pljevlja | Tender procedure for selection of contractor for works for reconstruction of existing building in Podgorica, Ulcinj and Pljevlja | Tender procedure for selection of contractor for works for reconstruction of existing building in Podgorica, Ulcinj and Pljevlja |
| Q1 2017 | Q2 2017 | Q3 2017 | Q4 2017 |
| Kindergarten Zagorič, Podgorica - Completion of the building construction | | | |
| Kindergarten Stari Aerodrom, Podgorica - Completion of the building construction | | | |
| Kindergarten Bar - Completion of the building construction | | | |
| Kindergarten Blok VI, Podgorica - Construction of the building | Kindergarten Blok VI, Podgorica - Construction of the building | Kindergarten Blok VI, Podgorica - Construction of the building | |
| Kindergarten Pljevlja - Construction of the building Pljevlja | Kindergarten Pljevlja - Construction of the building Pljevlja | Kindergarten Pljevlja - Construction of the building Pljevlja | |
| Kindergarten Tuzi - Construction of the building | Kindergarten Tuzi - Construction of the building | Kindergarten Tuzi - Construction of the building | Kindergarten Tuzi - Construction of the building |
| Kindergarten Ulcinj - Construction of the building | Kindergarten Ulcinj - Construction of the building | Kindergarten Ulcinj - Construction of the building | Kindergarten Ulcinj - Construction of the building |
| Reconstruction of buildings in Podgorica, Pljevlja and Ulcinj | Reconstruction of buildings in Podgorica, Pljevlja and Ulcinj | Reconstruction of buildings in Podgorica, Pljevlja and Ulcinj | Reconstruction of buildings in Podgorica, Pljevlja and Ulcinj |
| Q1 2018 | Q2 2018 | Q3 2018 | Q4 2018 |
| Project closing | Project closing | Project closing | |

8 ANNEX

| GDP (in € mill.) | 3457.9 | | 3,660.7 | | 3,868.0 | | 4,102.9 | | 4,310.5 | |
|--|----------------|--------------|----------------|--------------|----------------|--------------|----------------|--------------|----------------|-------------|
| Public expenditures | Execution 2014 | | Estimate 2015 | | Estimate 2016 | | Estimate 2017 | | Estimate 2018 | |
| | € mill. | % GDP | € mill. | % GDP | € mill. | % GDP | € mill. | % GDP | € mill. | % GDP |
| Source revenues | 1549.8 | 44.8 | 1532.4 | 41.9 | 1657.5 | 42.9 | 1669.5 | 40.7 | 1708.0 | 39.6 |
| Taxes | 950.1 | 27.5 | 920.6 | 25.1 | 971.3 | 25.1 | 1014.0 | 24.7 | 1042.5 | 24.2 |
| Personal income tax | 136.8 | 4.0 | 128.2 | 3.5 | 133.1 | 3.4 | 138.3 | 3.4 | 141.6 | 3.3 |
| Tax on profits of legal entities | 45.0 | 1.3 | 43.6 | 1.2 | 45.2 | 1.2 | 47.1 | 1.1 | 48.7 | 1.1 |
| Tax on turnover of immovable property | 14.9 | 0.4 | 16.0 | 0.4 | 16.3 | 0.4 | 16.6 | 0.4 | 17.0 | 0.4 |
| Value added tax | 497.6 | 14.4 | 467.9 | 12.8 | 488.1 | 12.6 | 513.8 | 12.5 | 531.9 | 12.3 |
| Excise | 156.5 | 4.5 | 163.8 | 4.5 | 183.1 | 4.7 | 190.4 | 4.6 | 193.3 | 4.5 |
| Tax on foreign trade and transactions | 22.3 | 0.6 | 22.5 | 0.6 | 23.0 | 0.6 | 23.9 | 0.6 | 24.3 | 0.6 |
| Local taxes | 71.1 | 2.1 | 72.0 | 2.0 | 73.9 | 1.9 | 74.9 | 1.8 | 76.4 | 1.8 |
| Other republic taxes | 6.0 | 0.2 | 6.5 | 0.2 | 8.7 | 0.2 | 9.0 | 0.2 | 9.4 | 0.2 |
| Contributions | 444.3 | 12.8 | 455.4 | 12.4 | 483.2 | 12.5 | 489.1 | 11.9 | 501.4 | 11.6 |
| Contributions for pension and disability insurance | 270.1 | 7.8 | 272.9 | 7.5 | 289.6 | 7.5 | 293.1 | 7.1 | 300.5 | 7.0 |
| Contributions for health insurance | 151.0 | 4.4 | 157.2 | 4.3 | 167.1 | 4.3 | 169.0 | 4.1 | 173.2 | 4.0 |
| Contributions for insurance against unemployment | 12.2 | 0.4 | 12.9 | 0.4 | 13.8 | 0.4 | 13.9 | 0.3 | 14.2 | 0.3 |
| Other contributions | 11.0 | 0.3 | 12.5 | 0.3 | 12.7 | 0.3 | 13.2 | 0.3 | 13.5 | 0.3 |
| Duties | 20.8 | 0.6 | 20.0 | 0.5 | 20.7 | 0.5 | 21.1 | 0.5 | 21.4 | 0.5 |
| Fees | 71.9 | 2.1 | 81.8 | 2.2 | 73.5 | 1.9 | 74.9 | 1.8 | 76.3 | 1.8 |
| Other revenues | 44.8 | 1.3 | 38.3 | 1.0 | 69.2 | 1.8 | 45.6 | 1.1 | 45.3 | 1.1 |
| Receipts from repayment of loans and funds carried over from previous year | 8.6 | 0.2 | 7.2 | 0.2 | 7.4 | 0.2 | 7.5 | 0.2 | 7.6 | 0.2 |
| Donations | 9.3 | 0.3 | 9.2 | 0.3 | 32.3 | 0.8 | 17.3 | 0.4 | 13.3 | 0.3 |
| Public expenditures | 1657.3 | 47.9 | 1772.1 | 48.4 | 1892.8 | 48.9 | 1920.5 | 46.8 | 1828.8 | 42.4 |
| Current public expenditures | 1540.2 | 44.5 | 1,485.1 | 40.6 | 1,512.9 | 39.1 | 1,540.7 | 37.6 | 1,558.4 | 36.2 |
| Current expenditures | 699.3 | 20.2 | 717.3 | 19.6 | 770.4 | 19.9 | 793.2 | 19.3 | 794.7 | 18.4 |
| Gross salaries and contributions at expense of employer | 424.2 | 12.3 | 424.7 | 11.6 | 455.8 | 11.8 | 459.3 | 11.2 | 461.9 | 10.7 |
| Other personal earnings | 14.3 | 0.4 | 13.9 | 0.4 | 12.4 | 0.3 | 11.6 | 0.3 | 11.5 | 0.3 |
| Expenditures for supplies | 34.8 | 1.0 | 33.6 | 0.9 | 37.0 | 1.0 | 38.3 | 0.9 | 38.8 | 0.9 |
| Expenditures for services | 62.3 | 1.8 | 56.6 | 1.5 | 53.8 | 1.4 | 55.2 | 1.3 | 55.9 | 1.3 |
| Current maintenance | 25.2 | 0.7 | 24.9 | 0.7 | 25.5 | 0.7 | 25.9 | 0.6 | 26.4 | 0.6 |
| Interest | 78.9 | 2.3 | 81.9 | 2.2 | 80.6 | 2.1 | 100.7 | 2.5 | 100.9 | 2.3 |
| Rent | 8.5 | 0.2 | 8.8 | 0.2 | 8.6 | 0.2 | 8.7 | 0.2 | 8.8 | 0.2 |
| Subsidies | 18.8 | 0.5 | 22.0 | 0.6 | 21.0 | 0.5 | 21.5 | 0.5 | 21.5 | 0.5 |
| Other expenditures | 32.3 | 0.9 | 31.9 | 0.9 | 35.3 | 0.9 | 34.7 | 0.8 | 34.8 | 0.8 |
| Capital expenditures in the current budget | 66.2 | 1.9 | 19.0 | 0.5 | 40.4 | 1.0 | 37.2 | 0.9 | 34.2 | 0.8 |
| Transfers for social care | 492.8 | 14.3 | 499.8 | 13.7 | 534.4 | 13.8 | 544.9 | 13.3 | 560.3 | 13.0 |
| Transfers to institutions, individuals, NGO and public sector | 134.5 | 3.9 | 167.6 | 4.6 | 186.1 | 4.8 | 181.2 | 4.4 | 182.5 | 4.2 |
| Capital expenditures | 117.1 | 3.4 | 287.0 | 7.8 | 379.9 | 9.8 | 379.9 | 9.3 | 270.4 | 6.3 |
| Borrowings and loans | 3.8 | 0.1 | 4.5 | 0.1 | 4.6 | 0.1 | 5.4 | 0.1 | 4.9 | 0.1 |
| Reserves | 16.0 | 0.5 | 17.9 | 0.5 | 17.4 | 0.5 | 16.0 | 0.4 | 16.0 | 0.4 |
| Guarantee repayment | 15.3 | 0.4 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Net increase in liabilities | 6.5 | 0.2 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Repayment of liabilities from previous period | 105.8 | 3.1 | 78.1 | 2.1 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Surplus/deficit | -107.5 | -3.1 | -239.7 | -6.5 | -235.3 | -6.1 | -251.0 | -6.1 | -120.9 | -2.8 |
| Primary deficit | -28.6 | -0.8 | -157.8 | -4.3 | -154.7 | -4.0 | -150.3 | -3.7 | -20.0 | -0.5 |
| Debt repayment | 452.2 | 13.1 | 608.5 | 16.6 | 450.2 | 11.6 | 263.0 | 6.4 | 163.5 | 3.8 |
| Debt repayment to residents | 254.4 | 7.4 | 236.7 | 6.5 | 59.7 | 1.5 | 58.0 | 1.4 | 43.6 | 1.0 |
| Debt repayment to non-residents | 197.8 | 5.7 | 321.8 | 8.8 | 321.2 | 8.3 | 146.2 | 3.6 | 81.5 | 1.9 |
| Repayment of liabilities from previous period | | | 50.0 | 1.4 | 69.4 | 1.8 | 58.8 | 1.4 | 38.4 | 0.9 |
| Shortfall | -569.4 | -16.5 | -859.0 | -23.5 | -685.5 | -17.7 | -514.1 | -12.5 | -284.3 | -6.6 |
| Financing | 569.4 | 16.5 | 859.0 | 23.5 | 685.5 | 17.7 | 514.1 | 12.5 | 284.3 | 6.6 |
| Borrowings and loans from domestic sources | 250.1 | 7.2 | 194.8 | 5.3 | 14.7 | 0.4 | 28.6 | 0.7 | 3.5 | 0.1 |
| Borrowings and loans from foreign sources | 295.4 | 8.5 | 651.9 | 17.8 | 659.1 | 17.0 | 475.0 | 11.6 | 272.4 | 6.3 |
| Privatisation receipts | 14.5 | 0.4 | 11.9 | 0.3 | 5.0 | 0.1 | 6.0 | 0.1 | 6.0 | 0.1 |
| Transfers from the MNE budget | 2.8 | 0.1 | 0.4 | 0.0 | 1.1 | 0.0 | 1.1 | 0.0 | 1.1 | 0.0 |
| Increase/decrease of deposits | -9.7 | -0.3 | -10.8 | -0.3 | 5.5 | 0.1 | 3.3 | 0.1 | 1.2 | 0.0 |

| | | | | | |
|------------------|--------|--------|--------|--------|--------|
| GDP (in € mill.) | 3457.9 | 3660.7 | 3868.0 | 4102.9 | 4310.5 |
|------------------|--------|--------|--------|--------|--------|

| Local self-government | Execution 2014 | | Estimate 2015 | | Estimate 2016 | | Estimate 2017 | | Estimate 2018 | |
|--|----------------|-------------|---------------|-------------|---------------|-------------|---------------|-------------|---------------|-------------|
| | € mill. | % GDP | € mill. | % GDP | € mill. | % GDP | € mill. | % GDP | € mill. | % GDP |
| Source revenues | 196.1 | 4.6 | 194.0 | 5.6 | 199.1 | 5.4 | 202.0 | 5.2 | 205.1 | 5.0 |
| Taxes | 116.9 | 2.7 | 119.6 | 3.5 | 123.1 | 3.4 | 124.4 | 3.2 | 126.9 | 3.1 |
| Personal income tax | 32.4 | 0.8 | 33.0 | 1.0 | 34.4 | 0.9 | 34.3 | 0.9 | 35.0 | 0.9 |
| Tax on turnover of immovable property | 13.4 | 0.3 | 14.6 | 0.4 | 14.9 | 0.4 | 15.2 | 0.4 | 15.5 | 0.4 |
| Local taxes | 71.1 | 1.6 | 72.0 | 2.1 | 73.9 | 2.0 | 74.9 | 1.9 | 76.4 | 1.9 |
| Duties | 5.7 | 0.1 | 6.2 | 0.2 | 6.3 | 0.2 | 6.4 | 0.2 | 6.5 | 0.2 |
| Fees | 54.5 | 1.3 | 55.1 | 1.6 | 56.2 | 1.5 | 57.3 | 1.5 | 58.4 | 1.4 |
| Other revenues | 15.1 | 0.4 | 10.2 | 0.3 | 10.5 | 0.3 | 10.8 | 0.3 | 10.1 | 0.2 |
| Receipts from repayment of loans and funds carried over from previous year | 0.1 | 0.0 | | 0.0 | 0.0 | 0.0 | | 0.0 | | 0.0 |
| Donations | 3.8 | 0.1 | 3.0 | 0.1 | 3.1 | 0.1 | 3.1 | 0.1 | 3.2 | 0.1 |
| Expenditures | 196.5 | 4.6 | 153.5 | 4.4 | 160.4 | 4.4 | 164.7 | 4.3 | 168.0 | 4.1 |
| Current budget expenditures | 147.1 | 3.4 | 108.5 | 3.1 | 115.4 | 3.2 | 119.7 | 3.1 | 123.0 | 3.0 |
| Current expenditures | 64.3 | 1.5 | 64.8 | 1.9 | 68.4 | 1.9 | 70.6 | 1.8 | 73.0 | 1.8 |
| Gross salaries and contributions at expense of employer | 36.8 | 0.9 | 37.0 | 1.1 | 40.0 | 1.1 | 41.3 | 1.1 | 42.6 | 1.0 |
| Other personal earnings | 2.3 | 0.1 | 2.3 | 0.1 | 2.4 | 0.1 | 2.4 | 0.1 | 2.5 | 0.1 |
| Expenditures for supplies | 6.2 | 0.1 | 6.2 | 0.2 | 6.3 | 0.2 | 6.6 | 0.2 | 6.8 | 0.2 |
| Expenditures for services | 8.2 | 0.2 | 8.2 | 0.2 | 8.4 | 0.2 | 8.7 | 0.2 | 9.0 | 0.2 |
| Current maintenance | 4.0 | 0.1 | 4.1 | 0.1 | 4.2 | 0.1 | 4.3 | 0.1 | 4.5 | 0.1 |
| Interest | 3.4 | 0.1 | 4.0 | 0.1 | 4.1 | 0.1 | 4.2 | 0.1 | 4.4 | 0.1 |
| Rent | 0.5 | 0.0 | 0.5 | 0.0 | 0.5 | 0.0 | 0.5 | 0.0 | 0.5 | 0.0 |
| Subsidies | 0.4 | 0.0 | 0.5 | 0.0 | 0.5 | 0.0 | 0.5 | 0.0 | 0.5 | 0.0 |
| Other expenditures | 2.5 | 0.1 | 2.0 | 0.1 | 2.0 | 0.1 | 2.1 | 0.1 | 2.2 | 0.1 |
| Transfers for social care | 0.6 | 0.0 | 0.6 | 0.0 | 2.0 | 0.1 | 2.1 | 0.1 | 2.1 | 0.1 |
| Social care benefits | 0.6 | 0.0 | 0.6 | 0.0 | 2.0 | 0.1 | 2.1 | 0.1 | 2.1 | 0.1 |
| Transfers to institutions, individuals, NGO and public sector | 35.5 | 0.8 | 38.0 | 1.1 | 39.7 | 1.1 | 41.0 | 1.1 | 42.4 | 1.0 |
| Transfers to institutions, individuals, NGO and public sector | 21.4 | 0.5 | 22.2 | 0.6 | 23.6 | 0.6 | 24.4 | 0.6 | 25.1 | 0.6 |
| Other transfers | 14.1 | 0.3 | 15.8 | 0.5 | 16.1 | 0.4 | 16.7 | 0.4 | 17.3 | 0.4 |
| Capital expenditures | 49.4 | 1.1 | 45.0 | 1.3 | 45.0 | 1.2 | 45.0 | 1.2 | 45.0 | 1.1 |
| Borrowings and loans | 1.3 | 0.0 | 2.2 | 0.1 | 2.3 | 0.1 | 3.0 | 0.1 | 2.5 | 0.1 |
| Reserves | 2.5 | 0.1 | 2.9 | 0.1 | 3.0 | 0.1 | 3.0 | 0.1 | 3.0 | 0.1 |
| Guarantee repayment | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Repayment of liabilities from previous period | 40.6 | 0.9 | 0.0 | 0.0 | | 0.0 | | 0.0 | | 0.0 |
| Net increase in liabilities | 2.4 | 0.1 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Surplus/deficit | -0.4 | 0.0 | 40.5 | 1.2 | 38.6 | 1.1 | 37.3 | 1.0 | 37.1 | 0.9 |
| Primary deficit | 3.0 | 0.1 | 44.5 | 1.3 | 42.7 | 1.2 | 41.5 | 1.1 | 41.5 | 1.0 |
| Debt repayment | 18.1 | 0.4 | 67.0 | 1.9 | 57.0 | 1.6 | 55.0 | 1.4 | 51.0 | 1.2 |
| Debt repayment to residents | 15.3 | 0.4 | 15.0 | 0.4 | 15.0 | 0.4 | 16.0 | 0.4 | 16.0 | 0.4 |
| Debt repayment to non-residents | 2.7 | 0.1 | 2.0 | 0.1 | 12.0 | 0.3 | 14.0 | 0.4 | 15.0 | 0.4 |
| Repayment of liabilities from previous period | | | 50.0 | 1.4 | 30.0 | 0.8 | 25.0 | 0.6 | 20.0 | 0.5 |
| Shortfall | -22.8 | -0.5 | -27.0 | -0.8 | -18.4 | -0.5 | -17.7 | -0.5 | -13.9 | -0.3 |
| Financing | 22.8 | 0.5 | 27.0 | 0.8 | 18.4 | 0.5 | 17.7 | 0.5 | 13.9 | 0.3 |
| Borrowings and loans from domestic sources | 5.2 | 0.1 | 19.57 | 0.57 | 4.70 | 0.13 | 5.33 | 0.14 | 3.5 | 0.09 |
| Borrowings and loans from foreign sources | 4.6 | 0.1 | 2.00 | 0.06 | 2.00 | 0.05 | 2.00 | 0.05 | 2.0 | 0.05 |
| Receipts from privatisation and sale of assets | 7.9 | 0.2 | 5.00 | 0.14 | 5.00 | 0.14 | 6.00 | 0.16 | 6.0 | 0.15 |
| Use of local self-government deposits | -4.4 | -0.1 | -0.5 | 0.0 | 5.5 | 0.2 | 3.3 | 0.1 | 1.2 | 0.0 |
| Transfers from the MNE budget | 2.8 | 0.1 | 0.4 | 0.0 | 1.1 | 0.0 | 1.1 | 0.0 | 1.1 | 0.0 |

Montenegro
Single list of priority infrastructural projects
(SPP) for 4 sectors ³⁹

| Project | Strategic relevance of the project | Project maturity according to Methodology | Total estimated costs (€ mill.) | |
|-------------------------|--|---|---|---------|
| ENERGY SECTOR | | | | |
| 1 | Use of hydropower potentials and Management of water catchment areas of rivers | 81% | 2c | 14.000 |
| 2 | ITALY-MNE-SRB-B&H Energy inter-connection – Montenegrin part Project segments: 1) Construction of SS 400/110/35 kV Lastva (and extension of SS Pljevlja) 2) Construction of 400 kV overhead line Lastva –Čevo 3) Construction of 400 kV overhead line Čevo –Pljevlja (and OHL 110 kV Brezna-Žabljak) 4) Construction of 400 kV overhead line Pljevlja – State border with Serbia 5) Replacement of high-voltage equipment in substations 6) Reconstruction of the protection system in transmission network 7) Reconstruction of SS 400/220/110 kV Pljevlja and SS 400/110/35 kV Ribarevine 8) Construction of SS 110/35 kV Brezna | 75% | Segment: 1) 2) 3) 8) - 1a Segment: 4) - 2c Segment: 5) 6) 7) - 1b | 131.284 |
| 3 | Adriatic-Ionian gas pipeline | 75% | 2c | 122,734 |
| 4 | Hydro power plant Komarnica | 73% | 2c | 187.700 |
| 5 | Hydro power plant Morača | 73% | 2c | 501.025 |
| 6 | Improvement of energy efficiency in public buildings | 58% | 1b | 97.440 |
| 7 | Improvement of quality of supply to tourist regions The Project includes the following segments: A. PENINSULA LUŠTICA 1) Construction of SS 110/35kV, 2x40MVA Radovici (Luštica) and 110kV connecting cables (two cables from SS Radovići to SS Tivat 12.5km long) B. HERCEG NOVI 2) Construction of overhead line 110kV Viulsi-Herceg Novi and reconstruction of substation 110/35kV Vilusi 3) Reconstruction of overhead line 110kV Nikšić - Bileća (section Nikšić Vilusi) C. DURMITOR 4) Construction of SS 110/35kV Žabljak D. BOKA KOTORSKA 5) Construction of overhead line 110kV Lastva - Kotor 6) Reconstruction of overhead line 110kV Lastva - Tivat E. BUDVA 7) Reconstruction of overhead line 110kV Lastva - Budva F. ULCINJ 8) Construction SS 110/35kV Zeta (Golubovci) i overhead line 110kV Podgorica 5 - Golubovci - Virpazar 9) Construction of overhead line 110kV Virpazar -Ulcinj | 56% | Segment: 9) - 2c Segment: 1) - 2c Segments: 2)3)5)6)7) -2b Segment: 4) 8) - 2b | 55.470 |
| 8 | Study on technical conditions for connecting renewable energy sources to the grid and the impact on energy system operation | 56% | 2c | 1.000 |
| 9 | Construction of 35kV overhead line Andrijevića – Gusinje | 44% | 2b | 1,839 |
| 10 | Regulation of informal settlements in Montenegro | 35% | 1b | 0.600 |
| TRANSPORT SECTOR | | | | |
| 1 | Reconstruction and modernisation of railway line Bar - Vrbnica (border with Serbia) 1) Rehabilitation of train track (superstructure), Culverts, Regulation of watercourses, reconstruction of steel bridges 2) Rehabilitation of slopes 3) Rehabilitation of slides, tunnels, concrete bridges and electric works | 96% | 1) 1a 2) 1b 3) 2a | 247.790 |
| 2 | High-way Bar - Boljare, section Mateševo -Andrijevića | 94% | 2b | 294.840 |
| 3 | Coastal variant AIH – Expressway along the Montenegrin Coast 1) Bridge over Boka Kotorska Bay, viaduct and access roads 2) Tivat and Bar bypasses 3) Herceg Novi and Budva bypasses, Tivat-Sozina road, Bar-Border with Albania road | 94% | 1) 1b 2) 2a 3) 2c | 950.400 |
| 4 | High-way Bar - Boljare, section Smokovac - Tološi - Farmaci (bypass around Podgorica) | 92% | 2b | 233.120 |

³⁹Source: Secretariat for Development Projects

| | | | | |
|----|---|---|--|--|
| 5 | High-way Bar - Boljare, section Đurmani - Farmaci | 92% | 2b | 404.080 |
| 6 | High-way Bar - Boljare, section Andrijevića - Boljare | 92% | 2b | 731.160 |
| 7 | Reconstruction and modernisation of railway line Podgorica - Tuzi – border with Albania (to Tirana) | 88% | 2a | 35.000 |
| 8 | Vessel traffic monitoring, information and management system (VTMIS) | 84% | 1b | 5.000 |
| 9 | Podgorica Airport Development 1) Reconstruction and extension of manoeuvring areas | 84% | 2c 1) 2a | 94.842 |
| | Project | Strategic relevance of the project | Project maturity according to Methodology | Total estimated costs (€ mill.) |
| | ENVIRONMENT SECTOR | | | |
| 1 | Construction of wastewater purification plant + wastewater collection Phase I, Podgorica | 98% | 2a | 38.000 |
| 2 | River bed regulation of the Lim River, Berane | 86% | 2c | 7.400 |
| 3 | River bed regulation of the Čehotina River, Pljevlja | 86% | 1b | 6.545 |
| 4 | Construction of wastewater purification plant – Phase I, Bijelo Polje | 85% | 2b | 6.066 |
| 5 | Construction of wastewater purification system in the Municipality of Rožaje | 84% | 2c | 8.490 |
| 6 | Wastewater collection Phase II - Podgorica | 82% | 2a | 13.860 |
| 7 | Recycling centre Možur, Bar | 82% | 1b | 2.800 |
| 8 | Construction of wastewater purification plant - Phase I + water supply Phase I, Cetinje | 80% | 2b | 10.235 |
| 9 | Improvement of waste management system through design and construction of 4 recycling yards, procurement of ancillary technical equipment and other necessary components, Podgorica | 76% | 2a | 3.298 |
| 10 | Construction of the plant for waste water purification and sewage network, Plav | 76% | 2b | 8.671 |
| 11 | Construction of wastewater purification and segments of water and sewage network in the Municipality of Kolašin | 75% | 1b | 3.200 |
| 12 | Construction of the sewage system in Štoj | 75% | 2c | 24.300 |
| 13 | Regulation of stormwater sewage in Djerane 1 and 2, in the Municipality of Ulcinj | 73% | 2c | 3.300 |
| 14 | Valorisation of plastic materials sorted in the Regional center for recycling and production of the granulate and foil, Podgorica | 73% | 1b | 0.860 |
| 15 | Improvement of the Wastewater Management System in the Municipality of Mojkovac | 69% | 2b | 2.000 |
| 16 | Fire station Pljevlja | 67% | 1a | 1.200 |
| 17 | Construction of the sewage system in Žabljak | 65% | 2a | 0.420 |
| 18 | Recycling yard / transfer station in Plužinama | 65% | 2c | 0.440 |
| 19 | Recycling yard in Kolasin | 65% | 2a | 0.300 |
| 20 | Construction of primary sewage network in the city area of Ulcinj | 65% | 2c | 11.500 |
| 21 | Recycling yard / transfer station in Savnik | 64% | 1b | 0.250 |
| 22 | Construction of a recycling yard and rehabilitation of former waste disposal sites and construction of a transfer station in Plav | 64% | 2a | 0.330 |
| 23 | Rehabilitation of the landslide Biogradska River and solving hydrological problems in the basin of Biogradsko Lake and Biogradska River | 62% | 2a | 0.500 |
| 24 | Plant for processing of drinking water in the municipality of Ulcinj | 62% | 2c | 4,07 |
| 25 | Improvement of the water supply system in the Municipality of Plav | 62% | 2b | 3.410 |
| 26 | Construction of the transfer station in Pljevlja | 62% | 2c | 0.700 |
| 27 | Construction of the main supply of raw water Potpeć-Pliješ with a return pipeline, Pljevlja | 60% | 2b | 7.350 |
| 28 | Construction and reconstruction of facilities for purification of drinking water Pliješ, Breznica and Bogiševac, Pljevlja | 60% | 2c | 1.500 |
| 29 | Pipeline Vrelo Bistrice (Majstorovina) – Reservoir Pobrjnica, Bijelo Polje | 60% | 2b | 1.250 |
| 30 | Rehabilitation of the “Glavni ponor (Main Abyss)” in Cetinje | 60% | 2b | 0.520 |
| | Project | Strategic relevance of the project | Project maturity according to Methodology | Total estimated costs |

| | | | | (€ mill.) |
|----|--|-----|---|-----------|
| | SOCIAL SECTOR | | | |
| 1 | Reconstruction of premises for the HLA laboratory and HLA typing in Montenegro | 93% | 2a | 0.173 |
| 2 | Improving of courts efficiency: 1) Reconstruction and adaptation of the courts: High Court in Bijelo Polje, Basic Court in Podgorica, Basic Court in Niksic along with adjusting of these facilities for access to courts for persons with disabilities; 2) Reconstruction of buildings of Basic courts in Kotor, Podgorica, Nikšić, Bijelo Polje and Berane in order to increase energy efficiency; 3) Improving efficiency through the implementation of one-stop-shops | 91% | 1) 2a 2) 2a 3) 2c | 2.124 |
| 3 | Construction of prison in Bijelo Polje | 83% | 2b | 6.366 |
| 4 | Reconstruction of the energy block - substations and auxiliary power sources of the Clinic center of Montenegro | 83% | 2a | 0.377 |
| 5 | Treatment of medical waste water in the Clinic center of Montenegro | 79% | 2c | 1.548 |
| 6 | Energy Efficiency Program in healthcare facilities | 79% | 2a | 12.000 |
| 7 | The use of renewable energy sources in the electricity supply, preparation of domestic hot water and cooling of the Clinic center of Montenegro | 75% | 2a | 1.090 |
| 8 | Reconstruction of premises for the operations of the Regional Institute for Tropical Diseases | 73% | 2c | 0.080 |
| 9 | Reconstruction of ITC infrastructure in the judicial institutions that use the PRIS in Montenegro | 63% | 2a | 1.310 |
| 10 | Higher education: 1) Reconstruction and superstructure upgrading of the Old Residence Hall facility, Podgorica; 2) Construction of the new students residence hall facility, Cetinje; 3) Construction of facility for the needs of Music Academy, Cetinje; 4) Construction of facility for the needs of Drama Academy at Cetinje | 63% | 1) 2a 2) 2a 3) 1a 4) 1a | 11.014 |
| 11 | Gymnasium: 1) Construction of new school facility - New gymnasium, Podgorica; 2) Construction of new school facility - New gymnasium, Ulcinj; 3) Construction of new school facility - New gymnasium, Bar | 59% | 1) 2a 2) 2a 3) 2a | 13.005 |
| 12 | Elementary education: 1) Construction of new facility – Public elementary school “Dusan Korac” and Public School for Elementary Music Education, Bijelo Polje; 2) Construction of new facility-Elementary school in the settlement Tolosi, Podgorica; 3) Upgrading of existing facility – Public elementary school “25 May”, Rozaje 4) Construction of the sports hall – Public elementary school “Lovcenski partizanski odred”, Cetinje; 5) Construction of new facility –Elementary school in the settlement Zabjelo, Podgorica | 59% | 1) 1a 2) 2a 3) 2a 4) 2a 5) 2c | 17.495 |
| 13 | Preschool education: 1) Construction of new facility - Children’s kindergarten and nursery, Rozaje; 2) Reconstruction, upgrade and superstructure upgrade - Children’s kindergarten and nursery in Kotor; 3) Upgrading and building of superstructure - Children’s kindergarten (Donja Gorica) in Podgorica; 4) Upgrading of existing facility - Children’s kindergarten and nursery on Nikac od Rovina street in Podgorica; 5) Construction of new facility – Children’s kindergarten and nursery, Bijelo Polje | 57% | 1) 2a 2) 2a 3) 2a 4) 2a 5) 2c | 5.975 |
| 14 | Construction of the State Prosecutor’s Office building in Podgorica | 55% | 2c | 7.899 |
| 15 | Construction of the Supreme court building | 53% | 2c | 3.839 |

Group 1 – Ready for tendering and investment realization

Group 1a – projects with technical documentation prepared, ready for tender preparation or tendering;

Group 1b– projects with preparation of technical documentation ongoing, and ready for tendering when it is finished, or some final approvals/permits are missing.

Group 2 – Ready for preparation of project documentation

Group 2a– projects with spatial planning documentation completed and property-related issues resolved;

Group 2b – projects with spatial planning documentation completed and resolving of property-related issues ongoing or property-related issues unresolved;

Group 2c – projects with gaps in spatial planning documentation and unresolved property-related issues or the resolving procedure is ongoing.