Montenegro Fiscal Strategy 2017-2020

Contents

1 FISCAL STRATEGY – OBJECTIVE, MEASURES AND RESULTS

In accordance with the Law on Budget and Fiscal Responsibility (Official Gazette of Montenegro, No 20/14 of 25 April 2014 and 56/14 of 24 December 2014) and the Work Programme of the Government for 2017, the Ministry of Finance, in cooperation with relevant institutions, has prepared a Proposal of the Montenegro Fiscal Strategy for the period 2017-2020.

The Fiscal Strategy for the period 2017-2020 is adopted by the Parliament of Montenegro, upon a proposal of the Government, for the period of office of the 41st Government of Montenegro. Annual Fiscal Policy Guidance for the period of 3 years and the annual budgets are to be prepared based on the Fiscal Strategy.

Economic Policy Objectives: **the strategic objective of the economic policy of Montenegro[1] is smart, sustainable and inclusive growth which will contribute to an improved quality of life for all citizens, precisely reduction of the development gap of the country and the European Union average**[2].

It should be emphasized that the economic policy is also determined by results and obligations from the Euro-Atlantic integrations. NATO membership has provided a long-term stability and security for Montenegro, which will have significant influence on improved conditions and assumptions for pursuit of economic activities. This is confirmed by experience of new NATO members where business climate was improved, attractiveness of the country for investors increased, both for foreign and domestic, and in some countries, the credit rating was also raised. At the same time, Montenegro as the EU membership candidate country has an obligation to structure its economic policy and align it with recommendations, or requirements and methodology of the European Commission over the medium term. To that end, Montenegro has been preparing, three years in a row, a comprehensive, consistent and document comparable with the EU members and candidate countries, the Economic Reform Program, where as part of selected reform areas, the priority structural reforms are presented aimed at improving the economy's competitiveness.

In the period 2017 – 2020, the priority of the economic or the fiscal policy is the strengthening of fiscal stability, and within such framework, generating the budget surplus and setting a downward trend of the public debt from 2019, while strengthening the economic activity and competitiveness of the Montenegrin economy.

Economic Policy Instruments: This objective could be achieved with combination of the economic policy measures, pertaining to the strengthening of the macro-economic stability of the country, consolidation of public finances and increasing the financial sector stability, as well as the economic policy measures pertaining to resolving structural problems in the economy, precisely removing key obstacles for

[1] Montenegro Development Directors for the period 2015-2018, as well as the Economic Reform Program for the period 2017-2019 define the strategic objectives of Montenegro in the economic development area for the medium-term period.

[2] According to the GDP per capita purchasing power party, Montenegro is at the level 42% of the EU average.

improving the country's competitiveness and increasing the potential economic growth over the medium and long term.

To that end, in addition to already established fiscal consolidation measures, precisely the Budget Deficit and Public Debt Recovery Measures for the period 2017-2021 (hereinafter referred to as the Recovery Plan), which were integral part of the Law on Budget for 2017, it is necessary to define additional measures to contribute to faster and more significant consolidation effects. Fiscal consolidation measures set by the Recovery Plan addressed: increase of the excise tax on mineral oils; strengthening of the fiscal discipline through regular collection of tax receivables; restructuring of the outstanding tax debt; abolishing some tax exemptions; continuation of progressive taxation of personal income by maintaining higher rate on personal income of 11%; centralisation of tax fiscal cash registers; reduction of costs for public sector wages; reduction of social welfare benefits; and reduction of general capital budget expenditures. It was estimated that these measures will contribute to the public finances consolidation in the level of 3.2% of estimated GDP.

Despite the significant effects expected from implementation of measures set in the Recovery Plan, taking into account increasing fiscal pressures, additional economic policy measures are being proposed pertaining to increase of revenues and rationalisation/reduction of expenditures. On the revenue side, additional measures will be focused on aligning the excise policy with the EU standards, increasing the standard VAT rate by 2 p.p. from 2018, which shall not distort the competitiveness of the Montenegro's tax system, with expected additional effects of the tax debt rescheduling. On the expenditure side, the gross wage bill was reduced resulting from reduction of the variable part of wage and redefining the employment policy. At the same time, the coefficient of wages was reduced by 1% for jobs with coefficient above 4.1. Furthermore, it is proposed that the group of jobs in categories A, B, and C are additionally reduces by 6%, whereby wages for this category would be reduced by 15% in total. The social policy will be also redefined in order to support fertility and protect the most vulnerable categories of population. Discretionary spending will be reduced to a level which will not put in question efficient functioning of spending units and meeting statutory and contracted obligations.

When measures were designed, a balanced distribution of tax burden was considered, which was achieved by increasing the VAT rate, while other taxes remain unchanged, which is in line with the need for Montenegro to remain competitive destination for foreign investments, in terms of level of tax burden. The analysis "Tax burden on labour in Montenegro" was also consulted in this process, prepared by the UNDP office in Montenegro in April 2017. Moreover, protection of certain categories of population was also taken into account, thus the pensions will not be reduced, but their regular adjustment will be done. In this manner, while considering recommendations of relevant international institutions and of the European Commission, objectives of the economic policy will be achieved for the subject period.

In addition, measures aimed at reduction of the grey economy level, reduction of the tax receivables, as well as cautionary approach in issuing guarantees, which must dominantly be in the function of development, will be intensified. Implementation of incentive measures, in the function of more balanced development of the country, precisely faster development of underdeveloped regions, will continue simultaneously.

The agenda of structural reforms, precisely measures for development and economic policy in the public and real sector is also provided, as support for strengthening the macro-economic stability and competitiveness of the economy, being prerequisite for increasing potential economic growth. To that end, implementation of systemic solutions aimed at strengthening competitiveness of the economic system will continue, by improving the business environment, providing financial and institutional support to development of entrepreneurship precisely to the small and medium-sized enterprises sector, and by doing so to development and diversification of the manufacturing industry. Activities to improve labour legislation will be undertaken at the same time, as well as activities to improve the pension and healthcare system, and to increase efficiency and productivity of the public administration. Measures implemented in the areas of energy, tourism, agriculture, as well as in transport, where Montenegro has comparative natural, geographic and other location-related advantages will contribute to the overall economic growth.

- ***Results or effects of the economic policy measures:*** Additional fiscal consolidation measures will not have a more significant effect on slowing down of the economic growth rates over the medium term, and they will contribute at the same time to achieving the sustainable economic growth over the long term. In the period 2017-2020, while doing so, respectable results will be achieved in the fiscal consolidation segment, which ensure full credibility of public finances of Montenegro, and with improving of the credit rating to a notable improvement of its position on financial markets. Whereby, the budget revenues will have a net increase of 132.9 million euro, while the expenditures will be reduced by 41.5 million euro, as a result of additional measures being implemented. However, due to new expenditures, resulting from corresponding laws and strategic documents, estimated to amount 57.4 million euro, the budget expenditures will be increased by 15.9 million euro. In line with the above stated, total net effect of additional fiscal consolidation measures is 117.0 million euro.

Effects of additional fiscal consolidation measures on the core macro-fiscal indicators:
- budget deficit will be reduced continuously in the period 2017-2020, and starting from 2020 will become a surplus to amount 4.5% of GDP;
- from 2019 a trend of reduced share of public debt in GDP will be set, which will be 67% of GDP in 2020, and lower by 7 p.p. if compared to 2019;
- in the period 2017-2020, real economic growth will be 2.6% on average annually;
- employment will be increased by around 0.9% on average annually;
- wages will be increased by around 1.4% on average annually.

The following table presents core macro-economic and fiscal aggregates, precisely their projections for the next four-year period, with included additional fiscal consolidation measures:

Table 1 Macro-economic and fiscal framework

Macro-economic framework		***Projections***			
		2017	***2018***	***2019***	***2020***
Macro-economic indicators	*Nominal GDP (in mil €)*	*3,957.2*	*4,192.4*	*4,372.2*	*4,536.4*
	GDP, nominal growth in %	*4.9*	*5.9*	*4.3*	*3.8*
	GDP, real growth in %	*2.7*	*3.2*	*2.3*	*2.1*
	Inflation (end year in %)	*2.3*	*3.1*	*2.1*	*1.6*
	Employment growth (%)	*2.0*	*0.5*	*0.5*	*0.5*
	Current account deficit (% of GDP)	*-19.1*	*-18.6*	*-16.8*	*-13.7*
Fiscal framework (% of GDP)		***Projections***			
		2017	***2018***	***2019***	***2020***

Fiscal indicators	*Direct revenues*	*39.9*	*40.5*	*40.1*	*39.8*
	Budget expenditures	*44.9*	*43.2*	*40.8*	*35.3*
	Deficit/ surplus	*-5.0*	*-2.7*	*-0.7*	*4.5*
	Interests	*2.4*	*2.1*	*2.1*	*2.0*
	Primary deficit/surplus	*-2.6*	*-0.5*	*1.4*	*6.5*
	Public Debt	*73.0*	*74.6*	*74.0*	*67.0*

Source: Ministry of Finance

In implementation of development measures and projects, Montenegro will rely on:

- ✓ attracting new foreign direct investments and their compatibility with domestic investment projects;
- ✓ development of public-private partnership forms;
- ✓ European Union funds which will be available in the integration process;
- ✓ favourable credit borrowing with international development institutions; and
- ✓ own financial resources.

2 CURRENT STATE OF THE ECONOMY – KEY CHALLENGES

Since the independence renewal, there has been significant progress in economy, with expressed cyclical trends by periods. Average real growth of gross domestic product in the period 2006-2016 was 3.2%, whereby GDP per capita increased by 76% compared to 2006 and in 2016 amounted to €6,060. Total net inflow of foreign direct investments during the observed period was 5,754.4 million euro or approximately 19% of GDP. Budget revenues in 2016 were 1,486.5 million euro and compared to 2006 they were higher by 73.0%, net average wages was increased from €282 in 2006 to €499 in 2016, and the average pension from €138 to €284. Average real wage growth in the observed period was 33%.

The gross domestic product in 2016, according to the preliminary data, has recorded a real growth of 2.5% if compared to 2015. Highest contribution to growth comes from investments and household consumption, whereby high import dependency of investments has reduced their expected effects which has also affected the GDP growth rate. Bering in mind that developments in the Montenegrin economy are substantially driven investment activities, one of the challenges of the economic policy over the medium term will be to create a supportive business and investment environment in order to ensure conditions for increase of overall investment, and specifically the segment of green field investments.

Development model is predominantly based on domestic consumption, which enables high inflow of foreign direct investments, is not sufficient for creating a more dynamic economic growth in the forthcoming period. In order to establish a long-term stable economic growth, systemic activities are required to expand manufacturing and export based of the economy. This is even more the case since manufacturing volumes are unsatisfactory, the diversification degree is low and the competitiveness of domestic products is infection which all in turn conditions high import dependency of the economy, which has resulting in deterioration of the country’s external position. Therefore, narrowing down the balance of payment deficit could be achieved by creating conditions for import substitution and increasing export of services, predominantly in the tourism sector. To that end, increase in industrial production need to be achieved in the forthcoming period, in particular in the manufacturing segment, and utilise sizeable natural potential for food production and energy generation.

Macro-economic stability is one of the key challenges for Montenegro. To that end, establishing a long-term fiscal and financial stability represents a particular challenge in the forthcoming period. The public finances disbalance, precisely deficit and public debt trends, is largely driven by implementation of the Highway construction project. At the same time, implementation of legislation governing wages and social welfare benefits represents a significant pressure on public finances. Whereby, due to changed schedule in implementation of the Highway project, which resulted in lower than planned capital spending 2016, the central government deficit was 129.4 million euro or 3.4% of GDP and was by 2.2 times lower than in 2015. As of 31 December 2016, the public debt was 2,546.05 million euro or 67.5% of GDP, which is higher by 127.2 million euro or 5.3% if compared to 2015.

The [Central] Government Debt as of 31 December 2016 was 2,402.96 million euro or 63.7% of estimated GDP, while the public debt was 2,546.06 million euro or 67.5% of GDP. Total public debt is composed of internal debt in the amount of 400.2 million euro, external debt in the amount of 2,002.8 million euro and local self-governments debt in the amount of 142.1 million euro. The net public debt of Montenegro as of end 2016, counting in the deposit stock of 47.36 million euro, was 2,498.69 million euro or 66.23% of GDP. The total public debt increased in 2016 if compared to the previous year by 127.0 million euro. The Eurobond issue on international and domestic market mainly drove the debt increase, in the amount of 300.0 million euro and 80.41 million euro respectively, while the debt repayment was 533.0 million euro.[3]

Total issued government guarantees, as of 31 December 2016, were approximately 590.0 million euro, of which the committed funds amount to approximately 494.0 million euro. Debt stock as of end 2016 resulting from issued guarantees, both to domestic and foreign creditors, was 344.9 million euro or 9.1% of GDP, of which 293.92 million euro is for foreign guarantees while the debt stock resulting from domestic guarantees amounts to 50.98 million euro.

No new guarantees were issued nor were existing guarantees called in 2016. The guarantees issued in previous years represented mainly support to companies for implementation of resolution plans of local self-governments, for implementation of various infrastructure projects, as well as for development of small and medium-sized enterprises and restructuring.

In order to reduce the budget deficit and public debt to a level set by the Maastricht criteria it is necessary to define further measures, in addition to adopted measures defined under the Resolution Plan, aimed at increasing revenues and reducing costs.

The financial system is stable, but a moderate systemic risk is still present. Whereby main features of the banking sector, being a dominant part of the financial system in Montenegro, are stability and continued growth of deposits. Liquidity and solvency are improved and are well above the statutory minimum. In 2016, if compared to the previous year, almost all banks' balance sheet items were increased: total assets, deposits, credits, capital. High level of non-performing loans, still high interest rates level, in spite of pronounced declining trend, as well insufficient lending activity of banks, represent a potential source of risks for the real and the banking sector in the forthcoming period.

Features of the labour market are adverse labour force activity, low employment, high unemployment, in particular of youth and women, which is consequence of insufficient labour market flexibility, amongst other things. Unemployment rate at the end of 2016 was 21.1% while the unemployment of youth, age 15-24, was 35.9%. Because of structural unemployment, precisely insufficient supply of certain professions, in particular those required in the construction and tourism sectors, foreign labour force employment is pronounced, which indicates to limited effect of investments on employment which is not resulting in increase of the employment rate. In order for country to continue on the path of diversification of the economy and export expansion, changes will be required both in the education system and in the students' preferences.

Improvements in physical infrastructure, first of all transport and energy will contribute in reducing differences in development of certain regions in the country and better connectivity with neighbouring countries and the EU. To that end, construction of the new transport infrastructure is of the key importance for strengthening the internal cohesion in the country. The good quality transport

[3] Payment of the Treasury Bills refinancing of 184.48 million euro is included.

connectivity with the North of the country is a prerequisite for faster development of this region, in particular for the sectors of tourism and agriculture and thus increasing the economic growth of the entire country.

3 Economic Policy Measures

Starting from the strategic economic policy objective one the one hand, and challenges ahead of the Government of Montenegro on the other hand, focus of the economic policy in the forthcoming period will be to establish sustainability of public finances, while strengthening the economic activity and competitiveness of the Montenegrin economy. This is could be achieved by carrying out economic policy measures pertaining to strengthening of the macro-economic stability of the country, in particular the public finances consolidation, as well as measures to increase the financial sector stability. At the same time, effectuating structural reforms and implementation of capital projects in the priority development sectors, in the first place, as well as implementation of public infrastructure projects, will tackle identified problems in the economy, precisely removing key barriers to improving the competitiveness of the country and increasing potential economic growth over the medium and long term.

Application of comprehensive and consistent structural reforms is the best but the hardest to apply economic policy instrument which achieves competitiveness of the economy and sustainability of public finances[4]. The Competitiveness Council was established for better coordination and an integrated approach in managing economic policy. The Council will coordinate activities of the state administration authorities and other competent bodies and institutions in terms of managing priority reform measures defined by the strategic development documents, serving to remove key obstacles for greater competitiveness and faster economic growth of Montenegro.

3.1 Budget Policy

One of the priorities of the Government of Montenegro is to establish sustainability of the public finances, precisely to reduce deficit and to set the public debt on a downward trend over the medium term. To that end, the Measures for Recovery of the Budget Deficit and Public Debt in the period 2017-2021 were adopted. Despite sizeable effects expected from implementation of adopted measures, having in mind the growing fiscal pressures, it is determined that additional measures need to be adopted in order to accelerate the public debt downward trajectory from 2019 and to generate budget surplus in 2020.

When measures were designed, a balanced distribution of tax burden was considered, as well as fairer distribution of social welfare benefits and protection of the most vulnerable layers of the society. At the same time, the need for Montenegro to remain competitive destination for foreign investments, in terms of level of tax burden, was also taken into account.

Measures on the revenue and expenditure side of the budget are directly affecting the public finances consolidation. In order to have a successful implementation of the overall fiscal consolidation, relevant legislation needs to be amended, inspection oversight needs to be strengthened and involvement of all relevant bodies increased, which would, amongst others, prevent operation in the informal sector. In this respect, the Action Plan for Suppressing the Grey Economy was adopted, which sets preventive, restrictive and incentive measures, to be carried out through a coordinated activity of all relevant institutions.

[4] Technical assistance from IPA funds has provided the expert support for the impact assessment of structural reforms on the economic growth and competitiveness.

Increase of budgetary revenues will be secured from implementation of tax policy measures, which pertain to:

- **Increase of the excise tax on cigarettes[5]:** In order to align the level of excise tax on cigarettes with the standard in the European Union[6], further alignment is required, precisely their gradual, annual increase[7]. To that end, the schedule for increase of the excise tax will be defined through setting the new excise calendar, in such manner as to increase the level of the specific excise on cigarettes:
  - from 1 July 2017 to 1 January 2018 - 30 euro per 1,000 pieces;
  - from 1 January 2018 to 1 January 2019 - 40 euro per 1,000 pieces;
  - from 1 January 2019 to 1 January 2020 - 50 euro per 1,000 pieces.

Ad valorem excise tax on cigarettes for this period would be 32% of the average weighted price of cigarettes, which amounts 1.9 euro in 2017, while its assumed price in 2018 would be 2.3 euro, and in 2019 would be 2.6 euro, when the level of the excise tax rate set by the EU directive is reached.

At the same time the excise tax on the fine cut tobacco will be also increased, which will not have significant effect on the budget revenues but will decrease the price gap[8].

Recognising the risk such excise policy could cause, in terms of increased trade in illicit market of cigarettes, as well as the level of excises in the neighbouring countries, additional inspection oversight measures will be undertaken, as defined in the previously mentioned Action Plan. Proposed measure contributes to the suppressing of negative effects caused by use of tobacco products on the health of citizens, and bearing in mind that gradual increase of the excise rates is being proposed for this excisable product, this will not have more significant effect on the standards of living of citizens.

Fiscal implication of the measure[9]: Implementation of this measure is planned from 1 July of the current year. Implementation of the measure will result in budget revenue increase by 4.6 million euro in 2017, 17.8 million euro in 2018, and 13.2 million euro in 2019, which represents a net effect of 35.6 million euro for the observed period. Application of this measure will also result in increase of revenues from the value added tax in the amount of 5.6 million euro for the observed period.

- **Increase of the excise tax on carbonated water with added sugar or other sweeteners or aromatisation agents:** Bearing in mind that the carbonated water with added sugar or other sweeteners or aromatisation agents has negative implication on the health of population, gradual increase of the excise rates is proposed for this type of excisable product[10] in the following manner:
  - from 1 January 2018 – 30 euro per hectolitre;

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[5] Directive 2011/64/EU

[6] Minimum excise tax in EU for all cigarettes is 90 euro per 1,000 pieces or 60% of the weighted average price of cigarettes.

[7] Present level of excise tax on cigarettes in Montenegro is 53.3 euro per 1,000 pieces, or 56.1% of the weighted average price of cigarettes.

[8] Empirical research indicates that the demand price elasticity for cigarettes in Montenegro is very low and that substitute price has very low impact on the demand.

[9] At the same time, it will be established that the excise tax is to be paid applying new rates not only for cigarettes to be produced or imported after their effective date, but also for all cigarettes in commercial distribution in the domestic market on the day the new rates become effective.

[10] Excise tax of 10 euro per hectolitre of carbonated water (0.10€/l) is paid for this product.

- from 1 January 2019 – 40 euro per hectolitre;
- from 1 January 2020 – 50 euro per hectolitre.

Fiscal implication of the measure[11]*:* Implementation of this measure will result in budget revenue increase of 7.7 million euro in 2018, 3.8 million euro in 2019, and 3.8 million euro u 2020, which represents a net effect of 15.3 million euro for the observed period. Application of this measure will also result in increase of revenues from the value added tax in the amount of 1.3 million euro for the observed period. Possible reduction of consumption for this type of excise product, due to possibly lower number of consumers, will have a certain impact in reducing its effects on the budget revenues.

- **Introducing the excise tax on coal:** In order to achieve the further harmonisation with EU standards[12], the excise tax on coal needs to be introduced and gradually increased. Funds from this source will be used to finance projects for mitigating consequences of air pollution. Application of proposed measure will result in the excise tax rate amount for this product as follows:
  - in 2019 – 0.15 euro/GJ,
  - in 2020 – 0.30 euro/GJ.

Fiscal implication of the measure: Implementation of this measure is envisaged to start in 2019 and the estimated net effect is 4.6 million euro (2.3 million euro each in 2019 and 2020). Application of this measure will also result in increase of revenues from the value added tax in the amount of 0.8 million euro for these years.

- **Increase of the excise tax on ethyl alcohol**.[13], The proposed measure would gradually increase the excise tax on ethyl alcohol[14] in the period from 2017 to 2020 and so as follows:
  - from 1 July 2017 until 1 January 2018 – 850 euro per hectolitre,
  - from 1 January 2018 to 1 January 2019 – 1,050 euro per hectolitre,
  - from 1 January 2019 to 1 January 2020 – 1,250 euro per hectolitre,
  - from 1 January 2020 to 31 December 2020 – 1,500 euro per hectolitre.

Fiscal implication of the measure[15]*:* Implementation of this measure will result in budget revenues to increase by 0.6 million euro in 2017, 1.1 million euro in 2018, 1.1 million euro in 2019, and 1.4 million euro in 2020, which represents a net effect of 4.3 million euro for the observed period. Application of this measure will also result in increase of revenues from the value added tax in the amount of 2.4 million euro.

[11] At the same time, it will be established that the excise tax is to be paid applying new rates not only for products to be produced or imported after their effective date, but also for all those products in commercial distribution in the domestic market on the day the new rates become effective.

[12] Directive EU 2003/96/EC of 27 October 2003 for taxation of energy products and electricity

[13] According to the applicable provisions, alcohol and alcoholic beverages subject to the excise tax are: beer, vine, other fermented drinks, intermediate alcoholic beverages and ethyl alcohol.

[14] The excise tax on ethyl alcohol is 650 euro per hectolitre of pure alcohol and the minimum excise tax stipulated by the Directive for this type of excise product is 550 euro per hectolitre of pure alcohol.

[15] To that end it will be established that the excise tax is to be paid applying new rates from the day they become not effective only for products to be produced or, but also for all products in commercial distribution in the domestic market.

- **Increase of the general VAT rate from 19% to 21%[16]**. Increase of the VAT rate will have sizeable contribution to increase of the budget revenues, whereby a major impact on the economic activity and competitiveness is not expected, since the VAT rate of 21% is still lower than in majority of countries, including those in the region and Europe. Implementation of this measure is planned to start from 1 January 2018.

Fiscal implication of the measure: It is estimated that the VAT rate increase by 2 p.p. will result in budget revenues increase by 42.8 million euro annually. However, the most important food commodities will continue to be taxed at the rate of 7%, thus the standard of economically vulnerable categories of population will not be endangered.

Reduction of budget expenditures will take place with appropriate rationalisation and savings measures. In the process of designing the measures, considerations were made that the set of measures has least negative effect on the economic growth and standard of living. In line with the above-stated, the following measures will be implemented:

- **Reduction of the gross wage bill:** Allocation for gross wages will be reduced as a result of reduction of allocation for the variable part of the wage and employment, whereby the need to strengthen capacities of state authorities required for further EU integration process implementation[17] will be taken into account. Expenditures of the budget will be reduced, as a result of this, by 3.5 million euro in the period 2017-2020.

- **Reducing the wage coefficients by 1%[18]**: In accordance with the Law Amending and Supplementing the Law on Wages of Public Sector Employees, the basic wage for employees with coefficient higher than 4.10 will be reduced by 1% from April 2017 and 2018.

Expected savings from this measure in 2017 and 2018 will be 2.8 million euro annually, which is the equivalent to the fiscal impact of wage reduction from stopping wage increase on the account of years of service. Since the amount of reduced wages will be paid back to employees in 2019 and 2020, the net effect of this measure is neutral.

- **Reducing the wage for groups of jobs A, B and C by 6% (gross effect)**: The coefficient for groups of jobs A, B, and C will be linearly reduced by 6%, in the segment of reducing expenditures for gross wages and contributions charged to the employer. Planned savings for the observed period amount to 1.7 million euro[19].

Implementation of this measure, through amendments to the Law on Wages of Public Sector Employees is planned to start for 1 July 2017.

[16] The World Bank analysis indicates that the VAT increase from 17 to 19% resulted in increase of the budget revenues by 8 to 9%, prices were increased from 0.67 to 0.85 percentage points in the first year with uniform distribution of the tax burden.

[17] Montenegro Public Administration Reform Strategy 2016-2020.

[18] Adoption of this measure will abolish the measure adopted under the Recovery Plan that pertained to the reduction of expenditures for supplement on the basic wage for the past year of service supplement, in such manner that the wage would not be increased as a result of this supplement in the period 01-Apr-2017 to 01-Jan-2019.

[19] The Recovery Plan introduced linear reduction of the coefficient for groups of jobs A, B, and C by 8%, with the fiscal savings amounting to 2.8 million euro.

- **Reduction of expenditures for social benefits:** Redefining social benefits policy, in particular measures concerning the benefit for mothers with three and more children[20], includes higher degree of predictability and non-discrimination in distribution of social funds. In order to increase the birth rate an increase to the child allowance amount is proposed for children of beneficiaries of the financial family support, children of beneficiaries of the custodial care and support allowance, children of beneficiaries of the personal disability allowance and children without parental care. At the same time, conditions for exercising rights to the financial family support will be redefined.

Redefining measures in this area, according to estimates, will result in reduction of expenditures for social and child protection by additional 25.2 million euro for the period 2017-2019, precisely 6 million euro in 2017, 13.5 million euro in 2018 and 5.7 million euro in 2019.

- **Reducing the discretionary spending:** Discretionary spending will be reduced to the level which will not endanger efficient functioning of spending units and meeting of statutory and contractual obligations. Planned effects of savings through reduction of current and capital budget spending are 11.0 million euro.

Whereby total effects of measures on the expenditure side will be reduced as a result of new expenditures arising from relevant legislation and strategic documents. To that end, the budget expenditures will be higher in 2020 if compared to 2017 as a result of:

- costs of regular pension adjustment (indexation) – amount of 22.3 million euro;
- allocation for defence in accordance with NATO standards - amount of 12.5 million euro;
- costs of healthcare system financing - amount of 7.0 million euro;
- obligations in line with the ICT Strategy, Judiciary Strategy and Strategy for enforcement of criminal sanctions - amount of 5.7 million euro;
- realisation of projects financed from EU funds and IPARD like projects - amount of 2.9 million euro;
- obligations resulting from purchase of ships for the Montenegrin Maritime company - amount of 3.0 million euro;
- Montenegro PBS digitalisation project – amount of 3.0 million euro;
- costs of holding presidential elections in 2018 – amount of 2.0 million euro;
- implementation of multiannual projects of the Ministry of Interior Affairs – amount of 1.0 million euro.

The Government of Montenegro is committed to take a cautionary policy of issuing guarantees in the next period and guarantees could be issued only to support development.

To that end and in accordance with the Law on Budget for 2017, on 20 March 2017 a loan facility was signed between the Railway Infrastructure JSC (*Željeznička infrastruktura AD*) and the European Investment Bank (EIB) for the project of reconstruction and improvement of the railway infrastructure in the amount of 20.0 million euro. Moreover, the Government of Montenegro will issue a guarantee for the loan facility between the Montenegrin Electricity Transmission System (*Crnogorski elektroprenosni sistem* - CGES) and the German Development Bank (KfW) for the Project of construction of the electricity

[20] Decision of the Constitutional Court has ruled as unconstitutional provisions of the Law Amending and Supplementing the Law on Social and Child Protection in the segment of benefits for mother with three and more children. At the same time, the Government of Montenegro was instructed to propose a new solution within three months. To that end, the Law on Implementation of the Constitutional Court Ruling and the Law Amending and Supplementing the Law on Social and Child Protection (public consultations in progress) are being prerared.

infrastructure on the Luštica Peninsula in the amount of up to 20.0 million euro and for the loan facility between the Regional Water supply system Montenegrin Coast (*Regionalni vodovod Crnogorsko primorje*) and Erste bank in the amount of up to 8.0 million euro, which has replaced the guarantee issued to the Abu Dhabi Fund, for a loan facility between the za Regional Water supply system Montenegrin Coast and the Abu Dhabi Fund.[21]

3.2 Other Public Sector Reforms

Long-term sustainability of the public finances system includes realisation of set of measures pertaining to increase of budgetary revenues, as well as relevant adjustments as part of the public expenditures system. In addition, important impact of the public sector reforms should be emphasized, including the public finance management reform, as well as reform of the pension and disability system, healthcare system, social and child protection system and education system.

3.2.1 Public Finance Management System Reform

Reform activities in the area of public finance management are implemented in accordance with the Programme of the Public Finance Management Reform 2016-2020. The reform is necessary in order to ensure fiscal sustainability and proper public finance management. The core objective of the Reform is to advance functioning of the budget system, manager's accountability system, budget execution, internal and external audit, as well as alignment with the European Union (EU) legislation.

The priority objectives of the Program are defined and grouped by reform areas: Sustainable fiscal framework, Planning and Budgeting of Public Spending, Budget execution, Development of the Internal Financial Control System, Financial Reporting and Accounting, the State Audit Institution's capacities in order to meet INTOSAI standards, State aid, Customs, and Auditing proceeds from EU funds.

Large number of activities in legislated with the Law on Budget and Fiscal Responsibility which govern budget planning and execution, fiscal responsibility, and other matters concerning the central and local government level. Furthermore, the Law also defines criteria for policy planning, medium-term budgetary framework, numeric fiscal rules and other provisions aimed at improving the public finance management. These reform activities are also a prerequisite for drawing down funds for direct budgetary support under the IPA program.

Formal introduction of the medium-term budgetary framework has improved projections of the main fiscal policy elements in particular in the segment of public expenditure planning by setting budget-spending ceilings for all spending units of the Budget of Montenegro. Additional improvements to the medium-term public finances framework are required in the following years, in order form them to reflect adequately the Government's strategic objectives and policies, increase their transparency and by doing so improve efficiency of public resources use.

[21] The Government of Montenegro has issued a gunratee for the Loan Agreement between the Erste Bank AD Podgorica and the Public Services Enterprise "Regional Water Supply System Montenegrin Coast', entered into on 25 April 2017 in the amount of 7.0 mil euro.

In the segment of budgeting process activities aimed at full implementation of the program budgeting are implemented, in order to create an efficient system of measuring performance of budget programme and improve planning and reporting on capital projects. The Law on Public Sector Accounting will be adopted and IT system improved to allow double bookkeeping, which will create prerequisites for introduction of the accrual accounting.

Montenegro has the obligation to align its legislation, processes and capacities with the requirements of the Directive 2011/85/EU pertaining to budgetary accounting and statistical reporting, forecasts, numerical fiscal rules, medium-term budgetary framework, and clear division of authorities. To that end, ESA 2010 methodology needs to be introduced in the public finances system, with adequate institutional coverage.

3.2.2 Public Administration Reform

The general objective of reform activities until 2020 is to create an efficient and service-oriented public administration, featured by an increased citizens' confidence in its work. The planning horizon for the public administration reform is the Montenegro Public Administration Reform Strategy 2016-2020.

Quality of the Montenegrin administrative apparatus has significantly improved in the previous period. Primarily as stable legislative preconditions are created through adoption of systemic laws and supporting enabling legislation all being of reform nature. In the Strategy implementation period 2016-2020, the legislative framework will be upgrade, but the focus of the reform will to implement adopted legislative framework and substantially change every day practices of the public administration.

To that end, the Law on Civil Servants and State Employees will be amended during 2017, which will include strengthening of implementation of the human resources plan instrument, meaning that in order for a certain vacant position to be filled it must be envisaged by the human resources plan. Along with already proposed measure of freezing new employment, described in the previous sub-chapter, these amendments will contribute to more rational spending of budgetary funds.

Main directions of reform activities may be summarised as follows:

- employees at all levels of the administrative system have a central role in the reform process, and they have to be professional competent and ready to respond to all challenges a modern administration system has to offer;
- work processes in the administration should be oriented towards quality delivery of administrative services;
- level of accountability in the administration system must be raised to a higher level, across all system levels, in order to improve functionality of the administrative apparatus and reduce costs for its work;
- new system of local self-government organisation should ensure a more functional and efficient system by redefining powers of local self-government units in line with their capacities and local population needs, which will contribute to utilisation of resources and implementation of strategic development policies of Montenegro.

3.2.3 Pension System

Key objective of the pension system reform is to reduce pressures posed by payment of pension benefits to the state budget. To that end, and in order to ensure greater fairness, legal requirements enabling early retirement will be re-examined and consequently prevent early exit from the labour market. This will certainly reduce inflow of new pensioners and increase revenues from contributions, but only in future years following the application of new provisions.

Statutory pension benefits adjustments will continue, as well as implementation of measures to improve financial standing of pensioners and so by co-financing housing construction for the needs of pensioners.

3.2.4 Healthcare System

Bearing in mind general sate of the healthcare system, reflected in increased dissatisfaction of citizens concerning availability and quality of health care, dissatisfaction of healthcare professionals with their status, and increase in costs, a need was recognised to intensify implementation of structural reforms in this area which will enable increase in efficiency and reaching financial sustainability of the health care system, while improving health of citizens and advancing quality of healthcare services. To that end, the following activities will be carried out in the forthcoming period:

- analysis of the basic package of health insurance services in order to provide for rationalisation in the segment of coverage list of medicines and introduce copayment for the copayment list of medicines, costs of sick leaves and other costs by introducing a centralised appointment system for doctor visits at all healthcare levels;
- more realistic planning of budgetary funds for the healthcare system;
- creating conditions for aligning the scope of rights from health insurance with available financial resources;
- revisiting organisation of work at all three levels of health care (primary, secondary and tertiary);
- securing additional financial sources;
- establish comprehensive control of procurement and consumption of medicines and medical devices in the public healthcare system;
- outsource technical tasks to specialised agencies;
- further develop and improve integrated health information system, and establish an information system in the Clinical Centre of Montenegro and specialised hospitals, as part of that system;
- motivate healthcare professionals to implement healthcare policy objectives by carrying out programmes of public interest;
- reduce waiting list for healthcare services;
- improve expert knowledge of healthcare professionals.

3.2.5 Social and Child Protection

Reform of the social and child protection system is aimed at establishing economically sustainable and socially acceptable level of protection which ensures timely and efficient protection of individuals and families in state of social need. In line with set objectives, it is necessary to ensure fairer targeting of social benefits, standardisation of decision-making procedure on social protection related rights and reduce misuse, which would enable more efficient planning of measures and programme intended for socially vulnerable categories of population. To that end:

- In order to redefine social benefits policy, achieving greater fairness and non-discrimination in distribution of social funds, legislation addressing this area will be amended. The Law on Execution of the Constitutional Court Ruling and the Law Amending and Supplementing the Law on Social and Child Protection are being prepared in connection with this (public consultations are in progress).
- Capital project “Integrated Social Welfare Information System – Social Card” will be completed;
- Activities to improve the organisation of services for persons with disabilities will be carried. A Centre for rehabilitation and social integration of persons with developmental disabilities will be established, in order to consolidate healthcare and social protection system, as well as education of children and youth with developmental disabilities.

3.2.6 Education

In order for Montenegro to have a competitive labour force, a continuous development and education from early childhood need to be provided. Structural mismatch of supply and demand, increased number of vocational secondary schools students who continue education, with an increase in number of unemployed university graduates, are features of the labour market state of affairs, which have a negative impact on competitiveness of the economy. In order to improve the situation in this area, series of reforms will be carried out, and they pertain to:

- Increasing the level of English language knowledge of children and students;
- Modernisation of educational curricula in secondary vocational education, for all levels of vocational education in order to ensure better linkage of the education nad labour market;
- Implementation of practical education with employers – dual education;
- Alignment of high education with the labour market needs;
- Valuation of practical education;
- Introduction of new model of study in all high education institutions based on the model 3+2+3;
- Redefining the professional development program for persons with completed high education;
- Redefining the criteria for enrolled in studies for teachers profession, while controlling enrolment of candidates to the programmed educating teachers in terms of scores obtained and relevancy of the education programme;
- Introduce new model of financing high education in order for the high education financing to be made efficient, sustainable and stable.

3.3 Structural Reforms of the Real Sector

In order to reduce/eliminate diagnosed obstacles to the growth and competitiveness of the economy, a series of structural reforms will be also carried out in the period 2017-2020, which will be supportive of the fiscal consolidation. Tackling sector obstacles will represent a particular problem which are impeding for the full potential for growth for be utilised for faster economic growth. These are primarily obstacles resulting both from unfavourable structure of the economy from the existing features of human capital and physical infrastructure.

3.3.1 Business Environment and Investment Climate

Improving the business environment includes implementation of reform measures and activities contributing to creation of an economic framework supportive of investment and development of entrepreneurship, precisely for opening new jobs while saving time and reducing operating costs. Its impact on the ranking of country is particularly important, in terms of its attractiveness for foreign investments, used primarily as foundation of the economic growth model.

In order to improve the ranking of Montenegro on rang lists of ease of doing business[22], identified obstacles are being removed for further improvement of the business environment. To that end:

- Simple and transparent procedures for getting an electricity connection will be set, development of the electricity grid will be aligned with urban-development plans;
- Procedures concerning start of construction of a building will be simplified. Instead of building permit and use permit, reporting works will be introduced and necessary documents required as a condition to start construction will be stipulated;
- E-services will be introduced in the work of cadastral offices;
- Procedures for simplifying paying taxes will continue;
- Identified problems in the enforcement procedures will continue to be eliminated.

Investment climate in Montenegro, with significantly improved environment for doing business and incentive tax system, is additionally improved with introduced incentives and relives for investors: the Decree on Incentives for Direct Investments, Programme of Incentives for Developing Business, the Decree on Subsidies for Employment of Certain Categories of Unemployed Persons, Program of Incentives for Clusters in Montenegro for the period 2017-2020, Program of increasing regional and local competitiveness by alignment with requirements of international standards of operation for the period 2017-2020, Programme for improving innovations in small and medium-sized enterprises, Program of support to modernisation of industry.

3.3.2 Financial Stability

The financial system is stable, but a moderate systemic risk is still present. Whereby main features of the banking sector, being a dominant part of the financial system in Montenegro, are stability and continued growth of deposits. Liquidity and solvency are improved and are well above the statutory minimum. In 2016, if compared to the previous year, almost all banks' balance sheet items were increased: total assets, deposits, credits, capital. Banks have carried out a cautionary real sector lending policy, while primarily relying on own liquid assets. Approximately 85% of funds from banks' deposits, which were significantly higher than the approved loans, were directed for lending to the economy. Sizeable share of new lending was for restructuring and refinancing of existing credits, which has had positive impact on recovery of the economy. Total loans and receivables of banks have recorded a mild growth (1.27%). Asset quality parameters have improved, which has a positive impact on the financial system stability. Even though share of non-performing loans in total loans is reduced, it is still sizeable (10.3% at the end of 2016), which causes a cautionary approach of banks to new lending, making their contribution in resolving problems of

[22] According to the report on ease of doing business for 2016-2017 (Doing Business 2017), Montenegro is ranked 51st out of 190 ranked countries.

pronounced lack of liquidity of the economy and in accelerating economic growth far below expected. Lending interest rates in spite of slight decline are still high and represent a barrier for a more dynamic recovery of the economy.

The Law on Voluntary Financial Restructuring of Debts towards Financial Institutions, adopted in order to resolve problems of non-performing loans as part of the Podgorica Approach Project has not yield desired results. In order to reaffirm the project, to extend the period of its validity until May 2018 and to increase coverage of loans that could be subject to voluntary restructuring, amendments and supplements to this Law were made and are adopted by the Parliament in June 2017. As part of the same project, the Decision on Minimum Standards for Managing Credit Risk in Banks was also amended, mandating to banks to review their strategies of dealing with non-performing loans for a three-year period and to define annual operational objectives to reduce non—performing loans. Implementation of this Decision, with permanent oversight of the Central Bank of Montenegro, has resulted in significant reduction of NPLs. It is expected that reduction of NPLs in the forthcoming period will be also impacted by growth in overall lending activity, due to increased competition in the banking sector.

In order to strengthen financial system stability and align wit with the European Union legislation in the area of financial services, sizeable reform of banking operation will take place:

- Law on Recovery and Resolution of Banks of Systemic Importance will be adopted until the end of 2017, in order to provide for financial system stability even in cases of problems with more important banks;
- Law governing establishment, operation and control of operation of leasing companies, micro-credit financial institutions ad legal persons engaged in credit-guarantee activities will be prepared;
- In order to carry out alignment with the European Union legislation in the area of financial services the Law on Banks will be adopted during 2017. The Law on the Central Bank of Montenegro will be amended, which will govern operation of the Central Bank of Montenegro from the day joining the EU and the European Monetary Union.

Stability in the insurance sector has been slightly strengthened, with positive growth rates of this activity, whereby the mandatory insurance classes are still predominant in the structure. There is a significant room for further development of this sector, which would have positive effects on stability of the financial system in the forthcoming period.

Main features of the capital market turnover in 2016 were transactions related to issuing of the Government bonds. Trade in shares of financial and non-financial sector of more sizable nature was not recorded, while the market capitalisation was lower than in the previous year. In order for the capital market to further develop, protection of minority shareholders needs to be improved and corporate governance principles need to be adhered to; higher transparency needs to be provided, in particular in the corporate financial reporting with consistent application of the Law on Accounting and the Law on Auditing; investments in capital of companies aligning their operation with long-term development objectives should be incentivised; knowledge of population, in particular of managers, should be improved in the area of capital markets and investment activities.

3.3.3 Small and Medium-sized Enterprises Sector

Development of small and medium-sized enterprises, one of the main drivers of economic development, is supported with measures implemented in order to improve financial and non-financial support.

Approximately 25,000 small and medium-sized enterprises operate in Montenegro, and their number is constantly growing. Objective of reform measures in this area is to establish new enterprises, increase quality and volume of production, access to new markets, strengthen innovation and by doing so higher share in GDP, exportation, employment and increase of the standard of living.

In order to reduce obstacles to financing of small and medium-sized enterprises, the Investment and Development Fund of Montenegro has intensified activities dedicated to incentives for entrepreneurship by improving financial support, by supplying of short-term and long-term loans for investments and liquidity. Relieves are also provided in form of conditions and procedures within a subset of lending facilities intended for various beneficiaries, such as unemployed persons with university education, youth in business, women in business, start-up enterprises, clusters, innovation enterprises, etc.

Affirmation of model of financing credit guarantees for financial intermediaries as part of the COSME programme (Competitiveness of small and medium-sized enterprises 22014-2020) for existing and new beneficiaries will continue.

Non-financial support for business start-ups is taking place in form of education and providing business advisory services.

3.3.4 Labour Market

Labour market reforms are aimed at increasing the labour force activity, increasing overall employment, in particular in the private sector, to reduce unemployment primarily of youth and women, which is largely a consequence of insufficient labour market flexibility. All these activities will have effect on increase of budget revenues and reduction of expenditures. To that end:

- New Labour Law will be adopted, to contribute to increased flexibility and mobility at employment and to reduce informal employment;
- the Law on Labour Fund will be amended, in order to create conditions and to secure funds for settlement of all labour-based receivables of employees who lost their jobs as a result of bankruptcy;
- new Law on Employment and Exercising Unemployment Insurance relate Rights will be adopted, which will impact reduction of unemployment and increase of employment;
- new Law on Professional Rehabilitation and Employment of Persons with Disabilities will be adopted, which will introduce provisions extracting the Fund for Professional Rehabilitation and Employment of Persons with Disabilities from the Employment Office and setting it as a separate legal person.

3.3.5 Research and Innovation

Montenegro is directing special attention to creation of new framework for incentivising innovation and knowledge exchange processes, as well as to strengthen links between the scientific and research institutions and real sector. To that end, the first Scientific and Technological Park will be established in Montenegro, which will have a direct impact on eliminating barriers between the science, research, innovation and business. A plan for establishing the Scientific and Technological Park (STP) includes a network of STP Podgorica and impulse centres in Nikšić (Tehnopolis), Bar and Pljevlja, as well as impulse centres that could be created in other towns.

Linking the system of science and research with innovation and business through a program of support to STP will enable: creation and attracting new small and medium-sized enterprises, and start-up and spin-off innovative entities; consolidation of existing enterprises; creating strong links with local and regional business centres, incubators, clusters and voucher schemes; fostering transfer of knowledge and high-end technologies from scientific institutions to enterprises; improving commercial research; incentivising creating and application of new or improving existing technologies, procedures, products, services and process on the market, based on high-end scientific results; as well as employment in existing and new business organisations.

3.3.6 Manufacturing Industry

Insufficiently used potential for development of the industry, as well as structural mismatch resulting in narrow and non-diversified production based, have imposed a need to take measures aimed at increasing volume of production, changing the production structure towards increase production with higher added value, and production with higher level of processing, which will impact improvement of export performances.

In order to do that, the implementation of measures to provide incentives to the industrial sector will continue, through implementation of the Decree on Incentivising Direct Investments, securing favourable loan facilities to provide incentives for development of manufacturing industry, implementation of programs to provide incentives for competitiveness by ensuring alignment with international standards, program for improving innovation of enterprises in the manufacturing industry, with starting new programmes aimed at co-financing investments in technical and technological equipping. Measures that will ensure better links of industry with ancillary sectors and strengthening links between the economy and research community will be implemented at the same time.

3.3.7 Agriculture, Rural Development and Forestry

Concept of development of agriculture is based on strengthening agricultural producers, family firms, new private business and domestic entrepreneurial class. To that end, it is necessary to create conditions for increasing investments, for improving competitiveness of the agricultural producers, by introducing new technologies, improving organisation of production and providing higher quality education, as well as for introduction of standards of quality. This will contribute to improvement of the food safety system in Montenegro.

In order to achieve objectives of the agricultural policy and align with the EU Common Agricultural Policy in the forthcoming period, the following reform measures will be implemented:

- strengthening competitiveness of agricultural production through investments;
- increasing degree of utilisation of agricultural land, and to that end better utilisation of state-owned agricultural land;
- improving the standard of living of population in rural areas, stopping migration from and increase employment, by improving the rural infrastructure;
- strengthening the food safety system in order to establish an efficient food safety system, increase export of agricultural and food products in the EU member states and to third country markets, as well as for selling food to tourisms in Montenegro (hidden export);
- improve used of forests and increase revenues for forestry activity.

3.3.8 Tourism

Primary objective of the tourism development policy is for Montenegro to become high-end year-round tourism destination. To that end, further strengthening of competiveness is required, with active correction of key obstacles, which are pertaining to improvement of tourism infrastructure, composition of accommodation capacities, improvement of connections and accessibility of the destination, overcoming the seasonally, reducing the regional misbalance, and shortening return-on-investments period in tourism industry through tax and other relieves and incentives for investors.

In order to increase competitiveness of the tourism sector, being an important generator of budgetary revenues, GDP and employment increase, activities to improve the tourism offer in the north of Montenegro are being carried out, through construction of necessary infrastructure on ski slopes. In order to improve the tourism offer in rural areas, in particular in the north of the country, the Rural Tourism Development Strategy will be adopted. Moreover, in order to diversify tourism offer measures to improve nautical segment are important, through construction of tourist resorts, marinas and supporting infrastructure.

3.3.9 Development of Infrastructure

3.3.9.1 Transport

Good physical infrastructure enables physical connectivity among population in various regions in Montenegro and is a prerequisite for various forms of international cooperation. Furthermore, the good quality physical infrastructure strengthens attractiveness of Montenegro as tourist and investment destination. Weakness in the physical infrastructure are at the same time an obstacle for generating faster real sector growth, which is actually an obstacle to increasing competitiveness and faster economic growth of Montenegro. One of the limitations Montenegro is facing, as an obstacle to increasing competitiveness, is insufficiently developed and connected high quality infrastructure. Investments in transport infrastructure have long-term implications not only for the development of the transport system, but also for development of the overall economy. Its connectivity and being a prerequisite in development of other activities, make transport a sector of strategic importance. Transport as service activity contributes to growth in trade, international services, development of tourism and industry. Likewise, it impacts the integration level of the country, both in regional and in wider international context.

3.3.9.2 Energy

Insufficient connectivity of the electricity system of Montenegro with electricity systems of countries in the region and the EU has negative impact on safety of supply of customers in Montenegro, possibility to export available electricity surpluses and to participate in the regional EU market. This is also one of the reasons why available energy resources of Montenegro cannot be sufficiently commercially utilised and contribute more to economic development of the country. Physical infrastructure of the country in this segment is also facing some challenges, like insufficient investment in existing energy capacities, losses in electricity distribution and high energy intensity. All this points to a necessity to have higher investments in the energy sector of Montenegro.

Investments in refurbishing of existing and construction of new facilities for generation, transmission and distribution of energy, as well we investment in programmes and project to increase energy efficiency are a focus in the energy sector of Montenegro.

3.3.9.3 Municipal Utilities Infrastructure

Since Montenegro is declared as an ecological state under the Constitution, it has the obligation to pay a special attention to protection and preservation of the environment. Problems in the area of municipal infrastructure, such as its obsoleteness, high capital investments cots, inadequate planning and financial resources, even though limited, spent for inadequate investments, have led to lower quality of services and higher costs of performing activities. This represents at the same time a key challenge for further increase of competitiveness in this area and for the overall economy. The local self-government units, their water supply and municipal utilities companies, have an important role in this process, since they participate in implementation of the most important infrastructure projects, which are pertaining to the treatment of wastewaters, water supply, municipal, veterinary medical and other waste.

3.3.9.4 Rural Infrastructure

Rural infrastructure is an important segment of physical infrastructure, where Montenegro, similarly to neighbouring countries, is facing significant problems. In order to prevent population outflow, to utilise available natural resources for general improvement of standard of living of rural population and to increase their competitiveness, a programme of improving the road, water supply and electricity infrastructure in rural regions of the country is being implemented.

3.3.9.5 Information and Communication Technologies Infrastructure

Active use of information and communication technologies, for a country of Montenegro’s size, is of key importance and largely contributed to competitiveness of the country, improving the investment climate and strengthening innovation potentials of the country. Investments in information and communication technologies infrastructure and associated human resources profiles, have a substantial positional in terms of economic growth strengthening and creating high quality jobs. In such context, special attention is assigned to improving both the business environment as well as to infrastructure related prerequisites for use of information and communication technologies business operations.

4 Effects of the Economic Policy Measures

This Chapter provides an overview of impact of the budget policy measures, as well as impact from implementation of the development measures and projects, and structural reforms on economic developments and macro-economic and fiscal aggregates. Whereby, due to nature of the budget policy measures, as well as due to expected short-term effects their impact on macroeconomic developments or fiscal aggregates was quantified. The effects of certain structural reforms, indirectly influencing the growth and increase of the economy's competitiveness, will be visible in the long-term.

The economic policy measures, for the purpose of fiscal consolidation, will have certain effect on slowing down of the economic activity over the medium term, but over the long term, they will contribute to improving the environment for new investments, strengthening competitiveness of the economy, or precisely increasing the potential for its growth. On the other hand, their impact on sustainability of public finances, precisely on deficit reduction and setting a downward trend for public debt is significant, which makes it one of the priorities of the Government of Montenegro.

Bearing in mind the aforementioned and the overall fiscal consolidation measures in the period from 2017 to 2020, the following activities are planned:

1) total consolidation effects, year-on year, will amount to 117.0 million euro, of which the increase in revenues will result in 132.9 million euro, reduction of expenditures will be 41.5 million euro and new obligations will amount to 57.4 million euro;
2) total value of consolidation measures is 2.8% of GDP (value of measures / GDP);
3) average real GDP growth rate will be 2.6%;
4) budget deficit will have downward path and it will be from 5.0% of GDP in 2017 to 0.6% of GDP in 2019, while in 2020 will reach the surplus (4.5% of GDP). Primary balance will be in surplus in 2019 and will be 1.4% of GDP;
5) public debt will grow until 2018, when will reach a maximum of 74.6% of GDP, after which a mild decline is expected in 2019, followed by sizeable reduction to 67.0% of GDP in 2020.

4.1 Macro-economic Projections for the Period 2017-2020

In the forthcoming period the economic activities developments will be under influence of expected investment activities growth, which contributes to increase of the real GDP growth rate and implementation of the fiscal consolidation measures, reducing to a certain extent economic activity and thus the real growth rates. Due to unfavourable diversification of economy, an increased investment activity will cause increase in imports, which in turn will have negative influence on net export. On the other hand, the fiscal consolidation measures, in particular in the first year of implementation, will influence a mild inflation rise, reduction of available household income and potential investments. At the same time, reduction of final consumption will affect reduction of import, which will have positive effect on net export.

The following table presents comparison of macro-economic developments, precisely updated Autumn Projections from 2016[23] and projections that include additional fiscal consolidation measures and effects of such measures on macro-economic indicators.

Table 2: Macro-economic scenario 2017-2020

Macroeconomic scenario 2017-2020 contained in Autumn Projections for 2016				
	2017	2018	2019	2020
GDP in mil euro	**3975.7**	**4227.2**	**4410.4**	**4566.7**
Nominal growth	*5.4*	*6.3*	*4.3*	*3.5*
Real growth	***3.3***	***4.4***	***2.6***	***2.0***
Deflator	*2.0*	*1.9*	*1.6*	*1.5*
Household consumption % of GDP	*75.9*	*73.6*	*72.7*	*72.3*
Investments % BDP	*28.5*	*30.9*	*30.1*	*27.6*
Goods import % BDP	*53.3*	*51.6*	*49.5*	*46.3*
Inflation %	*2.2*	*2.0*	*1.7*	*1.5*
Macroeconomic scenario 2017-2020, with additional fiscal consolidation measures				
	2017	2018	2019	2020
GDP in mil euro	**3957.2**	**4192.4**	**4372.2**	**4536.4**
Nominal growth	*4.9*	*5.9*	*4.3*	*3.8*
Real growth	*2.7*	*3.2*	*2.3*	*2.1*
Deflator	*2.1*	*2.7*	*1.9*	*1.6*
Household consumption % BDP	*75.5*	*73.2*	*72.5*	*72.2*
Investments % BDP	*28.5*	*31.2*	*30.4*	*27.9*
Goods import % BDP	*53.0*	*51.8*	*49.7*	*46.6*
Inflation %	*2.3*	*3.1*	*2.1*	*1.6*
Difference				
GDP in mil euro	**-18.4**	**-34.8**	**-38.2**	**-30.3**
Nominal growth	*-0.5*	*-0.4*	*0.0*	*0.2*
Real growth	*-0.5*	*-1.2*	*-0.3*	*0.1*
Deflator	*0.1*	*0.8*	*0.3*	*0.1*
Household consumption % BDP	*-0.4*	*-0.4*	*-0.2*	*-0.1*
Investments % BDP	*0.0*	*0.4*	*0.3*	*0.3*
Goods import % BDP	*-0.3*	*0.2*	*0.3*	*0.3*
Inflation %	*0.1*	*1.1*	*0.4*	*0.1*

As it could be observed from the Table, the impact of additional fiscal consolidation measures on the economic activity is observed through:

1. reduction of nominal GDP amount in 2020 by approx 30.3 million euro;
2. reduction of the nominal GDP growth rate in the period 2017-2020, by an average of 0.2 p.p.;

[23] Statistical Office has published at the end of March preliminary 2016 GDP data, which are used to update the Autumn Projections presented in the ERP.

3. lower real GDP growth rate by an average of 0.5 p.p.;
4. increase of the average deflator by 0.3 p.p.;
5. reduction of the household consumption in average by 0.3% of GDP;
6. slightly lower nominal amount of gross investments, but also an increase of their share in GDP by an average of 0.2% due to lower GDP;
7. increase of import of goods in average by 0.1% of GDP;
8. inflation rise by an average of 0.4 p.p., whereby the biggest effect is expected in 2018, caused by the schedule of the fiscal consolidation measures implementation. Increase of the VAT rate from 19 to 21% would increase consumer prices by around 0.8%, thus the real household consumption would decline by the same percentage. Increase of the excise tax rate for selected products would increase the inflation by approx 0.8% in aggregate.

However, bearing in mind that the real developments in the economy are very complex, it is not possible to assess effects of these measures with precision, primarily on the: grey economy, consumer preferences, price setting, employment trends, wages and other hard-to-measure categories which could result in discrepancies from the estimated effects of measures, whether measure will have stronger or weaker effects on the economic activity and thus on the macro-economic indicators.

According to projections, the average real GDP growth rate in the period 2017-2020 will be 2.6%. Whereby in the first two years it will be around 3%, after that will reduce to approx 2.2%, due to high baseline gross investments in the previous years, but still with high share of approx 28% of GDP[24] at the end of the period.

GDP trends in the period 2017-2020 are driven by the following categories:

- Domestic demand (household consumption, final government consumption and gross investments) is the main driver of the GDP growth and will grow by an average of 1.4% in the observed period, where the growth is higher in the first two years. Real growth of external demand will be on average 4.2%, with gradual reduction of import and strengthening of the export component, primarily through growth in revenues from tourism;
- Household consumption will be under influence of wage increase and increase of number of employed, and which will be the result of rising demand resulting from investment activities and increase of revenues from tourism. On the other hand, reduction in consumption may be a result of decline in the real growth rate and increase of prices. Average real growth rate of household consumption will be 0.3% in this period;
- Gross fixed capital formation assets will grow by an average rate of 6.9% over the medium term, whereby the average real growth rate in the first two years will be around 16.9%, in line with the schedule investment projects implementation, while it will be reduced in 2020 due to high baseline achieved;
- Government final spending will be under influence of implementation of fiscal consolidation measures, which includes controlled spending from the current budget and significant growth of the capital budget, being its development component, which will result in reduction of the government final spending by an average real rate of 1.1%;

[24] In the period 2010-2016 share of gross investments in GDP was on average approx 20%, which is above the global economy average (18%).

- Export of goods and services will grow by an average real rate of 2.1%, whereby the projected nominal growth for export of services (foreign tourist consumption) is 4.6%, while the growth of export of goods is 2%;
- According to the estimates, import of goods and services has reached amount of 2.5 billion euro, or 66% of the estimated GDP for 2016 and was higher by 263.0 million euro if compared to the previous year. This growth is conditioned by increased import for investments (import of building material and equipment) and increase of import of services related to construction industry (construction of the highway and other projects). The growth in import envisaged for the next two years is approx 2.2%, and after that will decline as result of schedule of investments.

Projections of the core macro-economic indicators for the period 2017-2020 are as follows:

- Balance of payments current account deficit will be on average approx 17.1% of GDP, whereby it will be reduced to 13.7% of GDP by 2020, with gradual decline of import and growth of export of goods and services;
- Employment will grow gradually during the entire period, at an average annual rate of 0.9%, and is a result of the economic activity growth, with limitation pertaining to the partial engagement of the domestic labour force in carrying out investments and the labour market supply and demand mismatch. During the observed period the nominal wages will grow at an average rate of 1.4%, which largely driven by the high unemployment rate and reduction of nominal wages in the public sector.
- Unemployment will be reduced from the estimated 17.7% (LFS) in 2016 to the level of 16.1% in 2020;
- Foreign direct investments will be 10.1% of GDP on average;
- Mild increase of prices is expected in this period, which is based on somewhat higher prices of energy (administrative inflation from increase of prices of oil derivates due to increase of excise tax on fuel of 9 euro cents/litre and increase of prices of the oil derivates in the global market) and mild pressure from increased demand, due to strengthening of economic activity. The fiscal consolidation measures (increase of the excise tax and VAT) are also one of the factors for inflation increase. It is estimated that the average inflation will be around 2.3%.

Risks of the macro-economic scenario for the period 2017-2020 materialising remain the same as in the Autumn Projections, and they relate to:

- change in paste of investments implementation;
- contingent instability on financial markets, which could increase interest rates for sovereign borrowing or make difficult borrowing required to refinance due liabilities;
- adverse weather conditions which could significantly impact the sectors of tourism and agriculture, as well as electricity generation;
- Geo-political risks.

4.2 Fiscal Projections for the Period 2017-2020

Based on the projected trends of macro-economic indicators and planned effects of additional fiscal consolidation measures, the projection of revenues and expenditures, or precisely budget deficit/surplus was prepared.

A need for fiscal consolidation in order to reduce the deficit level and to reduce debt caused introduction of additional measures on the revenues side, but also on the expenditure side of the Budget. At the same time the servicing of assumed obligations over the medium term needs to be taken into account.

The following table presents and overview of additional fiscal consolidation measures, described in the Chapter 3.1 with effect presented as year-on-year.

Table 3: Fiscal Consolidation Measures (in million euro)

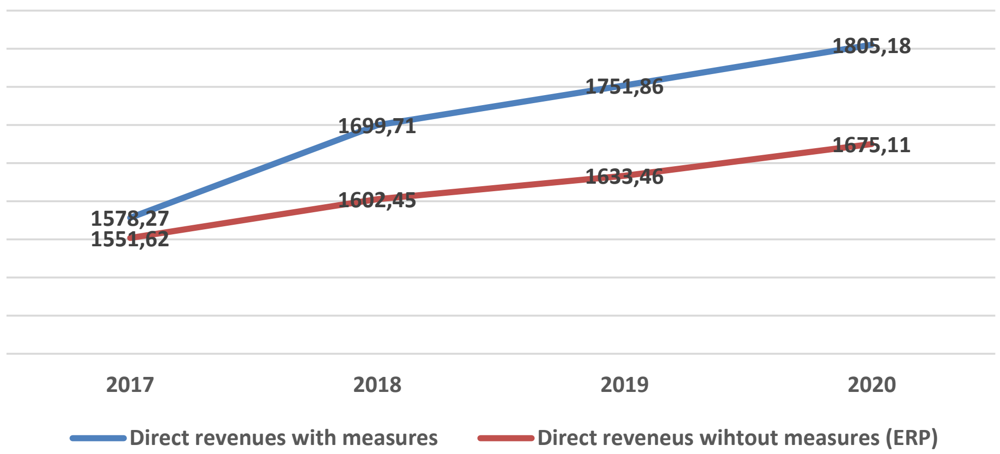
	2017	2018	2019	2020	2017-2020
Revenue side measures					
Excise tax on cigarettes	4.6	17.8	13.2	0.0	35.6
VAT from excise tax on cigarettes	0.7	2.8	2.1	0.0	5.6
Excise tax on carbonated water with added sugar	0.0	7.7	3.8	3.8	15.3
VAT from Excise tax on carbonated water	0.0	0.7	0.3	0.3	1.3
Excise tax on coal			2.3	2.3	4.6
VAT from Excise tax on coal			0.4	0.4	0.9
Excise tax on ethyl alcohol	0.6	1.1	1.1	1.4	4.3
VAT from Excise tax on ethyl alcohol	0.3	0.6	0.7	0.8	2.4
Increase of the standard VAT rate to 21% (2 p.p.)	0.0	42.8			42.8
Tax debt rescheduling	17.0	0.0	0.0	0.0	17.0
Pension contributions for mother to connect with previous employment	1.0	4.2	-2.1	0.0	3.2
I Effects of the revenue side measures	**24.2**	**77.7**	**21.9**	**9.1**	**132.9**
Expenditure side measures					
Reduction of the gross wage bill	1.0	1.5	1.0	0.0	3.5
Reduction of the wage coefficients by 1%	2.1	2.8	-2.1	-2.8	0.0
Reduction of wages for ABC by 6% (gross effect)	0.9	0.9			1.8
Benefits for mothers and package of social protection measures	6.0	13.5	5.7	0.0	25.2
Reduction of the discretionary spending	0.0	4.0	4.0	3.0	11.0
II Effects of the expenditure side measures	10.0	22.7	8.6	0.2	41.5
III New obligations		32.1	11.0	14.3	57.4
IV Total effect on expenditures (II-III)	**10.0**	**-9.4**	**-2.4**	**-14.1**	**-15.9**
Total consolidation effects (I +IV)	**34.2**	**68.3**	**19.5**	**-5.0**	**117.0**

Budget revenues during the observed period will be ranging from 1,578.3 million euro or 39.9% of GDP in 2017 up to 1,805.2 million euro or 39.8% of GDP in 2020. Whereby the biggest difference in revenue projections if compared to the autumn projection is for the VAT revenues, which will be higher by 9.9 million euro, 57.9 million euro, 63.6 million euro and 67.0 million euro respectively in the period 2017-2020. Increase in this category is a result of increase in the VAT rate by 2 p.p., increase in the excise tax rates which will increase the base for VAT calculation, as well as better collection of outstanding tax debt[25].

[25] The Recovery Plan envisages that the revenues generated from this source would be 60.0 million euro in the period 2017-2021. Total of 5,435 requests were submitted to the public invitation for registering tax debtors, closed on 3 April 2017, with total value of debt of 184.8 million euro. Where the total interest to be written-off will amount to 20.0 million euro. Bearing in mind the aforementioned, revenues from this source will be significantly higher than the initially planned and are included in the overall consolidation effects.

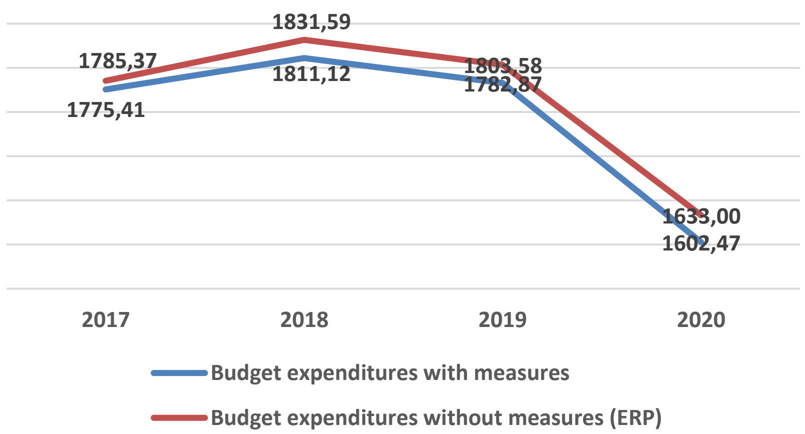
At the same time, the revenues from excise tax will be increased as well by 4.9 million euro, 30.3 million euro, 50.7 million euro and 58.7 million euro, respectively, due to change in schedule for harmonisation of the excise policy with the EU standards. Likewise, revenues from tax and contributions on wages will be also increased through collection of outstanding tax debt and strengthening of the tax discipline.

Figure 1: Budget revenues trend before and after the fiscal consolidation measures are introduced (in mil euro)



Budget expenditures in the period 2017–2020 are mainly allocated in line with the planned schedule for implementation of the Bar-Boljare Highway project construction, precisely in line with the schedule of allocation of funds for such purpose. In line with that, total budget expenditures planned under the Law on Budget for 2017 in the amount of 1,785.37 million euro or 45.4% of GDP, are lower and are estimated to 1,775.40 million euro, or 44.9% of GDP. In the period from 2018 to 2020, total expenditures are reduced, as well as their share in GDP and are ranging from 1,811.23 million euro or 43.2% GDP in 2018 to 1,602.47 million euro, or 35.3% of GDP u 2020.

Figure 2 Budget expenditures trend before and after the fiscal consolidation measures are introduced (mil euro)



At the same time, the current budget spending will grow in the observed period, given the character of these expenditures as well as expenditures for statutory and contracted obligations, which reduces the overall effect of the savings measures. Namely, the current budget spending planned under the Law on Budget for 2017 of 1,502.3 million euro or 38.2% of GDP will be reduced to 1,492.3 million euro and will make 37.7% of GDP. In the period from 2018 to 2020, the current budget spending will have a nominal increase and will amount to 1,519.4 million euro in 2020, when its share in GDP will be reduced to 33.5% of GDP.

In 2017, if compared to the previous year, spending reduction will be in the areas of payment of social welfare benefits and will amount to 12.7 million euro, which will primarily deal with reduction of spending for payment of benefits for mothers with three and more children, or to redefining the social benefit rights, as well as increase of child allowance and some other categories of social welfare benefits for those most in need. In 2018, the reduction of expenditures for this purpose will be by additional 25.9 million euro, and after that, the rights arising from this ground will remain at the same level. Reduction of expenditures for gross wages and contributions charged to the employer in the period 2017-2020, will result in savings for the budget of 3.5 million euro, which will be 432.9 million euro, or 9.5% of GDP at the end of the period.

Reduction of other expenditures in the budget in the segment of the discretionary spending is planned, which will be of such volume that will not endanger efficient functioning of the spending units and meeting of their statutory and contracted obligations. In the period 2017-2020, planned savings from this source in the current and capital budget will amount to 11.0 million euro.

However, obligations for servicing of assumed liabilities set by a law or strategic documents exceed total effect of measures taken on the expenditure side of the budget. Major increases of the current spending in the forthcoming period results from obligations to pay rights from the area of pension and disability insurance, which are due to obligation to carry out regular pension adjustment (indexation) and payment of benefits for pension and disability insurance for beneficiaries who in the previous period were entitled to the benefit on the account of birth of three and more children, will be increased from 411.2 million euro planned under the Law on Budget for 2017 to 444.9 million euro in 2020. Whereby the share of this expenditure in GDP will be reduced from 10.5% in 2017 to 9.8% of GDP in 2020.

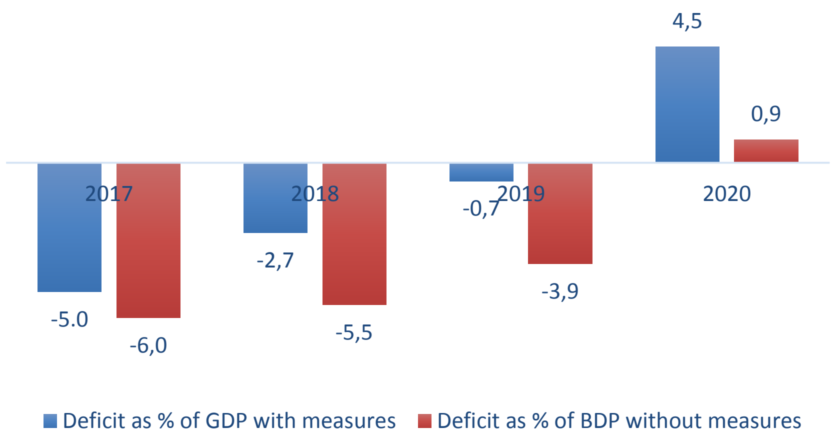
Increase of expenditures is also conditioned by the need to allocate additional funds for financing of the healthcare system. Additional budget allocation is planned for this purpose in 2018 in the amount of 7.0 million euro, and after that it will remain at the same level until 2020. At the same time, allocation for defence will be also increased, and in the period until 2020 additional funds of 12.53 million euro will be allocated and by doing so meeting the NATO standards.

In addition to the above stated the spending will be increased by 15.6 million euro for commitments resulting from laws and adopted strategic documents and contracted obligations.

Expenditures for the capital budget will be increased from 283.1 million euro in 2017 to 315.8 million euro in 2018, after which be reduced and will amount 277.6 million euro in 2019. The scope and dynamic of spending funds will be conditioned by the implementation of the highway construction project. Funds of 194.3 million euro will be allocated for such purpose in 2017, 230.0 million euro in 2018 and 194.8 million euro in 2019, when the completion of the project is planned. The capital expenditures for 2020 will be 83.1 million euro, when the budget surplus of 4.5% of GDP is planned.

Generally, total current spending will be financed continuously from the direct budget revenues, while in 2020, revenues to be generated are planned to be higher than the total budget expenditures, and precisely a surplus of 4.5% of GDP is planned. In other words, the budget deficit in the forthcoming period will be reduced gradually from 5.0% of GDP in 2017 to 0.7% of GDP u 2019, while in 2020 the budget will be in surplus (4.5% of GDP). The primary balance will be in surplus in 2019 and will be 1.4% of GDP.

Figure 3: Budget Deficit Trend



4.3 Public Debt Management 2017-2020

The planned borrowing, in accordance with the Law on Budget for 2017, amounts to 454.3 million euro, of which financing needs for debt repayment are planned to amount 220.4 million euro, financing the highway construction costs approx 200.0 million euro, while for the deficit financing and creating fiscal reserves the planned amount is approx 33.9 million euro. Lower amount will be required for debt repayment in 2018 of approx 215.0 million euro. Debt repayment obligations will grow substantially in 2019 and 2020, primarily due to repayment of Eurobonds issued in 2014 and 2015 in the amount of 280.0 million euro and 500.0 million euro respectively, and will amount approx 530.0 million euro, and approx 760.0 million euro respectively.

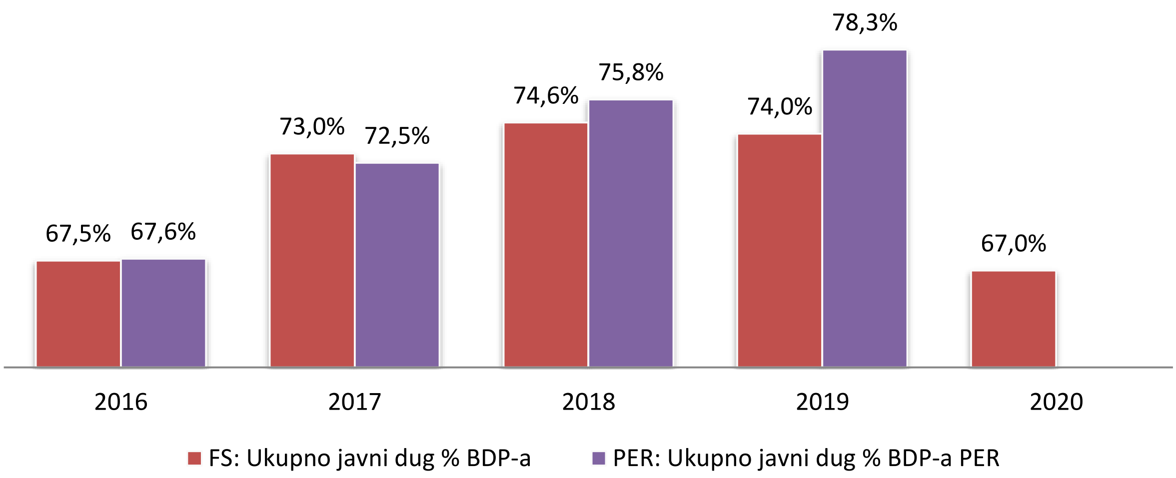
Taking into account the overall fiscal consolidation measures as of 2020, the following table presents projection of the government and public debt trend for the period until 2020.

Table 4: Government and Public Debt trend for the period 2016-2020

Year	2016	2017	2018	2019	2020
GDP	3,7,72.6	3,957.2	4,192.4	4,372.2	4,536.4
Internal Debt	400.2	363.6	327.1	297.2	187.2
External Debt	2.002.8	2,381.5	2,656.4	2,795.7	2,708.2
Total government debt	**2,403.0**	**2,745.1**	**2,983.5**	**3,092.9**	**2,895.4**
Total government debt as % of GDP	**63.7%**	**69.4%**	**71.2%**	**70.7%**	**63.8%**
Local self-government debt	143.1	143.1	143.1	143.1	143.1
Total public debt	**2,546.1**	**2,888.2**	**3,126.6**	**3,236.0**	**3,038.5**
Total public debt as % of GDP	**67.5%**	**73.0%**	**74.6%**	**74.0%**	**67.0%**

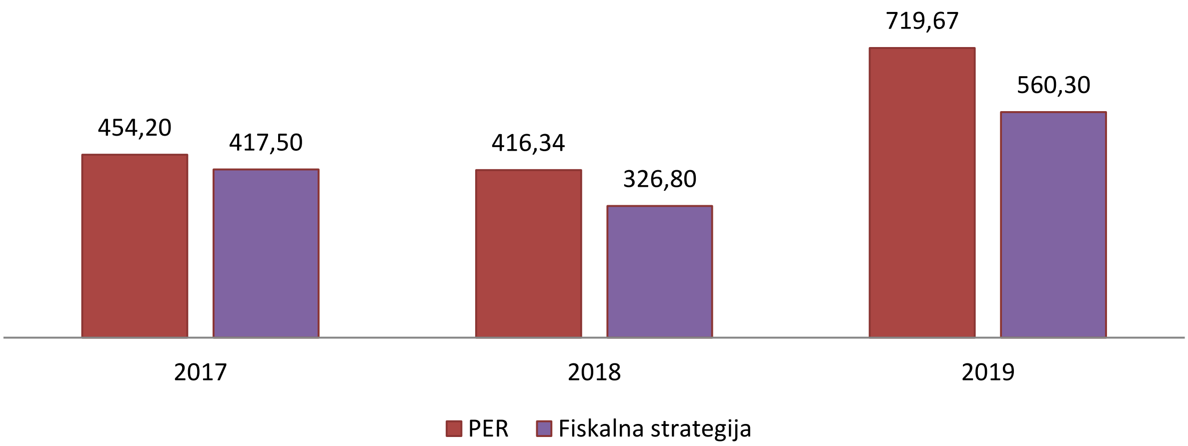
As it could be seen in the table, the public debt is expected to grow by 2018, when will reach the maximum of 74.6% of GDP, following by mild decline in 2019, and a significant decline to 67.0% of GDP in 2020. The debt increase in the next three years is caused mainly by the need to finance construction of the priority section of the Smokovac–Mateševo highway.

Figure 4: Comparison of the public debt with and without fiscal consolidation measures



It is expected that the government debt will be 69.4 % of GDP in 2017, while the public debt will be at the level of 73.0 %. In 2018 and 2019, it is envisaged that the public debt will be 74.6% of GDP and 74.0% of GDP respectively. Significant debt reduction is expected in 2020 by around 7% of GDP, when the government debt will be 63.8% of GDP, and public debt 67.0 % of GDP. Sizeable debt reduction is a result of significant effects of the fiscal consolidation measures, thus the amount of 720.0 million euro, which was predicted in the Autumn Projections, will be reduced to around 560.0 million euro in 2019. Surplus of approx 202.0 million euro is planned for 2020, which will impact the reduction of the borrowing needs, and consequently the debt reduction.

Figure 5: Comparison of shortfall with and without fiscal consolidation measures



In the event of the slower economic growth, the planned revenues may be lower and there may be an increased need for borrowing, which would result in the debt level increase.

In order to achieve the resilience of the fiscal and financial sector there is an interest to receive the World Bank financial support in form of a guarantee (development Policy Based Guarantee), which would be solely used for debt repayment and which would secure sizable support for the government budget financing.

ANNEX

Table 1. Macro-economic projections for Montenegro, 2017-2020					
	2016	2017	2018	2019	2020
	-	-	-	-	-
Nominal GDP in mill euro	3772.6	3957.2	4192.4	4372.2	4536.4
Nominal growth	4.1	4.9	5.9	4.3	3.8
Real growth	**2.5**	**2.7**	**3.2**	**2.3**	**2.1**
Inflation (average)	0.4	2.3	3.1	2.1	1.6
	% of GDP				
Main characteristics:					
Current account deficit	-18.8	-19.1	-18.6	-16.8	-13.7
Export	42.2	41.9	40.8	40.5	40.5
Import	-65.7	-65.3	-63.6	-61.1	-57.7
Other	4.6	4.3	4.1	3.8	3.5
Household spending	78.1	75.5	73.2	72.5	72.2
Gross investments	24.7	28.5	31.2	30.4	27.9
Government spending	20.4	19.4	18.3	17.7	17.2
GDP deflator	1.6	2.1	2.7	1.9	1.6
	Real growth rates in percentage				
Real GDP growth	**2.5**	**2.7**	**3.2**	**2.3**	**2.1**
Domestic demand	**7.5**	**2.8**	**2.8**	**0.6**	**-0.7**
Household spending	2.6	-0.9	-0.3	1.1	1.7
Gross investments	29.6	19.6	14.2	0.1	-6.3
Changes in inventories	0.0	0.0	0.0	0.0	0.0
Government spending	1.0	-1.7	-1.5	-0.6	-0.7
Export of goods and services	5.1	2.5	1.8	2.0	2.0
Import of goods and services	14.1	2.7	1.6	-1.2	-3.5
	Share in real GDP growth in percentage				
Real GDP growth	**2.5**	**2.7**	**3.2**	**2.3**	**2.1**
Domestic demand	**8.9**	**3.5**	**3.5**	**0.7**	**-0.8**
Household spending	2.1	-0.7	-0.3	0.8	1.2
Gross investments	6.0	4.8	4.0	0.0	-1.9
Changes in inventories	0.6	-0.3	0.0	0.0	0.0
Government spending	0.2	-0.3	-0.3	-0.1	-0.1
Net export	**-6.4**	**-0.8**	**-0.3**	**1.6**	**3.0**
Export of goods and services	2.2	1.0	0.8	0.8	0.8
Import of goods and services	-8.6	-1.8	-1.1	0.8	2.1
Main assumptions:	growth in percentage unless otherwise indicated				
Employment growth	1.0	2.0	0.5	0.5	0.5
Wages growth	4.0	0.5	1.5	1.5	2.0
Unemployment (LFS)	19.4	17.8	17.0	16.6	16.1
FDI as % of GDP	9.9	10.6	10.7	10.3	8.8
Domestic credit (corporate and retail)	6.0	3.4	4.2	3.0	2.6

GDP (in mil €)	3957.2		4192.4		4372.2		4536.4	
Table 2: Budget of Montenegro	**Estimate 2017**		**Estimate 2018**		**Estimate 2019**		**Estimate 2020**	
	mil. €	**% BDP**	**mil. €**	**% BDP**	**mil. €**	**% BDP**	**mil. €**	**% BDP**
Direct revenues	**1578.27**	**39.9**	**1699.71**	**40.5**	**1751.85**	**40.1**	**1805.18**	**39.8**
Taxes	**968.0**	**24.5**	**1082.3**	**25.8**	**1134.6**	**26.0**	**1173.7**	**25.9**
Personal income tax	131.8	**3.3**	133.8	**3.2**	136.1	**3.1**	139.5	**3.1**
Corporate profit tax	48.0	**1.2**	49.7	**1.2**	51.8	**1.2**	53.4	**1.2**
Immovable property transactions tax	3.8	**0.1**	3.9	**0.1**	4.0	**0.1**	4.1	**0.1**
Value added tax	534.7	**13.5**	614.4	**14.7**	638.5	**14.6**	661.7	**14.6**
Excise taxes	215.3	**5.4**	245.4	**5.9**	268.6	**6.1**	278.9	**6.1**
Tax on international trade and transactions	24.6	**0.6**	25.0	**0.6**	25.3	**0.6**	25.6	**0.6**
Other government revenues	9.8	**0.2**	10.1	**0.2**	10.3	**0.2**	10.5	**0.2**
Contributions	**499.7**	**12.6**	**511.2**	**12.2**	**517.7**	**11.8**	**530.7**	**11.7**
Duties/charges	**13.2**	**0.3**	**13.6**	**0.3**	**13.9**	**0.3**	**14.1**	**0.3**
Fees	**25.3**	**0.6**	**25.7**	**0.6**	**26.0**	**0.6**	**26.3**	**0.6**
Other revenues	**32.5**	**0.8**	**33.0**	**0.8**	**33.4**	**0.8**	**33.7**	**0.7**
Receipts from loan repayment	4.3	**0.1**	4.4	**0.1**	4.5	**0.1**	4.5	**0.1**
Donations	35.2	**0.9**	29.5	**0.7**	21.8	**0.5**	22.2	**0.5**
Expenditures	**1775.40**	**44.9**	**1811.23**	**43.2**	**1782.87**	**40.8**	**1602.47**	**35.3**
Current budgetary spending	**1492.3**	**37.7**	**1495.4**	**35.7**	**1505.3**	**34.4**	**1519.4**	**33.5**
Current expenditures	**747.0**	**18.9**	**744.1**	**17.7**	**754.1**	**17.2**	**763.4**	**16.8**
Gross wages and contributions charged to the employer	**434.2**	**11.0**	**429.0**	**10.2**	**430.1**	**9.8**	**432.9**	**9.5**
Other personal earnings	**10.2**	**0.3**	**10.2**	**0.2**	**10.2**	**0.2**	**10.2**	**0.2**
Expenditures for material and services	**82.6**	**2.1**	**90.1**	**2.1**	**92.2**	**2.1**	**92.8**	**2.0**
Current maintenance	**21.2**	**0.5**	**20.2**	**0.5**	**20.2**	**0.5**	**20.2**	**0.4**
Interest	**95.4**	**2.4**	**88.6**	**2.1**	**91.4**	**2.1**	**91.4**	**2.0**
Rent	**9.3**	**0.2**	**9.3**	**0.2**	**9.3**	**0.2**	**9.3**	**0.2**
Subsidies	**24.9**	**0.6**	**24.9**	**0.6**	**24.9**	**0.6**	**24.9**	**0.5**
Other expenditures	**33.0**	**0.8**	**33.0**	**0.8**	**33.0**	**0.8**	**33.0**	**0.7**
Capital expenditures in the current budget	**36.1**	**0.9**	**38.7**	**0.9**	**42.7**	**1.0**	**48.6**	**1.1**
Social protection transfers	**562.4**	**14.2**	**550.2**	**13.1**	**556.7**	**12.7**	**561.5**	**12.4**
Social protection related rights	101.4	**2.6**	75.5	**1.8**	75.5	**1.7**	75.5	**1.7**
Funds for technological redundancies	20.6	**0.5**	20.6	**0.5**	19.6	**0.4**	16.6	**0.4**
Rights from pension and disability insurance	415.9	**10.5**	429.6	**10.2**	437.1	**10.0**	444.9	**9.8**
Other health care related rights	15.9	**0.4**	15.9	**0.4**	15.9	**0.4**	15.9	**0.4**
Other health insurance related rights	8.5	**0.2**	8.5	**0.2**	8.5	**0.2**	8.5	**0.2**
Transfers to institutions, individuals, NGO and public sector	**166.2**	**4.2**	**183.6**	**4.4**	**177.7**	**4.1**	**177.7**	**3.9**
Capital Budget	**283.1**	**7.2**	**315.8**	**7.5**	**277.6**	**6.3**	**83.1**	**1.8**
Borrowings and loans	**2.4**	**0.1**	**2.4**	**0.1**	**2.4**	**0.1**	**2.4**	**0.1**
Reserves	**14.3**	**0.4**	**15.1**	**0.4**	**14.3**	**0.3**	**14.3**	**0.3**
Surplus/ Deficit	**-197.1**	**-5.0**	**-111.5**	**-2.7**	**-31.0**	**-0.7**	**202.7**	**4.5**
Adjusted surplus/deficit	**-197.1**	**-5.0**	**-111.5**	**-2.7**	**-31.0**	**-0.7**	**202.7**	**4.5**
Primary deficit	**-101.8**	**-2.6**	**-22.9**	**-0.5**	**60.4**	**1.4**	**294.1**	**6.5**
Debt repayment	**220.4**	**5.6**	**215.3**	**5.1**	**529.3**	**12.1**	**759.5**	**16.7**
Debt repayment to residents	51.9	**1.3**	100.2	**2.4**	77.6	**1.8**	147.6	**3.3**
Debt repayment to non-residents	134.8	**3.4**	100.1	**2.4**	436.7	**10.0**	596.9	**13.2**
Repayment of liabilities from the previous period	33.7	**0.9**	15.0	**0.4**	15.0	**0.3**	15.0	**0.3**
Shortfall	**-417.5**	**-10.6**	**-326.8**	**-7.8**	**-560.3**	**-12.8**	**-556.8**	**-12.3**
Financing	**417.5**	**10.6**	**326.8**	**7.8**	**560.3**	**12.8**	**556.8**	**12.3**
Borrowings and loans from domestic sources	70.0	**1.8**	50.0	**1.2**	100.0	2.3	100.0	2.2
Borrowings and loans from foreign sources	354.2	**9.0**	276.8	**6.6**	460.3	10.5	456.8	10.1
Privatisation proceeds	0.0	**0.0**	0.0	**0.0**	0.0	0.0	0.0	0.0
Increase/decrease of deposits	**-6.6**	**-0.2**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**

GDP (in mil €)	3773.0		3957.2		4192.4		4372.2		4536.4	
Table 3: Public Spending	**2016**		**2017**		**2018**		**2019**		**2020**	
	Mil €	**%**	**mil.€**	**%**	**mil.€**	**%**	**mil.€**	**%**	**mil.€**	**%**
Direct revenues	**1683.67**	**44.62**	**1778.43**	**44.94**	**1928.47**	**46.00**	**1985.18**	**45.4**	**2043.18**	**45.0**
Taxes	**1012.75**	**26.84**	**1096.16**	**27.70**	**1217.59**	**29.04**	**1272.60**	**29.1**	**1314.40**	**29.0**
Contributions	**462.89**	**12.27**	**499.66**	**12.63**	**511.16**	**12.19**	**517.72**	**11.8**	**530.71**	**11.7**
Duties/charges	**18.90**	**0.50**	**19.27**	**0.49**	**19.75**	**0.47**	**20.14**	**0.5**	**20.50**	**0.5**
Fees	**120.21**	**3.19**	**72.25**	**1.83**	**93.60**	**2.23**	**95.25**	**2.2**	**96.91**	**2.1**
Other revenues	**47.30**	**1.25**	**45.72**	**1.16**	**46.50**	**1.11**	**47.15**	**1.1**	**47.78**	**1.1**
Receipts from loan repayment	**4.28**	**0.11**	**4.34**	**0.11**	**4.41**	**0.11**	**4.46**	**0.1**	**4.51**	**0.1**
Donations	**17.33**	**0.46**	**41.03**	**1.04**	**35.46**	**0.85**	**27.86**	**0.6**	**28.39**	**0.6**
Public spending	**1820.32**	**48.25**	**1942.95**	**49.10**	**2002.14**	**47.76**	**1977.59**	**45.2**	**1801.09**	**39.7**
Current public spending	**1714.47**	**45.44**	**1618.20**	**40.89**	**1623.85**	**38.73**	**1636.26**	**37.4**	**1652.98**	**36.4**
Current expenditures	**812.20**	**21.53**	**827.12**	**20.90**	**787.12**	**18.77**	**794.79**	**18.2**	**799.89**	**17.6**
Social protection transfers	**556.08**	**14.74**	**563.53**	**14.24**	**551.35**	**13.15**	**557.87**	**12.8**	**562.69**	**12.4**
Transfers to institutions, individuals, NGO and public sector	**213.17**	**5.65**	**208.17**	**5.26**	**226.41**	**5.40**	**221.37**	**5.1**	**222.24**	**4.9**
Capital Budget	**105.86**	**2.81**	**324.75**	**8.21**	**378.28**	**9.02**	**341.33**	**7.8**	**148.11**	**3.3**
Borrowings and loans	**3.54**	**0.09**	**3.11**	**0.08**	**3.12**	**0.07**	**3.14**	**0.1**	**3.15**	**0.1**
Reserves	**20.84**	**0.55**	**16.27**	**0.41**	**17.11**	**0.41**	**16.35**	**0.4**	**16.39**	**0.4**
Repayment of liabilities from the previsou period	**108.63**	**2.88**	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**	**0.0**	**0.00**	**0.0**
Surplus/deficit	**-136.66**	**-3.62**	**-164.52**	**-4.16**	**-73.67**	**-1.76**	**7.59**	**0.2**	**242.09**	**5.3**
Adjusted surplus//deficit	**-136.66**	**-3.62**	**-164.52**	**-4.16**	**-73.67**	**-1.76**	**7.59**	**0.2**	**242.09**	**5.3**
Primary deficit	**-51.23**	**-1.36**	**-65.00**	**-1.64**	**19.18**	**0.46**	**103.35**	**2.4**	**337.94**	**7.4**
Debt repayment	**550.41**	**14.59**	**280.42**	**7.09**	**276.25**	**6.59**	**593.31**	**13.6**	**823.51**	**18.2**
Repayment of principal to residents	240.52	6.37	78.91	1.99	127.16	3.03	107.62	2.5	177.64	3.9
Repayment of principal to non-residents	309.89	8.21	137.79	3.48	104.09	2.48	440.69	10.1	600.87	13.2
Repayment of liabilities from the previous period	0.00	0.00	63.72	1.61	45.00	1.07	45.00	1.0	45.00	1.0
Shortfall	**-687.07**	**-18.21**	**-444.94**	**-11.24**	**-349.92**	**-8.35**	**-585.72**	**-13.4**	**-581.42**	**-12.8**
Financing	**687.07**	**18.21**	**444.94**	**11.24**	**349.92**	**8.35**	**585.72**	**13.4**	**581.42**	**12.8**
Borrowings and loans from domestic sources	329.21	8.73	80.00	2.02	60.00	1.43	110.00	2.5	110.00	2.4
Borrowings and loans from foreign sources	325.41	8.62	358.17	9.05	280.77	6.70	464.34	10.6	460.80	10.2
Proceeds from privatisation and sale of assets	11.13	0.30	5.00	0.13	5.00	0.12	5.00	0.1	5.00	0.1
Transfers from the Budget of Montenegro	1.75	0.05	3.00	0.08	3.00	0.07	4.00	0.1	4.00	0.1
Use of government deposits	**19.56**	**0.52**	**-1.23**	**-0.03**	**1.15**	**0.03**	**2.39**	**0.1**	**1.62**	**0.0**

Source: Ministry of Finance of Montenegro

Table 4: Investments 2017-2020

SECTOR						Sources of Funds									
						Funds from public sources					Other sources				Total 2017-2020 (1+2)
	2017 Plan	2018 Plan	2019 Plan	2020 Plan	Total 2017-2020	MNE Budget	LG Budget	Credit	EU funds	Total	Private funds	Donations	Funds of state-owned companies	Toral	
Transport	**278.9**	**422.9**	**150.7**	**1.4**	**853.9**	**188.2**	**0.0**	**661.4**	**4.0**	**853.6**				**0.0**	**853.6**
I Highway Bar-Boljare (section Smokovac-Uvač-Mateševo)	**180.5**	**280.0**	**74.6**		**535.1**	**80.3**		**454.8**		**535.1**				**0.0**	**535.1**
II Regional and arterial roads	**79.5**	**105.0**	**66.7**	**0.0**	**251.2**	**74.1**		**177.1**		**251.2**				**0.0**	**251.2**
III Air Transport	**0.2**	**29.5**	**0.0**	**0.0**	**29.7**	**0.0**	**0.0**	**29.5**	**0.0**	**29.5**				**0.0**	**29.5**
IV Railway transport	**17.5**	**8.1**	**6.8**	**1.4**	**33.8**	**33.8**	**0.0**	**0.0**	**0.0**	**33.8**				**0.0**	**33.8**
V Maritime transport	**1.2**	**0.3**	**2.6**	**0.0**	**4.0**			**0.0**	**4.0**	**4.0**				**0.0**	**4.0**
Telecommunications	**41.5**	**32.2**	**25.7**	**17.9**	**117.3**					**7.7**				**109.6**	**117.3**
Energy	**205.9**	**199.0**	**242.2**	**228.7**	**875.8**	**0.0**	**0.0**	**14.9**	**0.0**	**14.9**	**799.2**	**2.3**	**59.4**	**860.9**	**875.8**
Mining and Quarrying	**6.1**	**5.2**	**3.4**	**3.0**	**17.7**						**17.7**			**17.7**	**17.7**
Industry	**29.4**	**17.6**	**19.2**	**9.3**	**75.6**	**8.2**	**0.0**	**0.0**	**0.0**	**8.3**	**67.2**	**0.0**	**0.0**	**67.2**	**75.5**
Tourism	**242.7**	**354.3**	**317.8**	**29.3**	**944.1**	**85.5**	**0.0**	**0.0**	**0.0**	**85.5**	**858.6**	**0.0**	**0.0**	**858.6**	**944.1**
Agriculture	**25.7**	**25.3**	**14.0**	**13.9**	**79.3**	**10.0**	**0.0**	**40.3**	**0.0**	**50.3**	**0.0**	**29.5**	**0.0**	**29.5**	**79.8**
Municipal utility infrastructure	42.3	17.9	9.6	8.4	78.2	1.8	6.8	53.3	15.1	**77.0**	**0.0**	**1.2**	**0.0**	**1.2**	**78.3**
TOTAL	**872,5**	**1074,5**	**782,6**	**311,9**	**3041,9**	**293,7**	**6,8**	**769,9**	**19,17**	**1097,3**	**1742,7**	**33,0**	**59,4**	**1944,7**	**3042,1**