GOVERNMENT OF MONTENEGRO

ECONOMIC REFORM PROGRAMME FOR MONTENEGRO

2017–2019

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CONTENTS

LIST OF ABBREVIATIONS

GVA – Gross Value Added
CEFTA – Central European Free Trade Agreement
GPA- The Agreement on Government Procurement (WTO)
METS – Montenegrin Electricity Transmission System
COSME – EU Programme for the Competitiveness of Enterprises and Small and Medium-Sized Enterprises
EBRD – European Bank for Reconstruction and Development
EIB – European Investment Bank
EIF – European Investment Fund
EEN – Enterprise Europe Network
EFP – Economic and Fiscal Programme
EC – European Commission
EPCG – Electricity Utility of Montenegro
IPA – Instrument for Pre-Accession Assistance
IPARD – IPA for Rural Development
IRFCG – Investment Development Fund of Montenegro
PE – Public Enterprise
PPP – Public–Private Partnership
KfW – German Development Bank
SME – Small and Medium-Sized Enterprises
ERP – Economic Reform Programme
NATO – North Atlantic Treaty Organization
NQF – National Qualifications Framework
OECD – Organisation for Economic Cooperation and Development
PEP – Pre-Accession Economic Programme
DDM – Development Directions for Montenegro 2015–2018
RCC – Regional Cooperation Council
RUP – Pljevlja Coal Mine
SEETO – South-East Europe Transport Observatory
FDI – Foreign Direct Investments
SEE 2020 Strategy – South-East Europe 2020 Strategy
WTO – World Trade Organization
TPP – Thermal Power Plant, Pljevlja

1 Economic Framework and Economic Policy Goals

The Economic Reform Programme is the key Montenegrin document that is used in its dialogue with the European Commission and the EU Member States. At the same time it is also the country's key strategic document for medium-term macroeconomic and fiscal programming. It contains the Agenda of Structural Reforms important for the reduction or elimination of barriers to economic growth and the strengthening of the country's overall competitiveness. Just as in previous years, the topics covered in the Economic Reform Programme for the period 2017–2019 have been discussed and analysed in the inter-ministerial working group established by the Government. The majority of the activities on the finalization of this Programme, including the process of consultation with the stakeholders were carried out in the period December 2016–January 2017.

Economic policy and the process of Euro-Atlantic integration

Montenegro has made huge progress in the process of integration into NATO. After receiving the invitation for NATO membership in December 2015, Montenegro signed the Protocol on the Accession of Montenegro to the North Atlantic Treaty Organization. The process of ratifying the Protocol is in progress in the NATO Member States and it is expected that it will be finalized in the first half of 2017. Thus the country will achieve one of its most important foreign-policy goals – membership of NATO, which will ensure long-term stability and security and bring significant economic benefits.

The process of negotiations regarding Montenegrin membership of the EU continued in 2016. Four additional negotiation chapters were opened, which means that a total of 26 chapters had been opened by the end of 2016, while the total number of temporarily closed chapters remained unchanged in comparison to the previous year. This shows that the focus of the accession process is increasingly on the implementation of legislation that has so far been harmonized with the EU *acquis*. This is related to significant institutional challenges, but also has fiscal implications. According to the Programme of Accession to the EU, Montenegro should by the end of 2018 achieve full harmonization of its national legislation with the EU *acquis* and develop the appropriate administrative capacities for its efficient implementation, so that the accession negotiations can be successfully finalized.

In addition, Montenegro, as a World Trade Organization (WTO) member, on a regular basis fulfils its commitments deriving from a multilateral trade system and agreements within the WTO, with the goal of reducing barriers to the enhancement of competitiveness. Furthermore, measures on trade facilitation within the region of signatory countries of the Central European Free Trade Agreement (CEFTA) have been implemented, as important measures for the growth of competitiveness in the region to which Montenegro belongs.

The strategic development goal in the forthcoming medium-term period and the directions of economic policy aimed at its achievement

The strategic development goal of Montenegro defined in the Economic Reform Programme 2017–2019 is sustainable and inclusive economic growth that will contribute to a reduction in the development gap between Montenegro and the EU average, and to the improvement of the quality of life of all its citizens. Although, due to accelerated economic growth since its restoration of independence, the GDP per capita nominally increased to around EUR 6,000, it is in purchasing power standards, currently at the level of 42% of the EU average. The aforementioned shows at the same time that higher growth rates and their sustainability in Montenegro are much needed in order to provide faster convergence of its GDP per capita with the EU level, and consequently, provide that its living standards converge faster with those of EU citizens.

To achieve the above strategic development goal, the Government of Montenegro will in the coming medium-term period combine two sets of economic policy measures. The first set of measures will be related to the strengthening of the country's macroeconomic stability, particularly the consolidation of public finances, as well as increasing the stability of the financial sector. The second set of economic policy measures will be focused on solving the structural problems in the economy, i.e. the elimination of key barriers to improvement of the country's competitiveness and improvement of potential economic growth in the medium term and in the long term. The above is significantly influenced by the fact that Montenegro is a small economy that uses the euro, where fiscal policy is the key instrument of economic policy. In that respect, ensuring and strengthening of the fiscal stability and broader macroeconomic stability is not only a precondition for the country's long-term economic growth, but is also the key determinant of the conditions under which Montenegro will have access to international financial markets.

Harmonization of the EU recommendations with the priorities of the Government of Montenegro

The Economic Reform Programme is a document that is fully consistent with the annual Budget Law and medium-term budget framework, as well as with the country's strategic development documents. The European Commission provides its annual assessments of the economic reform measures and policies contained in this document. It was in that context that the EC gave its recommendations for the development of the Economic Reform Programme 2017–2019. The recommendations were issued within the Ministerial Dialogue in May 2016, and they are based on the Economic Reform Programme for 2016. These are the six recommendations contained in Table 1.1 of this chapter, which at the same time coincide with the key development priorities of Montenegro defined in the following strategic documents: Development Directions for Montenegro 2015–2018; The South-East Europe 2020 Strategy; Sustainable Development 2030 Strategy; as well as various sectoral development strategies and policies. These priorities include*: strengthening of fiscal stability and sustainability of the economy; preserving the predictable and competitive tax system; strengthening of the physical infrastructure; a systemic reduction of the informal economy; strengthening of support for small and medium-sized enterprises with diversification of the production and export basis; development of human resources and increasing flexibility in the labour market; strengthening of social inclusion; and further strengthening of the rule of law.*

Starting from the above, this document contains the fiscal policy and structural reform measures with the macro-fiscal and sectoral impact that Montenegro has designed to respond to the recommendations of the EU from the ministerial meeting held in May 2016. Table 1.1 below shows the reform measures implemented by the end of 2016 or planned for 2017 as a response to the recommendations from the ministerial meeting held in Brussels.

Table 1.1: Recommendations from the ministerial meeting held in May 2016 and their implementation (already implemented or envisaged for 2017)

Recommendation for Montenegro:	*Measures implemented by the end of 2016 and measures envisaged in 2017.*
1. To stabilise the debt-to-GDP ratio net of debt related to capital investments already underway in 2016, and then reduce it over the remainder of the programme period.	*December 2016:* *Adoption of the five-year Plan for the Rehabilitation of Public Finances in the Field of Public Debt. It envisages that the share of public debt in GDP will continue growing until 2019 (predominantly due to the construction of the national highway), and that it will start declining after 2019.*
2.To take immediate measures to restrain current spending, including on pensions and the public sector wage bill. To generate budgetary savings and improve revenue collection, conduct a comprehensive review of tax expenditure as well as exemptions, and implement tax increase in a growth-friendly manner.	• *December 2016:* *Adoption of the five-year Plan of Rehabilitation of Public Finances in the Field of Budget Deficit. It envisages Montenegro eliminating the budget deficit by 2019 by combining measures aimed at increasing revenues and reducing budget expenditures.* *From 2017 onwards (according to the adopted Plan of Rehabilitation) the following measures of fiscal consolidation are being undertaken on the expenditure side:* • *Salaries for public officials are to be nominally reduced by 8%* • *Social expenditures in the form of benefits for mothers with three or more children are to be reduced by 21% and 25% nominally (through amendments to the Law on Social and Child Care).* • *Implementation of the provisions of the Law on Social and Child Care that refer to the payment of child benefits for children whose parents are registered at the Employment Office of Montenegro as unemployed is postponed until 1 July 2017* • *Expenditure for the financing of political parties is to be reduced to 0.5% of the current*

	budget • *Expenditure from the capital budget is to be reduced, with the exception of expenditure for the highway* • *From April 2017 until the end of 2018 the number of years of work experience will not be included in the calculation of salaries of employees in the public sector.* *The overall effect of these measures is reflected in a reduction of budget expenditure by EUR 67.6 million in 2017.* *On the revenue side effects are expected from the following measures:* • *The value added tax (VAT) rate on computer equipment turnover has been increased to 19%.* • *The Law on Deferred Payment of Tax Debt* • *Measures for the strengthening of fiscal discipline (reduction of the informal economy) have been defined. One of them is fiscalization, which will produce effects from 2018 onwards.* • *The higher tax rate on personal income tax has been maintained at the level of 11% of gross monthly salaries above the average for the following three years.* • *Excise duties on the mineral oils have been increased to EUR 90/1000 litres* *The overall effect of the measures on the revenue side is reflected in a projected increase in budget revenues of EUR 59.3 million in 2017.* *The effect of the measures from the Rehabilitation Plan in 2017 will be translated into EUR 126.9 million, or about 3.2% of the projected GDP.*
3. Develop a comprehensive strategy to further foster the disposal of non-performing loans by banks, including participation by all relevant stakeholders, while establishing a bank lending survey to better gauge underlying credit dynamics.	*The Central Bank of Montenegro has proposed amendments to the Law on the Voluntary Restructuring of Debts to financial institutions. The amendments assume an increase in the coverage of those loans that can be subject to voluntary restructuring and an extension of the implementation of this Law until May 2018 with a view to reducing the share of NPLs out of the total loans of the banking sector (at the end of September 2016 this share was reduced to 10.2%).* *In the future period the Central Bank will continue its intensified supervision of the implementation of the obligations of banks that stem from the Decision on the minimum standards for managing credit risks in banks. This will additionally contribute to a further gradual reduction in the level of non-performing loans.*
4. To ensure effective, efficient and independent regulatory and safety authorities to implement the full opening of rail and energy markets.	*In the recent period the Law on Energy and the new Law on the Cross-Border Transmission of Electricity and Natural Gas were adopted, transposing the legislation of the third Energy Package. These laws significantly strengthened the role of the regulators in this sector, and the obligations and responsibilities of all the participants in the energy sector are clearly defined in line with the directives and regulations. The legal unbundling of the electricity distribution system operator was implemented. This created the preconditions for the development of the market in a transparent and fair way. Activities to establish a national electricity stock market are in progress.* *As for the response to the recommendations in the field of transportation, in 2017 Montenegro will amend the Law on the Railways so that the new model of the functioning of the regulatory body and the security body in the field of the railways can be harmonized with EU legislation from the beginning of 2018. Amendments to the law will consider two possible models for dealing with the measures for closing negotiation Chapter 14 and at the same time, this will be the response to Recommendation No. 4 issued at the meeting in Brussels in May 2016. The first model means that investments from the Directorate will be relocated to another state body that does similar tasks, while the Directorate will continue working as a regulatory and security body in line with Directive 2012/34. The second model is the same as far as the rescheduling of the investments is concerned, while it envisages the regulatory activities being joined to some of the existing independent agencies, and the security body would continue functioning independently as the Railways Directorate of Montenegro with a view to improving security in railway transportation and increasing Montenegro's economic growth and competitiveness.*
5.*Continue to facilitate the provision and range of financial and non-financial support services for SMEs with*	*In the response to this recommendation, two priority reform measures have been proposed.* *Priority reform measure No. 13: Improvement of financial support to the sector of small and*

a view to foster ***participation in global value chains. Support the development*** *of the private consultancy market.*	*medium-sized enterprises* *Priority reform measure No. 14: Improvement of non-financial support to the sector of small and medium-sized enterprises*
6.Prolong working lives and reduce disincentives to work through strengthening the link between activation measures and social assistance, in order to improve the labour market participation of the long-term unemployed, women and youth. Implement strategies to align education and skills policies with labour market needs.	*According to the mentioned recommendation, reform measures were proposed in the fields of education and skills, social inclusion, poverty reduction and equal opportunities.* *They include:* *Priority reform measure No. 17: Development of qualifications in line with labour market needs* *Priority reform measure No. 18: Alignment of higher education with labour market needs* *Priority reform measure No. 19: Amendments to statutory provisions related to the labour market* *Priority reform measure No. 20: Amendments to the Law on Social and Child Protection*

<u>Macroeconomic projections for the period 2017–2019</u>

In the period 2017–2019 the Montenegrin model of economic growth **will be based on investment activity that will strongly impact its economic flows.** The second key determinant of the economic activities in the years to come will be implementation of the consolidation of public finances on the basis of the Rehabilitation Plan for the Budget Deficit and Public Debt, adopted in December 2016 together with the Budget Law for 2017.

Starting from the above and according to the base scenario for Montenegro contained in the Economic Reform Programme for this year, the average annual rate of real economic growth in the period 2017–2019 will be 3.4%, which breaks down to 3.2% in 2017, 4.4% in 2018 and 2.6% in 2019. Based on a scenario of lower economic growth, the average annual rate of real economic growth in the period 2017–2019 will be 2%.

<u>Fiscal framework for the period 2017–2019</u>

Montenegrin fiscal policy is focused on intensifying investment in infrastructure and optimization of current consumption. The aim of the fiscal policy for the period 2017–2019 is the consolidation of public finances aimed at creating the conditions for a reduction of the public spending deficit and a slowing down of the growth of public debt.

Projections of Montenegrin public finances for the coming three-year period are contained the five-year Plan for the Rehabilitation of the Budget Deficit and Public Debt for the period 2017–2021, which the Government of Montenegro prepared on the basis of the Law on the Budget and Fiscal Responsibility which the Parliament of Montenegro adopted, together with the Law on the Budget for 2017 in December 2016. The medium-term projections of Montenegrin public finances contained in the Rehabilitation Plan and in the Economic Reform Programme for the period 2017–2019, as two fully linked documents, are based on the recommendation to finance current spending from the budget's own resources. According to the Rehabilitation Plan, which is the basis of the fiscal projections in ERP 2017–2019, the rehabilitation, i.e. fiscal consolidation, comprises an increase in budget revenues with a focus on an increase in excise duties on mineral oil, the strengthening of fiscal discipline through regular collection of tax dues, reprogramming old tax debts, repealing certain tax exemptions, continuing progressive taxation of income by retaining the higher rate of personal income tax (11%) and centralization of the tax cash registers. On the side of the budget expenditure, consolidation is focused on expenditure that has a relatively less negative impact on economic growth and the standard of living, and that is related to the reduction of costs for a part of the salaries in the public sector, reduction of social expenditure (securing more fairness in their distribution) and reducing certain costs for the capital budget. Thus, the Rehabilitation Plan and the Economic Reform Programme 2017–2019 which is harmonized with it, represent the *optimum mix of economic policy measures that will ensure the stabilization of public finances, a continuation of sustainable economic growth and maintenance of the level of social protection for the most vulnerable groups in society*. According to the above, on the basis of the fiscal consolidation measures contained in this document and as a consequence of the Economic Reform Programme for Montenegro for the period 2017–2019, the budget deficit will account for 6.1% of GDP in 2017. If the above fiscal consolidation measures had not been proposed, the budget deficit would be at a level of about 9% of GDP in 2017.

Table 1.2 *(also contained in Chapter 3 of this document)* shows the projections of Montenegrin public finances for the period 2017–2019 in the basic scenario and the lower-growth scenario.

Table 1.2: Summary of macroeconomic and fiscal projections for Montenegro for the period 2017–2019 (the basic scenario and the lower-growth scenario)

Macroeconomic framework		*Implementation*	*Assessment*	*Basic scenario*			*Lower growth scenario*		
		2015	*2016*	*2017*	*2018*	*2019*	*2017*	*2018*	*2019*
Macroeconomic indicators	*GDP, nominally (in millions of euros)*	*3,625.6*	*3,729.5*	*3,928.5*	*4,176.9*	*4,357.8*	*3,874.1*	*4,038.5*	*4,152.2*
	GDP, nominal growth (%)	*4.9*	*2.9*	*5.3*	*6.3*	*4.3*	*3.9*	*4.2*	*2.8*
	GDP, real growth (%)	*3.4*	*2.4*	*3.2*	*4.4*	*2.6*	*2.0*	*2.7*	*1.3*
	Inflation (at the end of the year) (%)	*1.4*	*0.4*	*2.2*	*2.0*	*1.7*	*2.0*	*1.5*	*1.5*
	Employment growth (%)	*1.2*	*1.0*	*2.0*	*1.0*	*0.5*	*0.0*	*0.5*	*0.5*
	Current account deficit (% GDP)	*−13.3*	*−21.0*	*−20.8*	*−18.8*	*−16.9*	*−16.5*	*−13.3*	*−12.0*

Fiscal Framework (in % of GDP)		*Implementation*	*Assessment*	*Basic scenario*			*Lower growth scenario*		
		2015	*2016*	*2017*	*2018*	*2019*	*2017*	*2018*	*2019*
Fiscal indicators	*Direct public revenues*	*42.4*	*45.1*	*44.8*	*43.9*	*42.9*	*44.9*	*44.5*	*43.8*
	Public spending	*50.9*	*49.0*	*50.8*	*49.4*	*46.7*	*51.5*	*51.1*	*49.0*
	Deficit/surplus	*−8.4*	*−3.8*	*−6.1*	*−5.5*	*−3.8*	*−6.6*	*−6.7*	*−5.2*
	Deficit/surplus without the highway	*−2.5*	*−3.0*	*−1.1*	*0.0*	*0.3*	*−1.6*	*−1.0*	*−0.9*
	Interest	*2.4*	*2.2*	*2.6*	*2.3*	*2.4*	*2.6*	*2.4*	*2.5*
	Primary deficit/surplus	*−6.0*	*−1.7*	*−3.5*	*−3.3*	*−1.4*	*−4.0*	*−4.3*	*−2.7*
	Public debt (% of GDP)[1]	*62.8*	*66.6*	*71.6*	*74.9*	*77.5*	*73.1*	*78.8*	*84.0*
	Public debt without the highway[2] *(% of GDP)*	*60.9*	*61.7*	*60.5*	*57.3*	*54.9*	*61.3*	*59.4*	*57.8*

Source: Ministry of Finance

Starting from the above, according to the base scenario, if the fiscal consolidation measures are implemented, the budget deficit is projected at 6.1%, 5.6% and 3.8 % for 2017, 2018 and 2019 respectively. At the same time, due to the construction of the first section of the highway, the public debt will increase to 71.6%, 74.9% and 77.5% of GDP in 2017, 2018 and 2019 respectively and afterwards a downward trend will commence. In this year's Programme the medium-term forecast for the deficit and public debt, or the simulation of the development of key fiscal indicators has been also done in the scenario with the exclusion of highway construction costs, with the aim of pointing out the difference between including and excluding these costs in the development of key fiscal indicators. In that sense, the basic scenario forecast shows that with the exclusion of highway construction costs, *the budget deficit decreases faster, while the public debt decreases from 60.5% of GDP in 2017 to 54.9% of GDP in 2019.*

According to the EC guidelines issued to the Western Balkan countries and Turkey for the development of this Programme, in addition to the basic scenario, we also provide the scenario of lower economic growth in the medium-term period, which is presented in Chapter 3 of this document.

Structural reforms for the period 2017–2019

The best, but also the hardest to apply, instrument of economic policy that can be used to achieve competitiveness of the economy and sustainability of public finances is the implementation of comprehensive and consistent structural reforms. In his presentation of the new government on 28 November 2016 the nominated prime minister said: "*Structural reforms in combination with fiscal consolidation are aimed at fiscal stability, productivity growth and competitiveness of the economy.*"

[1] The level of public debt in the table is presented according to the EDP methodology used to submit data to Eurostat.

[2] The level of public debt in the table is presented according to the EDP methodology used to submit data to Eurostat.

Starting from the reform priorities defined in the country's key development documents, the obstacles to competitiveness and economic growth identified in Chapter 4 of this document, the Budget Law for 2017, the adopted Plan of Rehabilitation of the Budget Deficit and Public Debt, and from the recommendations from the ministerial dialogue from Brussels of May 2016, Montenegro has defined its priority reform measures in the relevant chapter of the Economic Reform Programme for the period 2017–2019. These measures are closely linked with the measures in Chapter 3, as well as in Chapter 2 of the document. In the medium term they should together create positive macro-fiscal effects and improve the competitiveness of the country. Thus, in the Economic Reform Programme for 2017, the key development priorities of the Government are elaborated in nine areas of structural reforms defined in the Guidelines of the European Commission[3] for the development of ERP 2017–2019, within which 20 priority reform measures have been defined.

The implementation of the reform measures in the ERP 2017-2019 will be also monitored by the Competitiveness Council, that the Government is planning to establish in 2017.

[3] 1. Public Finance Management; 2. Energy, transport and telecoms markets; 3 Sectoral developments; 4: The business environment and reduction of the informal economy; 5: Research and innovation, 6: External trade and investment facilitation; 7: Education and skills, 8: Employment and labour markets; and 9: Social inclusion, poverty reduction and equal opportunities.

2 MACROECONOMIC FRAMEWORK

In the first and second quarters of 2016 the global economy grew by 0.7%, which is significantly lower than the previous year. We should also bear in mind that emerging economies grew by 1.0%, while developed economies recorded only 0.4% growth. After relatively low growth rates in the first two quarters amounting to 1.2% and 2.9% respectively, the US economy recorded a strong growth in GDP in the third quarter at a level of 3.2% per annum. Better performances by the US economy will compensate for the slower growth recorded by Japan and the countries of the European Union. According to data on the leading indicators of the global economy (PMI[4]), the assessments show that the global economy had stronger economic growth in 2016 than was expected.

An increase in oil prices was the result of an agreement between OPEC members and other producers, primarily Russia. Thus, the Brent Crude oil price at the end of 2016 reached the level of 56 USD/barrel, while the average price for 2015 was about 42 USD/barrel. This will significantly improve the position of exporters, i.e. it will strengthen the growth of these countries in the forthcoming period. At the same time, the expected increase in the prices of raw materials strengthens the potential growth of Latin American countries, Russia and the Commonwealth of Independent States (former USSR countries). The gradual growth of emerging economies and the stable growth of developed economies (around 1.8%) are expected to lead to a mild strengthening of economic activities in the next two years.

Table 2.1 below shows the projected GDP growth for the selected countries and regions.

Table 2.1: GDP growth forecast in %

	2016	2017	2018
World	***3.0***	***3.4***	***3.5***
USA	*1.6*	*2.1*	*1.9*
Japan	*0.7*	*0.8*	*0.4*
EU	*1.8*	*1.6*	*1.8*
Developed economies overall	***1.7***	***1.9***	***1.8***
Emerging economies overall	***4.0***	***4.6***	***4.7***
China	*6.6*	*6.2*	*6.0*
India	*7.4*	*7.4*	*7.5*
Latin America	*−0.6*	*1.7*	*2.0*
Russia	*−1.0*	*0.6*	*0.8*
Candidate countries for EU membership	***2.7***	***3.0***	***3.3***
Serbia	*2.7*	*3.0*	*3.3*
Former Yugoslav Republic of Macedonia	*2.1*	*3.2*	*3.3*
Albania	*3.2*	*3.5*	*3.5*
Montenegro	*2.7*	*3.4*	*3.1*

Source: European Commission; Forecast – Autumn 2016

The identified risks in achieving the projected growth rates are primarily related to:

- the impact of the policy to be implemented by the new US administration in relation to fiscal incentives for the domestic economy, significant investments in infrastructure, immigration policies and the impact on world trade, relations with China and Russia, etc.
- the impact of an increase in interest rates (FED – December 2016) on global markets and the impact of emerging economies. The price of the US bonds declined, while the US dollar grew stronger in relation to the euro (the exchange rate is about 1.04 USD to the euro), which has a negative impact on term debt in US dollars;
- instability in the Middle East;
- uncertainty related to the influence of Brexit on economic growth and employment, both in the UK and in the EU;
- uncertainty caused by the outcome of the December referendum in Italy and the crisis in the banking sector there, which are additionally pronounced because of the elections announced for

[4] Purchasing Managers' Index – An indicator of the expectations of managers in terms of employment, investments and procurement.

next year, strengthening of the impact of populist parties, some of which have announced a revision and analysis of the joint-currency policy.

Technical preconditions and euro exchange rate projections, as well as projections of interest rates, oil prices and other indicators used in this document are taken from the autumn forecasts of the European Commission and they make up part of the Annex to this document.

2.1 Current economic trends

2.1.1 Gross Domestic Product

After weaker growth in the first quarter of 2016, the Montenegrin economy accelerated its growth, boosted by the intensification of work on infrastructure projects, as well as on projects in tourism and the energy sector.

According to preliminary Monstat data (consumption method), in the first quarter of 2016 Montenegrin real GDP grew at a rate of 1.1%, while more intensive investment activity in the second quarter boosted the GDP growth to a level of 2.7%. In the third quarter the Montenegrin economy had real GDP growth of 2.4%. Thus, the growth rate in the first nine months of 2016 amounted to 2.2%. Personal consumption by households of 2.2% had the largest impact on growth. The reason for this lies in the implementation of new legislation in the field of salaries, pensions and social care, as well as in gross investment in fixed assets of 29.9%, which come as a result of infrastructure works, construction of tourist facilities and plants in the energy sector. On the other hand, the high dependence on imports that can be noted in relation to investments influenced a significant growth in the importing of goods and services of 16.5%, which is at the same time the largest cause of the lower GDP growth in this period. On the basis of the data available for the third quarter, Montenegro is still recording growth in investments, growth in revenues from the exporting of goods and services, but also growth in the importing of goods and services. The assessments show that real growth for 2016 will amount to 2.4%, provided that the trends of the macroeconomic parameters in the fourth quarter remain within the range of the first three quarters.

It is worth saying, though, that if we compare these figures with the projections from the previous ERP, significant deviations are clearly visible. Specifically, the previous year's ERP projected a real GDP growth rate for 2016 of 4.1%. Table 2.2 below shows the difference between last year's values and the updated GDP projections by component.

Table 2.2: Difference between the projections from ERP 2016–2018 and updated projections

	Projection 2016 (in %)	*Assessment 2016 (in %)*	*Difference*
Real GDP growth	*4.1*	*2.4*	*1.7*
Domestic demand	*4.7*	*7.7*	*−3.1*
Household consumption	*1.5*	*3.7*	*−2.2*
Gross investments	*18.7*	*28.1*	*−9.4*
Government spending	*2.5*	*1.2*	*1.3*
Export of goods and services	*0.7*	*8.0*	*−7.3*
Import of goods and services	*2.8*	*16.6*	*−13.8*

Source: Ministry of Finance

The previous year's projections show that household consumption was underestimated due to a lack of information about the impact of the increase of public-sector salaries and expenditure on social benefits, as well as a significant increase in borrowing by the population. The growth of gross investment was also underestimated due to a lack of detailed information about the pace of the implementation of infrastructure projects. Due to a highly negative deflator (fall in prices) in 2016, the export of goods and services was also underestimated, which influenced an increase in the real growth rate. At the same time, the importing of goods and services was underestimated, particularly the part referring to the importing of services based on hiring foreign companies to carry out investment works. The second reason for the underestimate in imports is a negative deflator (a fall in the price of imported goods and services).

Observed by the production method, the most significant impact on the GDP in 2016 came from:

Tourism (the total direct and indirect contribution of tourism and travel to the GDP amounted to 22.1% in 2015, while the share of the services of accommodation and food made up 9.2% of the gross value added (GVA). After a record-breaking 2015, the turnover in tourism in the first nine months of 2016 recorded a moderate increase in arrivals (5.2%) and overnight stays (1.2%). According to the preliminary data of the Central Bank, the revenues from tourism (overnight stays by foreign tourists) for the observed period amounted to EUR 800.6 million, which is 2.1% more than in the same period in 2015, while, according to the estimate of the Ministry of Sustainable Development and Tourism, the total revenues from tourism (overnight stays by domestic and foreign tourists) in the nine months amounted to EUR 843.0 million, or 1.7% more than in the same period of the previous year. In the structure of overnight stays, foreign tourists make up 93.9%[5] of the total, with a growth of 1.6% in comparison to the same period last year, while domestic tourists, which account for 6.1% of the total number of overnight stays, recorded a decline of 3.9%. Tourist turnover has a pronounced seasonal character, which can be seen in the number of overnight stays by month. In the period January–September 2016, the largest number of overnight stays were recorded in July and August – EUR 7.2 million (66.6% of the total number of overnight stays). Due to the construction of high-category hotel capacities, the structure of the tourists visiting Montenegro is changing. The number of tourists with stronger purchasing power is on the increase. Montenegro currently has about 40,184 beds in hotels, apartments and rooms (42.0% are beds in hospitality facilities with 4 or 5 stars). Twenty new hotels were opened in 2016 (more than 90% are 4- and 5-star hotels and apartments) with about 2,000 beds, which is a growth of approximately 5.0%.

Industrial output (share of 12.9% GVA in 2015). In the first nine months of 2016 industrial output recorded a fall of 4.2% due to a decrease in output in all sectors. The most significant fall was recorded in the sector of "extraction of ore and stone" (26.1%), due to interruptions in the production of the Thermoelectric Power Plant (TPP) in Pljevlja that occurred twice for periods longer than two months. This is also connected to lower output from Pljevlja Coal Mine. The strongest impact on the decline in industry came from a fall in the processing industry, due to its high share in total industrial output (59.9%). After a mild recovery in 2015, the processing industry recorded a fall of 3.2% in the period January–September in comparison to the relevant period of the previous year. It also recorded a fall in almost all fields of activities. Out of the total of 17 fields of activities, only the following three, which make up 40.0% of the processing industry, recorded any growth: food products (6.7%), wood and cork products (14.3%) and pharmaceutical products and preparations (24.0%). In addition to this, there is an obvious declining trend in the share of the production of base metals and growth in the share of production of pharmaceuticals and preparations.

Turnover in retail (trade is 14.5% GVA in 2015). Turnover in retail in the period January–September (current prices) is 3.9% higher, while in constant prices it is 2.3% higher. Monthly indicators record mild fluctuations, and the turnover in the summer months corresponds to the results achieved in tourism, with lower growth rates than in the previous years, due to a high starting level in 2015.

Transportation (share of 4.5% in the GVA for 2015). According to Monstat data, in the period January–September 2016, Montenegro recorded growth in the amount of goods transported by rail (1.2%), road (1.0%) and in the turnover of goods in airports (3.2%). It also recorded an increase in the number of transported passengers by rail (6.7%), air (4.0%) and road (10.7%), as well as an increase in mobile telephony services provided (1.4%). The maritime transport of goods declined (-22.1%), as did the transfer of goods at ports (-10.5%).

Construction (share of 4.6% in the GVA for 2015). The intensified investment in construction that started in the second quarter of 2016, influenced the strong growth in the value of the construction works in the first nine months of 2016 (27.8%), in implemented working hours (14.4%), as well as in the number of issued construction permits (28.3%).

[5]The largest number of overnight stays were generated by Russian visitors (27.3%, or 4.4% more than in the same period in 2015) and visitors from Serbia (26.6%, or 4.5% less than in the same period in 2015). The share of visitors from Bosnia and Herzegovina was significant and growing – 10.1% of the total foreign visitors staying overnight, which is an increase of 8.4% in comparison to the relevant previous period.

2.1.2 Inflation

As an open and highly import-dependent economy, the Montenegrin economy is strongly influenced by international market trends. In 2016 the low prices of food, oil and oil derivatives in the global market had a "spill-over" effect on Montenegro and through so-called "import inflation" exerted a deflationary pressure on the trends of prices in Montenegro. As for internal market trends, there was a mild inflationary pressure from tobacco prices, because of the regular annual harmonization of excise duties, as well as from accommodation prices that rose during the entire period[6]. Electricity prices did not grow in 2016. The annual inflation rate (CPI) in September amounted to -0.1%, while the average rate for the first nine months of 2016 amounted to -0.4%. A monthly breakdown of the data shows minor changes in those categories that had the strongest impact on the reduction of inflation through the year (food and fuel). The price of tobacco recorded stable growth, while the prices of pharmaceuticals, clothes, footwear and accommodation services continuously recorded mild growth. This partly compensated for the decline in the prices of the above-listed products. In September the annual inflation rate, measured by HICP, amounted to 0.2%. Estimated annual inflation rate for 2016 was 0.4%.[7]

2.1.3 Employment and salaries

Although there are certain improvements, the labour market is still characterized by a high rate of inactive labour, a low employment rate, long-term unemployment, a structural mismatch between demand and supply and a high unemployment rate, particularly among the young. A particular challenge in the labour market is new legislation in the field of social policy which enables an early exit from the labour market for certain categories of women, creating fictive unemployment on one hand, and work in the grey economy on the other.

According to data from the Labour Force Survey, the size of the population willing and able to work in the third quarter of 2016 was 279,500. Out of this number, 232,400 people (83.1%) were employed, while 47,100 (16.9%) were unemployed. The number of employed people was 3.4% higher than in the previous quarter, while the number of unemployed people went down by 1.1%. The activity rate for the third quarter of 2016 was 55.9%, the employment rate was 46.5% and the unemployed rate was 16.9%.

According to administrative sources, the number of employed people amounted to 180,409 in September 2016 and it was 0.9% higher than in the same period of 2015. A significant increase in the number of employees was recorded in the construction sector (8.0%), transport and storage (4.3%) and administrative activities and supporting services (3.9%). A decrease in employment was recorded in six sectors, most significantly in the sectors of "ore and stone mining" (17.3%), "agriculture, forestry and fisheries" (9.7%) and "electricity, gas, steam and air conditioning supply" (3.9%).

The number of unemployed people amounted to 42,483 in September 2016 and was 25.8% larger than in the same month of 2015. The rate of registered unemployment on 30 September 2016 was 18.3%, which is 3.8 p.p. more than on the same day in the previous year. In the first nine months of 2016 a total of 26,665 job vacancies were advertised, which is 10.1% less than in the relevant comparative period.

The average monthly salary amounted to EUR 753.00 in September 2016, which is 4.6% higher than in the same period in the previous year. The average monthly salary after taxes and contributions was EUR 501.00 which was 5.0% less than in the same period in the previous year. Real net salaries recorded a decline of 1.1%.

2.1.4 Credit activity of banks

The banking system of Montenegro (15 banks) is dominated by banks with a majority foreign ownership and registered offices in European Union countries. The level of market concentration is moderate, since five large banks cover 64.5% of the banking market.

[6] Accommodation prices recorded their highest growth in May (11.1%).

[7] According to Monstat data from January 2017, average inflation in 2016 was -0.2%, while inflation at the end of the year was 0.9%. This increase was due to the increase in fuel prices in November and December last year.

The banking sector is stable, solvent and liquid. The business operations of the banks were characterized in the first nine months by a growth in assets, credits, deposits and capital. The high liquidity parameters show that credit activity is limited because the banks are still cautious. This is reflected also in the high interest rates. Still, the trend of decreasing interest rates is a positive signal of an increase in demand and a recovery of the credit activities of the banks. At the same time, it is a factor of potential risk for insufficiently competitive banks, which could jeopardize their profitability because of the higher costs of financing and higher operational costs, as well as because of a smaller client base. The total deposits of the banks at the end of September reached a maximum of EUR 2,854.1 million, which is a growth of 8.8% annually. The structure of the terms of the deposits is not satisfactory, since 55.5% of the total deposits are sight deposits, while 44.4% are term deposits. In comparison to the situation in September 2015, sight deposits recorded a growth of 21.1%, while term deposits declined by 2.5%. As for the availability of long-term financial sources, the situation is even more unfavourable given that short-term deposits (up to one year) make up 76.0% of total deposits, while term deposits for over three years make up a meagre 3.3% of total deposits.

Total loans at the end of September amounted to EUR 2,506.6 million, which is 5.1% higher than at the end of the previous year, while at the annual level they are 1.5% lower. Out of total bank loans, EUR 916.6 million (36.6%) was lent to the economy, while EUR 998.9 million (39.8%) was lent to the retail sector. On an annual level, loans to the economy recorded a decline of 1.6%, while loans to the retail sector recorded a 9.3% growth. Long-term loans dominate with 72.1% in the term structure of total loans.

The lending activity of banks increased significantly in the observed period. In the first nine months of 2016 the banks granted new loans amounting to EUR 819.3 million, which is 26.0% more than in the same period of the previous year. A total of EUR 352.0 million in loan funds was granted to the retail sector, while EUR 361.7 million was lent to industry. In comparison to the first nine months of 2015, newly granted loans to the retail sector were EUR 111.4 million (46.3%) larger in 2016, while the loans granted to industry were EUR 33.0 million (10.0%) higher.

Non-performing loans (NPL) at the end of September amounted to EUR 254.9 million, i.e. 10.2% of total loans. In spite of a significant reduction of 27.5% on an annual level, these loans are still under continuous and intensified supervision.

At the end of September 2016, out of the total number of 80,334 legal entities and entrepreneurs, 15,312 or 19.1% were non-liquid. The value of debt on the basis of frozen accounts amounted to EUR 614.6 million, which is 12.2% higher than in December 2015.

2.1.5 External sector

2.1.5.1 Current account

The current account deficit for the first nine months of 2016 increased by 105.5% compared to the same period the previous year. This was caused by a significant increase in the goods deficit and a reduction of the surplus in the account of services and primary income. The export of goods increased by 5.8%. The most significant export product is aluminium, with a share of 23.0% and its export increased by 15.3%. Production of base metals fell by 15.6% and that mostly led to a decrease in the export of iron and steel by 35.7%. Imports of steel and iron products increased by 71.0%, i.e. from EUR 36.0 to 62.0 million.

Total imports grew by 12.0%, which is a consequence of the larger importing of machines and transport devices needed for infrastructure projects and projects in the field of energy and tourism. Thus, the importing of insulated wire for the instalment of the energy cable between Italy and Montenegro increased, as well as the import of electricity generators due to the construction of mini-hydroelectric power plants and wind turbines. The importing of electrical transformers and various other appliances related to the production of electricity increased as well. The instalment of 23 wind turbines in Krnovo was completed. The value of this project was EUR 140.0 million. The importing of metal constructions also increased, while the importing of mineral fuels declined by EUR 14.0 million. Given this implementation of large investment projects, Montenegro recorded an expected goods deficit increase.

On the services account there is a surplus of EUR 748.5 million, which is 3.9% lower than in the same period of 2015. An increase in revenues in comparison to the previous year is a consequence of larger outflows in transport, travel and tourism, and telecommunication services. In the observed period, the scope of the exchange of services was 7.1% larger than in 2015, and it amounted to EUR 1.4 billion. The assessed revenues from travel and tourism in the first nine months of 2016 amounted to EUR 800.6 million.

On the primary incomes account the surplus reduced by 72.0% in comparison to the relevant period in 2015. In the observed period total expenditure grew by 37.4%, due to stronger outflows based on paid dividends. In the secondary incomes account Montenegro recorded a surplus that was 10.2% higher than in 2015. The total inflow of transfers to Montenegro increased by 4.4% in comparison with the previous year, while the largest inflow came from personal transfers from abroad. This inflow amounted to EUR 83.6 million. In the same period, outflows of personal transfers to abroad amounted to EUR 24.2 million.

2.1.5.2 Capital and financial account

In the first nine months of 2016, the net inflow of foreign direct investment amounted to EUR 281.9 million or 46.3% less than in the same period in 2015. The inflow of foreign direct investment amounted to EUR 551.9 million, while the outflow was EUR 270.0 million. This significant reduction in the net inflows is a consequence of the payment of dividends from accumulated profits from the past, which, according to IMF methodology, is recorded as a withdrawal of capital. Inflows in the form of ownership investment amounted to EUR 227.4 million, which is 41.2% of the total inflow. In the structure of ownership investments, EUR 139.5 million is related to investments in companies and banks. That is 25.3% of the total inflow, while the inflow of investments in property amounted to EUR 87.9 million. The inflow of FDI in the form of inter-company debt amounted to EUR 135.0 million, which is 24.5% of the total inflow. The inflow of money based on the withdrawal of funds by residents, invested abroad amounted to EUR 189.5 million (34.3% of the total inflow).

Table 2.3: External sector- Balance of Payments (in EUR million)

	Jan-Sept '15	Jan-Sept '16	Change in %
A. CURRENT ACCOUNT (1+2+3+4)	−203,5	−418.17	105.5
1. Goods	−1,119.2	−1,265.7	13.1
1.1. Exports, FOB	225.0	239.8	6.6
1.2. Imports, FOB	1,344.1	1,505.5	12.0
2. Services	779.0	748.5	−3.9
2.1. Revenue	1,060.5	1,093.0	3.1
2.2. Expenditure	281.4	344.5	22.4
3. Primary income	62.7	17.5	−72.0
3.1. Revenue	184.8	185.3	0.3
3.2. Expenditure	122.1	167. 8	37.4
4. Secondary income	74.0	81.5	10.2
4.1. Revenue	126.9	132.4	4.4
4.2. Expenditure	52.9	50.9	−3.7
B. CAPITAL AND FINANCIAL ACCOUNT	−11.9	35.5	−397.8
B1. Capital account	0	0.8	
B2. Financial account	−11.9	34.7	−390.8
1. Direct Investment – net	524.5	281.9	−46.3
1.1. Assets	−14.8	174.4	−1,278.4
1.2. Liabilities	539.3	107.5	-80.1
2. Portfolio Investment – net	191.1	−2.7	−101.4
2.1. Assets	15.74	−43.3	−375.1
2.2. Liabilities	175.4	40.6	-76.8
3. Other Investment – net	−571.9	−139.9	-75.5
3.1. Assets	−579.3	−229.4	−60.4
3.2. Liabilities	7.4	89.5	1,114.8
B3. Change in the Central Bank of	−155.6	−104.6	−32.8

Montenegro reserves			
C. NET ERRORS AND OMISSIONS	*215.4*	*382.7*	*77.7*
Source: Central Bank of Montenegro			

The total outflow of foreign direct investment in the period January–September 2016 amounted to EUR 270.0 million. The largest part was related to the payment of dividends, while the outflow based on the investments of residents abroad amounted to EUR 15.1 million.[8]

In the account of portfolio investments Montenegro recorded an inflow amounting to EUR 431.1 million, which was a 29.5% reduction in comparison to the previous year. Investments in domestic securities amounted to EUR 398.0 million, where investment in equity securities amounted to EUR 23.9 million, while investments in debt securities were much larger and amounted to EUR 374.1 million. The largest part of the investment into debt securities is related to the issuing of Eurobonds on the international capital market. The inflow from the withdrawal of funds invested into securities amounted to EUR 33.0 million. In the account of portfolio investments Montenegro recorded an increased outflow of 3.2%. The outflow of funds on the basis of portfolio investments amounted to EUR 433.8 million. The largest part refers to the refinancing of debt based on Eurobonds issued in recent years. Investments by Montenegrin residents in securities abroad amounted to EUR 76.3 million, with a growth of 9.0% in comparison to the same period last year. As a result of the above trends in portfolio investment accounts, Montenegro recorded a net outflow of EUR 2.7 million. In 2015 there was a net inflow of EUR 191.1 million in this account.

In the account of other investments Montenegro recorded a net outflow of EUR 139.9 million. Trends in this account are characterized by a reduction in the liabilities of the state and banks for loans taken, while the deposits of banks abroad increased, as well as the liabilities of other sectors (economy) for the loans taken.

The significant level of net errors and omissions in the balance of payments of Montenegro is a consequence of the inability of the balance of payments to cover all transactions. The high value of non-cash payments, especially in tourism, as well as remittances from abroad, are the main sources of errors and omissions. A working group has been set up to better cover this data, which will monitor trends in the tourist sector and work on amendments to the regulations concerning data collection and find new sources of information relevant to coverage of these transactions in the future.

2.2 Macroeconomic projections for the period 2017–2019

The Montenegrin economic growth model designed for the coming period is based on strong investment activity that will have a dominant effect on economic trends. The consolidation measures for public finances (presented in detail in Chapter 3) will influence the trends of economic activity and have a stabilizing effect on public finances and on a rise in investor confidence. However, there are negative effects from these measures: investments will be squeezed out and there will be a real decline in household consumption, because the rehabilitation measures (an increase in excise duties for fuel, collection of tax liabilities, taxation of the salaries of officials, freezing of the percentage allocated to years of service in the calculation of salaries and a reduction in expenditure on social benefits) will reduce the available income of both households and companies. The fact that the Montenegrin economy is undiversified significantly reduces the positive effects of the investments, because there are no capacities for the production of goods needed for the implementation of investment, and therefore the high import level that accompanies the investment cycle has a negative effect on the projected growth rates. The investments have a limited impact on employment too, due to an imbalance between the supply of and demand for labour.

Negative influences on the growth model set up in this way can come from instability in the external environment (economic and geopolitical risks), but also from the internal vulnerability of the Montenegrin economy.

[8] During ERP 2017-2019 development, there were available data on Balance of Payments for the first nine months of 2016.However, there is an update on Foreign direct investments data. Based preliminary data of the Central Bank of Montenegro the FDI net inflow during the first 10 months amounted to EUR 312.7 million.

This chapter shows two macroeconomic scenarios for the period 2017–2019, both taking into account the economic policy measures needed for the implementation of the Plan for Rehabilitation of the Budget Deficit and Public Debt for the Period 2017–2021 adopted in December 2016. The basic scenario is based on the Budget Law for 2017, while the alternative scenario details the macroeconomic projections for the case in which the economic growth is lower than predicted in the basic scenario due to external and/or internal factors.

2.2.1 Basic macroeconomic scenario 2017–2019

2.2.1.1 Real sector

The macroeconomic framework for the period 2017–2019 is based on the assumption that real GDP growth will be 3.2% in 2017, 4.4% in 2018 and 2.6% in 2019. In the period 2017–2019 the Montenegrin economy will grow due to a rise in investment activities and engagement of domestic potentials, primarily in the construction and transport sectors, but also due to knock-on effects in the related sectors. The strong contribution to the construction sector will be boosted by the engagement of the domestic workforce in the construction of infrastructure, tourist facilities and power plants. In the operational stage of these projects, significant growth of the economic potential is expected, as well as knock-on effects for the entire economy. A particular contribution is expected from the agricultural sector, due to significant investment. The effects will be visible through a lowering of food imports and an increase in food exports. The average projected GDP growth rate for the period 2017–2019 amounts to 3.4%.

A slightly lower real growth of the economy in 2019 will be a consequence of a high gross investment base from previous years. The average share of gross investments during the period 2010–2015 was at a level of 19% of GDP. During the period 2017–2019 it will reach an average value of about 30%. Restrictions related to the lack of domestic savings needed for investments and fiscal consolidation, have been compensated by either higher borrowings or investments from abroad. This pace reflects a level of investments of over EUR 1.2 billion, which is an extremely high value, given the previous period of 2010–2015 when they amounted to an average of EUR 650 million, or about 19% of GDP.

Our assessment is that fiscal consolidation will reduce real growth by about 1.3% in 2017 and that this influence will be negligible in the subsequent period. Fiscal consolidation measures will reduce household consumption by 0.6%, which will lead to a reduction of GDP of 0.5%. The reduction of investments, through the squeezing-out effect, will be around 1.7%, which will reduce the GDP growth rate by 0.5%. The fiscal multiplier will influence (an indirect effect of the measures) the reduction of economic activity of 0.3% of GDP. The use of the euro requires an internal devaluation, which is reflected in the control of nominal salaries in the public sector and the stagnation of real salaries in the rest of the economy, to increase the competitiveness of the economy and improve export performance, because, as a small economy, Montenegro is turned towards external demand. The need to strengthen competitiveness is a necessary condition for economic growth to be sustainable in the medium and long term.

The macroeconomic scenario 2017–2019 has the following components on the expenditure side:

- Domestic demand will grow at a rate of 2.1%, but household consumption and final government spending will have a negative influence (1.3%) due to fiscal consolidation measures, while the contribution of investments will be 4.9%.
- Gross investments[9] in fixed assets will grow at the average rate of 10.0% in the medium term, and the average rate for the first two years is projected at a level of 14.7%, in line with the estimated pace of the implementation of the investment projects. The 0.3% growth rate in 2018 is a consequence of the high base from the previous years.
- Due to the above consolidation measures, final government spending will realistically decline at an average rate of 1.2%.

[9] The table of investments for the period 2017–2019 is included in the Annex.

- The exporting of goods and services will grow at an average real rate of 2.1% in the period 2017–2019; projections show that export services (spending by foreign tourists at a nominal rate of 4.7%) will grow faster than the exporting of goods, because the newly constructed buildings in the tourist sector and the improvement of the local infrastructure will raise the quality of supply, generating higher incomes.
- Imports of goods and services will grow at a real rate of 0.1%, and imports of goods will grow because of increased imports required for investments (imports of construction materials and equipment), as well as imports of services that are related to construction (construction of the highway and other projects). Imports of goods and services reached a record value of 68.0% of GDP in 2016 (EUR 310.0 million more than the same period in the previous year), with a reduction in the value of imports of oil and oil derivatives.

Table 2.4: Basic macroeconomic scenario

Montenegrin macroeconomic projections for the period 2017–2019				
	2016	*2017*	*2018*	*2019*
Nominal GDP (in millions of euros)	*3,729.5*	*3,928.5*	*4,176.9*	*4,357.8*
Nominal growth	*2.9*	*5.3*	*6.3*	*4.3*
Real growth	***2.4***	***3.2***	***4.4***	***2.6***
Inflation (at the end of the year)	*0.4*	*2.2*	*2.0*	*1.7*
	% GDP			
Key features:				
Current account deficit	*−21.0*	*−20.8*	*−18.8*	*−16.9*
Exports of goods and services	*42.8*	*42.3*	*41.1*	*40.7*
Imports of goods and services	*−67.7*	*−66.5*	*−63.2*	*−60.7*
Other	*3.9*	*3.5*	*3.4*	*3.1*
Household consumption	*79.5*	*76.2*	*73.8*	*72.9*
Gross investments	*25.2*	*29.0*	*30.4*	*29.7*
Government spending	*20.1*	*19.1*	*17.9*	*17.3*
GDP deflator	*0.4*	*2.0*	*1.9*	*1.6*
	Real GDP growth rates (%)			
Real GDP growth	***2.4***	***3.2***	***4.4***	***2.6***
Domestic demand	***7.7***	***2.9***	***2.7***	***0.8***
Household consumption	*3.7*	*−1.3*	*1.0*	*1.4*
Gross investments	*28.1*	*19.6*	*9.8*	*0.3*
Changes in stocks	*0.0*	*0.0*	*0.0*	*0.0*
Government spending	*1.2*	*−1.7*	*−1.5*	*−0.6*
Exports of goods and services	*8.0*	*2.4*	*1.8*	*2.0*
Imports of goods and services	*16.6*	*2.1*	*−0.5*	*−1.3*
	Share of the real growth of GDP (%)			
Real GDP growth	***2.4***	***3.2***	***4.4***	***2.6***
Domestic demand	***9.2***	***3.6***	***3.3***	***1.0***
Household consumption	*2.9*	*−1.0*	*0.7*	*1.0*
Gross investments	*5.7*	*4.9*	*2.8*	*0.1*
Changes in stocks	*0.3*	*0.0*	*0.0*	*0.0*
Government spending	*0.2*	*−0.3*	*−0.3*	*−0.1*
Net exports	***−6.8***	***−0.3***	***1.1***	***1.6***
Exports of goods and services	*3.4*	*1.0*	*0.7*	*0.8*
Imports of goods and services	*−10.1*	*−1.4*	*0.3*	*0.8*
Indicators	*Growth in % if not stated otherwise*			
Employment growth	*1.0*	*2.0*	*1.0*	*0.5*
Salary growth	*4.0*	*0.5*	*2.0*	*2.0*
Unemployment growth (ARS)	*19.4*	*17.8*	*17.0*	*16.6*
FDI (% GDP)	*7.8*	*8.9*	*8.9*	*8.5*
Domestic loans (corporate and retail)	*2.8*	*3.7*	*4.4*	*3.0*

Source: Projections of the Ministry of Finance

Macroeconomic indicators

- The current account deficit in the balance of payments will be 18.8% of GDP on average, while it will decline to 16.9% of GDP with the decline in imports and increase in exports in 2018.
- The estimated foreign direct investments in the medium term are still linked with a high level of uncertainty when it comes to the pace of investments in companies, the financial sector and property. Estimates show that this will be at a level of about 8.8% annually.
- Loans to companies and households will grow at an average rate of 3.7%, which is slightly lower than the nominal GDP growth rate. The growth of economic activities requires support from the financial sector and it is expected that this will be provided, since these are projects that are completely unpinned financially, which means a lower credit risk.
- As a consequence of the growth of economic activities, employment will gradually increase throughout the entire period (1.2% per year on average). This should lead to a decline in the unemployment rate to 16.6% by the end of the period. This projection is made on the basis of an estimate of the average unemployment rate for 2016, which sharply increased in comparison to the previous year as a consequence of implementation of the amended Social Care Law.
- In the period 2017–2019 Montenegro expects a growth in salaries of 1.5% on average (nominally) due to weak growth in 2017 (impact of fiscal consolidation measures and a high unemployment rate).
- In this period Montenegro expects a moderate growth in prices, based on the increase in the price of energy sources on the global market and the increase in excise duties on fuel, with stable food prices. The average value is projected at 2.0%. The influence of the increase in the price of energy sources in the market in 2017 is uncertain. EC estimates say that the increase will be 18% (USD 45–55 per barrel 2016/2017).

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

- Projected real growth in the agriculture sector in the period 2017–2019 will amount to an average of 4.0%. Such a significant growth has been projected on the assumption that Montenegro will increase investments in agriculture and that the credit line to this sector will increase in the period 2017–2019. If these rates are achieved, they will have an impact on an increase in exports and a reduction of food imports.
- The sector of ore and stone extraction will grow at an average annual rate of 8% in the medium term, which will be the result of increased demand for the materials required for the highway project (stone, gravel and materials for the road base).
- The processing industry will record a 5.0% growth in the forthcoming period, provided that the measures proposed in the document Montenegrin Industrial Policy to 2020 produce results in terms of dealing with bottlenecks and revitalizing this sector. Montenegro expects a particularly strong contribution from growth in the subsectors of food processing and processing of meat products, in the wood industry and metal industry.
- Under the influence of the announced investments, the construction industry will record the largest growth. In the first two years this growth will amount to 20% on average, while it will slow down in 2018 as a consequence of the high base from the previous year (engagement of domestic construction workers will have a knock-on effect on areas linked to the functioning of this sector: trade, transport, financial and insurance services, smaller production services, etc., although due to the structure of the economy, i.e. a lack of demand, this effect will be limited).
- This scenario envisages growth of 4.5% in accommodation and food services which cover part of the tourist sector. The phased finalization of started investments in tourism will increase the offer of higher-category hospitality facilities, which is a precondition for an increase in the contribution of this sector to GDP growth.

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

Table 2.5: Production sectors – real growth rates and share of GVA

	Real growth rate in %				*Share of GDP growth in %*				*Share of gross value added in % (GVA)*			
	2016	*2017*	*2018*	*2019*	*2016*	*2017*	*2018*	*2019*	*2016*	*2017*	*2018*	*2019*
Agriculture	*2.0*	*4.0*	*4.0*	*4.0*	*0.2*	*0.3*	*0.3*	*0.3*	*9.8*	*9.7*	*9.7*	*9.8*

Industry	*−4.6*	*4.3*	*5.3*	*3.2*	*−0.5*	*0.4*	*0.5*	*0.3*	*12.2*	*12.1*	*12.2*	*12.3*
Construction industry	*30.0*	*25.0*	*6.0*	*5.9*	*1.0*	*1.1*	*0.8*	*0.2*	*5.4*	*6.4*	*7.1*	*7.1*
Services[10]	*2.0*	*3.3*	*3.3*	*2.3*	*1.2*	*0.5*	*1.9*	*1.3*	*72.6*	*71.7*	*71.0*	*70.7*
- of which accommodation and food services									*9.0*	*9.0*	*9.0*	*9.2*
Gross value added	*2.3*	*4.7*	*4.4*	*2.6*	*1.9*	*2.3*	*3.5*	*2.1*	*100.*	*100.*	*100.*	*100.*
Taxes/subsidies	*3.0*	*4.7*	*4.4*	*2.6*	*0.6*	*0.9*	*0.8*	*0.5*				
GDP	*2.4*	*3.2*	*4.4*	*2.6*	*2.4*	*3.2*	*4.4*	*2.6*				

Source: Projections of the Ministry of Finance

In the growth model based on investments, with a high share of foreign capital in the Montenegrin economy, the growth rates of economic activities are significantly increased. However, such a model also imposes certain restrictions:

- Strong growth of the real GDP rate is not accompanied by strong growth in household consumption, due to the sending abroad of the profits and salaries of non-residents and the lack of a stronger increase in salaries, which results in a reduced level of income available for consumption.
- A growth model based on investments will have a limited impact on public finances in the short term, because the collection of revenues will not be fully in line with the intensified economic activity and the nominal GDP growth rate, due to the fact that the purchase of goods necessary for investment is subject to a VAT refund, but also due to certain exemptions or reductions in tax payments (the Law on VAT, the Law on Excise Duties and the Law on the Highway). However, it is uncertain whether the correlation between an increase in the importing of goods and an increase in the collection of import VAT will be disrupted in the forthcoming year through the VAT refund.
- An inadequate labour supply (a lack of supply of construction profiles in Montenegro) prevents the situation where stronger economic activities can reduce the unemployment rate to a significant extent. Due to this effect, unemployment is reduced in the neighbouring countries.

Table 2.6 provides a comparative overview of the real growth rate produced by the Ministry of Finance and international institutions. The growth estimates for 2016 are rather similar, except for the IMF projections, which have not been updated. Projections by international institutions for 2017 are almost identical – about 3.5%, while the projections of the Ministry of Finance are based on a higher growth in investment activities, while on the other hand the impact of fiscal consolidation measures have been taken into account.

Table 2.6 Real growth rate (in %)

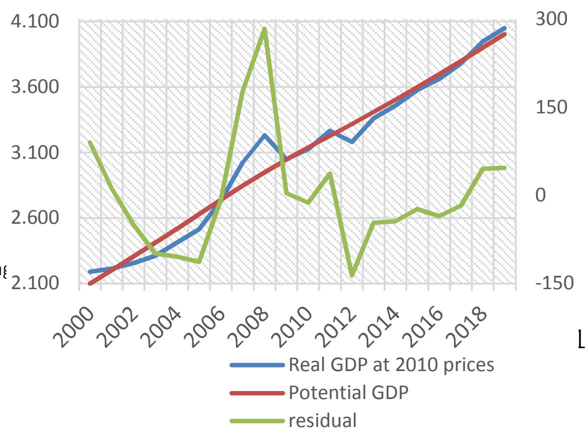
	2016	*2017*	*2018*	*2019*
MoF	*2.4*	*3.2*	*4.4*	*2.6*
EC	*2.7*	*3.4*	*3.1*	*-*
IMF	*5.1*	*3.6*	*-*	*-*
WB	*3.2*	*3.6*	*3.0*	*-*

Risks for the realization of the macroeconomic scenario:

- A change in the pace of implementation of investments would influence a change in the projections of economic growth in the medium term.
- The need for significant fiscal adjustments in the medium term different from those that are envisaged in the proposed Rehabilitation Plan, would additionally reduce economic growth.
- Potential instability in the financial markets can increase interest rates on sovereign debts or hinder borrowing by Montenegro required to refinance due liabilities.
- Unfavourable weather conditions can have a significant influence on tourism, agriculture and electricity generation.
- Geopolitical risks.

2.2.1.2 Potential growth

The fact that data regarding the value of capital in the Montenegrin economy is unavailable makes any estimate of the potential growth through a break-down of the production factors impossible. In earlier



[10]Services refer to all the production-approach sectors of GDP, except for a

economic reform programmes, we showed the trends in the Montenegrin economy (HP filter) over the past years and emphasized the boom period (average growth during the period 2006–2008 of 8.7%), the double recession caused by the financial crisis (2009 – 5.7% decrease) and the consequences of the crisis in the Eurozone and its spill-over to the countries on its periphery (2012 – 2.7% decrease). It was only in 2013 that the Montenegrin economy reached the level of GDP recorded in 2008, which means that the double recession during this period cancelled out the overall economic growth achieved in that period.

Regardless of the unreliable findings of the cyclic position of the Montenegrin economy measured by the HP filter, the limitations of the potentials through production factors are clearly recognizable. They refer to capital and labour and the overall factor productivity.

The limitations on the capital side are related to the insufficient and/or unused capacities available to us. In the tourist sector there is a clear lack of high-category hotel accommodation, transport connections are poor, environmental awareness is low and there are deficiencies related to the offer not related to accommodation.

Labour-force supply is the second constraining factor, because there is an obvious mismatch between supply and demand in labour. A lack of labour in construction and tourism is noteworthy, although the unemployment rate was above 20% at the end of 2016. These factors lead the pace of the economy towards extensive growth, because the sectors that are recognized as the drivers of growth (tourism, the energy sector and food production) cannot experience significantly higher growth rates, due to a low technological profile. Montenegro is still far from being a knowledge-based society that generates strong growth rates in the short term through the use of advanced technologies. In the period 2017–2019, with the projected growth rates, the Montenegrin economy will have potential growth close to the trend level after the decline in 2009 and 2012 and moderate growth rates during the periods 2010–2011 and 2013–2015.

The average real growth rate during the period 2002–2016 amounted to 3.2%, while the potential growth rate in the post-2009 period had a downward trend after the boom in 2005–2008. The impulse for the growth of potential will come from further implementation of structural reforms in the labour market, as well as from the removal of bottlenecks to stronger economic growth, which are related to various types of business barriers (see Chapter 4). If we exclude the cyclic influence of the construction of the highway and other investments on the Montenegrin economy, we get a more realistic picture of potential growth, because higher growth rates do not come as a consequence of the internal strength of the Montenegrin economy. The growth is based on foreign investments instead, and therefore we can expect lower effects on the available income and standard of living of Montenegrin citizens.

Ageing of the population is also a long-term problem for dynamic economic growth. It has two negative effects on the growth of the economic activities: the first is reflected in low labour activity, while the second is related to the pressure on the sustainability of the pension and health insurance system, which will be even more emphasized in the coming period.

2.2.1.3 Inflation

There is no possibility for pursuing monetary policy in the euro-zone economies, since there is no outflow function, and there is a negligible impact on referential interest rates and the foreign exchange rate. In such constraining conditions, the goal of the Central Bank's monetary policy is to preserve and to encourage financial stability, to control the financial system and to preserve and encourage a sound and stable banking system. Thus the Central Bank of Montenegro has neither the mandate nor the instruments to control inflation. Given the weighted coefficient of consumer prices, where fuel has a share of 4.7%, an increase in fuel prices from USD 45 to 55 per barrel (the presumption from the EC projection) and an increase in excise duties on mineral fuels of EUR 0.09 per litre, would cause inflation to go up by 1 percentage point.

The assumption is that food prices will remain stable. The projection starts from an assumed level of inflation in the EU, as the key trade partner of Montenegro.

The basic scenario projects inflation of 2.2% in 2017, 2.0% in 2018 and 1.7% in 2019. A certain decline in prices in 2019 is a consequence of a mild decline in investment activity.

2.2.1.4 The external sector and its medium-term sustainability

The high level of the current account deficit on the balance of payments, estimated at 21.0% of GDP in 2016, shows a deep foreign-trade imbalance. The key negative contribution to the current account deficit is related to the balance of goods, which amounted to 44.4% of GDP in 2016, but it was partly adjusted by a surplus in the service account (19.6% of GDP) and a balance in the accounts of primary and secondary incomes of 3.9% of GDP. The deficit in the current account was partly covered by foreign direct investments and government borrowing on the international and national financial markets. However, a large part of the current account financing is related to the presence of net errors and omissions. This shows that certain transactions are not included at all (errors) or that they are valued in an inadequate manner (omissions). These refer to unrecorded incomes from tourism, remittances and other unregistered cash payments. In the case of Montenegro, since it uses the euro as its currency and has a significant proportion of cash payments, particularly in the field of tourism (the grey economy), it is not simple to cover all transactions, because it is impossible to make a difference between euros of national and of foreign origin.

The structure of the current account deficit and its financing are a risk for the sustainability of the balance of payments position. It can lead to a deterioration of that position, due to the following:

- The basic scenario assumes stable growth of incomes from tourism in the coming year due to an increase in the offer of accommodation facilities in the coming period. However, we should not exclude the risk of unfavourable weather conditions or an unstable security situation in the international community, because they could lead to a significant decline in incomes on this basis.
- A reduction in the inflow of FDI, due to political or financial instability in the countries that the capital comes from, would lead to a deterioration and decline in the number of sources for financing the current account deficit.
- Instability on the global financial markets that could lead to a rise in the price of sovereign debt and to a reduction in the demand for risky securities. This would also reduce the sources for financing the current account deficit.

The data on the total debt in Table 2.7 shows the structure of debt and the trends of the individual components in the previous period:

Table 2.7: Structure of debt and trends of certain components in the previous period

Total foreign debt in millions of euros		*31 December 2013*	*31 December 2014*	*31 December 2015*
1.	*Government*	***1,433.0***	***1,561.7***	***1,956.4***
	Loans	*973.0*	*914.3*	*998.6*
	Bonds	*460.0*	*647.4*	*957.8*
2.	*Banks*	***332.4***	***237.4***	***206.9***
	Short-term loans	*16.0*	*3.0*	*8.5*
	Long-term loans	*316.4*	*234.4*	*198.4*
3.	*Other sectors*	***1,929.5***	***1,999.7***	***1,813.5***
	Short-term loans	*142.0*	*149.4*	*88.1*
	Long-term loans	*1,787.5*	*1,850.4*	*1,725.4*
4.	*Inter-company debt*	***1,157.6***	***1,307.6***	***1,321.1***
	Short-term loans	*114.8*	*80.9*	*47.6*
	Long-term loans	*1,042.8*	*1,226.8*	*1,273.6*
	TOTAL FOREIGN DEBT	***3,694.9***	***3,798.8***	***3,976.7***
	TOTAL FOREIGN DEBT WITH INTER-COMPANY DEBT	***4,852.5***	***5,106.5***	***5,297.8***

Source: Central Bank of Montenegro

The macroeconomic scenario 2017–2019 envisages a high current account deficit, of 18.8% of GDP on average. This is caused by stronger growth in imports of goods and services necessary for the implementation of investments, with a simultaneous growth in incomes from services and a stable surplus in the accounts of primary and secondary incomes. The macroeconomic scenario 2017–2019 envisages a lower inflow of FDI, which will in the medium term amount to 8.8% of GDP on average. This will not be enough to cover the imbalance in the current account.

Measuring the competitiveness of Montenegrin economy by the usual indicators via the real effective exchange rate (REER) is not reliable, since Montenegro has significant source revenues from tourism, which is of a seasonal nature. For this reason the weightings for calculating the effective rate fluctuate throughout the year (the weighting for Russia varies because of the high inflow of tourism revenues in the summer months).

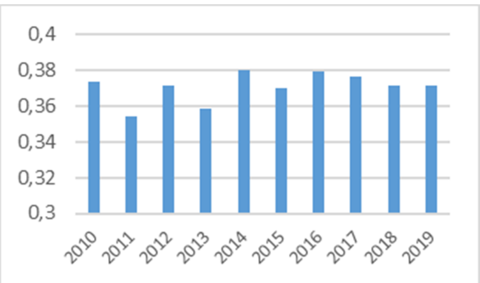
This shows the deficiencies in the analysis of the competitive position of Montenegro measured by the REER, including tourism which makes up a significant share of the Montenegrin economy and has a seasonal character. REER analysis for the field of tourism shows that the available income for consumption in Russia declined in 2016 due to high inflation of about 7%, with a stable rouble–euro exchange rate, while the available income in Serbia is at the same level, given the stable dinar–euro exchange rate and relatively low inflation. Forecasts for 2017 envisage a further decline in the purchasing power of Russian citizens, which can have a negative effect on tourist revenues in Montenegro.

Table 2.8: Ratio of revenues and number of tourist overnight stays

	Foreign tourist overnight stays	Revenues from tourism in € millions	Ratio of revenues from tourism and number of overnight stays in euros
	1	2	3=2/1
2011	7,818,803	619.5	79
2012	8,143,007	643.2	79
2013	8,414,215	665.6	79
2014	8,596,656	682.3	79
2015	10,307,371	813.0	79
2016	10,123,949	800.6	79

Comparison of the revenues from tourism and the number of overnight stays yields a constant value (EUR 79), which implies a constant average income from foreign tourists. This does not correspond to the strengthening of supply through the construction of high-category facilities (and the implied expectations of higher average revenues per overnight stay). Therefore, the revenues from tourism estimated in this way, indicate the possibility that they are being significantly underestimated and can partly explain the high level of errors and omissions in the balance.

Chart 2.2: Unit labour price coefficient



Analysis of competitiveness done on the basis of unit labour prices (ULC)[11] shows that price competitiveness deteriorated in 2016 because of an estimated growth in salaries of 4%. The reliability of the analysis is limited due to the change in the data source for the number of employed people (2010) and the fight against the grey economy, i.e. legalization of employment. Given the taken assumptions about the growth in salaries, employment and GDP, competitiveness will stagnate in the medium term. Analysis of the net investment position in relations with foreign countries cannot be processed, since the Central Bank of Montenegro does not have the data required for such an assessment.

2.2.1.5 Financial account

Although there is a downward trend, non-performing loans still exist and this indicates the fact that credit risk will remain a key challenge of the banking sector in the coming period. However, the credit risk is less and less a systemic problem and increasingly an individual problem, the solving of which requires the implementation of activities aimed at the rationalization of business operations and reduction of the operational costs of individual banks.

A comprehensive strategy for dealing with non-performing loans (NPLs) in Montenegro is being implemented within the project "The Podgorica Approach" based on two regulatory documents – the Law on the Voluntary Financial Restructuring of Debts to Financial Institutions with an implementation

[11] The model of calculation of the unit labour price was prepared by the Ministry of Finance. The coefficient shows the level of gross salaries as a proportion of the gross value of output, i.e. total economic output. The coefficient of 0.37 shows that the level of gross salaries is EUR 0.37 per euro of total output value. This model was prepared on the basis of data on salaries, employment (ARS) and the value of the gross production published by MONSTAT. The gross value of production for the period 2016–2019 is extrapolated based on the real GDP rate.

period of two years (May 2015–May 2017) and the Decision on the amendments to the Decision on the minimum standards for managing credit risks in the banks, with an implementation period from January 2014. All the restructuring processes in this period were implemented between individual banks and clients, and no other creditors were involved in the restructuring process. Supervision by the Central Bank of implementation of the concerned Decision which obliges banks to prepare three-year strategies for dealing with NPLs, with the defined operational goals, resulted in their significant reduction. To encourage interest from economic entities and banks for the promotion of this Law, the Memorandum of Understanding on the implementation of this Law was signed in December 2015 by the Chamber of Commerce of Montenegro, the Central Bank of Montenegro and the Ministry of Finance of Montenegro.

Analysing in a critical manner the limitations in the implementation of this Law, and with a view to ensuring its reaffirmation and respect for the conclusions from the ministerial meeting from May 2016, the Central Bank prepared amendments to: extend the deadline for the implementation of the Law until May 2018; extend the scope of the loans that can be restructured voluntarily; simplify the procedure, etc. The amendments to this Law will shortly be submitted to the line ministry (see Section 4.3.3.3.2 on Financial Services).

In the economy there is an obvious increase in mutual debts and an increase in illiquidity. This is confirmed by the fact that 19.1% of the total registered economic entities have their accounts blocked. A total number of 2,065 debtors were constantly blocked for up to one year with the blocked amount totalling EUR 61.6 million (10.0% of the total value of blocked funds). A total number of 13,247 judgement debtors were blocked for more than one year, with the blocked amount totalling EUR 553 million (89.9% of the total amount of blocked funds).

At the end of September 2016 the average weighted effective interest rate on total bank loans amounted to 7.72%, or 7.61% for new loans. The trend of decline in the average weighted nominal and effective interest rates (PPNKS and PPEKS) that started in the last quarter of 2014 continued during 2016. Thus, at the end of September 2016 the interest rate on total bank loans was 1.71 percentage points lower at the annual level. On the other hand, in spite of the clear volatility in the trends of PPEKS on newly granted bank loans in the observed period, this rate recorded a decline of 2.02 percentage points at the annual level.

The above trends, combined with a multiannual trend of decline in passive interest rates, led to a reduction in interest rates ranging from 7.61 percentage points in September 2015 to 6.76 percentage points at the end of September 2016. This had an impact on the business operations of certain banks. If this trend continues, it will exert additional pressure on the profitability of the banks, particularly smaller ones. This will, in turn, require their faster adjustment to new market conditions through the reduction of operational costs and redirecting their business activities towards the provision of new, more competitive products and services.

2.3 Alternative scenario

As a small, open and undiversified economy, Montenegro is subject to influences from both inside and outside. In the basic scenario, the key development driver is based on strong investment activity, adjusted by fiscal consolidation measures. Given the potential risks, it is clear that the activation of any of these can more or less jeopardize the projected growth rates. Respecting the importance of investments for the Montenegrin economy on one hand and the uncertain pace of investment activities on the other, as well as the high level of investments made in 2016, the lower-growth scenario starts from the presumption that investment activities may slow down during the observed period. Thus, this year's alternative lower-growth scenario envisages that in the period 2017–2019 investments will decline from the high level that was achieved in 2016, due to the changed pace of implementation of investments. The assumption of fiscal consolidation will be kept as in the basic scenario.

Under such conditions it is justified to consider a scenario based on the assumption that this risk might come true.

Assumptions of the scenario:

- Gross investment will decline from the high level achieved in 2016 (estimated at EUR 968 million) by 6.5% in 2017 and will remain at a level of about EUR 877 million in 2018 and 2019 (about 21% of GDP).
- Due to increased investor caution caused by the trends in the internal and external environment, investment would be reduced.
- The assumption of fiscal consolidation and of all the effects on macroeconomic indicators is the same as in the basic scenario.

Trends of components of GDP (the expenditure approach)

- Household consumption would be almost the same level in all three years (average annual real growth of 0.4%) due to stagnation or a slight rise in salaries at the level of entire economy, reduction in the social contributions and increases in fuel prices. A slight growth in employment would also slow down the growth of spending.
- Gross investment would realistically be 7.9% lower on average in 2017, with an additional mild decline in the two years that follow (1.5% realistically).
- The final government spending would realistically decline due to the mentioned consolidation measures (as in the basic scenario) at an average rate of 1.2%.
- The assumptions about the trends in the importing of goods and services are the same as in the basic scenario, i.e. the assumptions about the growth in the imports of goods and revenues from tourism are retained.
- Imports of goods and services would decline by 3.4% on average due to this pace of domestic demand and fiscal consolidation.
- This pace of imports and exports would lead to a sharp decline in the current account deficit to 12% of GDP in 2019.

The realization of these assumptions would have a moderately negative effect on macroeconomic trends, because of lower household consumption, lower employment, an increase in unemployment, stagnation in real salaries and other negative effects. And because of the nominally lower GDP growth this scenario would see worsened fiscal parameters that will be discussed in more detail in Chapter 3. In this scenario the average real GDP growth would be 2%.

Table 2.9: Montenegro's macroeconomic projections 2016–2019

	2016	2017	2018	2019
Nominal GDP (in millions of euros)	3,729.5	3,874.1	4,038.5	4,152.2
Nominal growth	2.9	3.9	4.2	2.8
Real growth	2.4	2.0	2.7	1.3
Inflation (at the end of the year)	0.4	2.0	1.5	1.5
GDP deflator	0.4	1.9	1.5	1.5
		Real growth rate		
Real GDP growth	2.4	2.0	2.7	1.3
Domestic demand	7.7	−1.9	−0.1	−0.1
Household consumption	3.7	0.0	0.6	0.5
Gross investments	28.1	−7.9	−1.5	−1.5
Changes in stocks	0.0	0.0	0.0	0.0
Government spending	1.2	−1.7	−1.5	−0.6
Exports of goods and services	8.0	1.5	1.5	1.5
Imports of goods and services	16.6	−5.4	−3.6	−1.3
Indicators		in % if not stated otherwise		
Employment growth	1.0	0.0	0.5	0.5
Salaries growth	4.0	0.0	1.0	1.0
Unemployment growth (ARS)	19.4	19.4	19.0	18.6
FDI as % of GDP	10.7	5.2	5.6	6.0
Domestic loans (corporate and retail)	2.8	2.7	3.0	2.0

3 Fiscal Framework

3.1 Fiscal policy strategic framework and medium-term goals

Montenegrin fiscal policy is focused on intensifying investments in infrastructure and optimizing current consumption. The aim of the fiscal policy in the period 2017–2019 is to consolidate public finances so that the conditions can be created for a reduction of the public spending deficit and for a slow-down in the growth of public debt.

In the preceding period, the Government of Montenegro undertook measures to limit basic fiscal pressures. These measures were aimed at ensuring the sustainability of public finances, improving the business environment and harmonizing tax policy in line with the obligations from the EU accession process. Fiscal policy was adapted to the basic concept of the economic development of Montenegro, the key goal of which was to create conditions for dynamic economic growth that would be used to finance the increased public debt in the long term.

The decision to start construction of the priority section of the Bar–Boljare highway, which is the largest investment in infrastructure in recent Montenegrin history, as well as amendments to the legislation regulating the salaries of people employed in the public sector and rights in the field of social care, have created additional pressure on public consumption and have increased the risk of instability in public finances.

Given the increased fiscal risks, but also the important financial needs for borrowing in the forthcoming medium-term period, and with the aim of maintaining macroeconomic stability and strengthening competitiveness, complying at the same time with the obligations defined in Article 21 of the Law on the Budget and Fiscal Responsibility, Montenegro adopted the Plan for Rehabilitation of the Budget Deficit and Public Debt for the period 2017–2021 in December 2016.

The aim of the measures from this Plan is to achieve two strategic goals:

- To reduce the budget balance deficit in the forthcoming five-year period from a value of 6.1% of GDP in 2016 to a value of 3.8% of GDP in 2019, after which the budget balance would be in surplus; and
- To prevent a further increase in the public debt, i.e. to establish a downward trend after 2019.

Implementation of the fiscal consolidation measures contained in the Plan, together with the parallel implementation of structural reforms in all fields of the system, will ensure sustainable growth in the future and facilitate access to international financial markets. Fiscal consolidation is designed in such a way that it does not jeopardize the business environment, i.e. so that the attractiveness of Montenegro as an investment destination is preserved, given that there is no increase in VAT. Its aim is also to protect the living standards of the socially most vulnerable categories of the population.

Due to the need to continue implementing the project of highway construction that is being financed through capital spending, the rehabilitation measures focus on the rationalization of the current budget spending and on an increase of public revenues.

If the Government had not developed the Plan for Rehabilitation, which was also its duty on the basis of the Law on the Budget and Fiscal Responsibility, i.e. if there had been "no changes", the public finance deficit in 2017 would be at a level of more than 9% of GDP.

Although the Plan for Rehabilitation of the Budget Deficit and Public Debt was adopted as a medium-term document, the measures for its implementation are at this stage precisely elaborated only for 2017. In the first half of 2017 the new government will prepare a Fiscal Strategy for the period of its term of office. This strategy will be fully consistent with the adopted Plan for Rehabilitation of the Budget Deficit and Public Debt. It will consider the most important economic measures that would produce positive fiscal effects in the medium term. In line with that, during the current year Montenegro will consider the need to redefine, above all, its social policy. The focus will be on optimizing the number of employees in the public administration through implementation of the Public Administration Reform Strategy for the period 2016–2020.

Table 3.1 provides a detailed overview of the measures designed to implement the planned fiscal consolidation contained in the Plan for Rehabilitation of the Budget Deficit and Public Debt, while the measures are explained in details in Section 3.3, which deals with the fiscal projections for the period 2017–2019.

Table 3.1: Fiscal consolidation measures in 2017 with an estimate of the fiscal effect in millions of euros and % of GDP

Fiscal consolidation measures	Effects of the measures in 2017
Receipts	59.30
Collection of tax debt arrears	12.00
Repealing tax exemptions	1.50
Strengthening the fiscal discipline of taxpayers	15.00
Reduction in salaries of public officials	−1.20
Increase in excise duty on mineral oils	32.00
Expenditure	67.61
Gross salaries and contributions paid by employers (effects of an 8% reduction in the salaries of public officials and of deferred calculation of the years of experience for the period between 1 April 2017 and December 2018)	4.90
Social care rights (effects of a reduction in the benefits for mothers and of postponed implementation of the law adopted in 2016 related to the payment of child allowance for the period to 1 July 2017 for children whose parents are on the records of the Employment Office as unemployed and are not users of any other type of social benefits)	15.75
Capital budget	10.00
Other expenditure	36.96
TOTAL FISCAL CONSOLIDATION	126.91
ESTIMATED GDP FOR 2017	3,928.5
% GDP	3.23%

The adopted Plan for Rehabilitation of the Budget Deficit and Public Debt deals efficiently with both of the key recommendations (No. 1 and No. 2) issued to Montenegro in the field of fiscal policy that were adopted at the ministerial meeting in May 2016 and were clearly reflected in the annual report of the European Commission of October 2016. As for the recommendations about the budget deficit [12], measures within the Rehabilitation Plan are focused on the proposed reduction in current consumption, particularly in the field of salaries and social transfers and partially in the field of capital expenditures. On the budget revenue side, the focus is primarily on an increase of the excise duties on mineral oils, keeping the higher personal income tax rate (11%), collection of the arrears in tax debts, strengthening of fiscal discipline and repealing some tax exemptions. Efforts have been made to introduce measures that would have as mild a negative effect on economic growth as possible.

The second recommendation from the ministerial meeting that refers to the field of fiscal policy and that deals with public debt[13] is also clearly tackled in the Plan for Rehabilitation of the Budget Deficit and Public Debt. The fact is that, due to the decision to finance the highway construction, the public debt in the adopted five-year plan cannot return to a level of below 60%. Therefore, the Plan envisages that public debt will grow until 2019 (the envisaged end of the construction of the first section of the

[12] To take immediate measures to restrain current spending, including on pensions and the public sector wage bill. To generate budgetary savings and improve revenue collection, conduct a comprehensive review of tax expenditure as well as exemptions, and implement tax increase in a growth-friendly manner.

[13] Stabilise the debt-to-GDP ratio net of debt related to capital investments already underway in 2016, and then reduce it over the remainder of the programme period.

highway) when it will reach its highest level of about 79.5% of GDP[14], after which a downward trend will be established and public debt will reach a level of 74% of GDP in 2021.

To ensure that all of the above measures can be fully effective, Montenegro will have to intensify its activities on the reform of public finance management. This will improve Montenegro's readiness to identify, prevent or to manage fiscal risks, excessive fiscal deficit and macroeconomic imbalance. Therefore, the activities that will be implemented in the forthcoming period, aimed at structuring spending in such a way that the servicing of all its needs is ensured, along with a maximum impact on development, will have to focus on:

- Improving fiscal discipline and the predictability of spending trends. To achieve this, Montenegro has to adopt a medium-term budget framework that will reflect the Government's policy and strategic goals, and comply with the defined spending limits for all the first-rank spending units;
- Full implementation of the programme budget, i.e. budgeting based on performance measuring, to increase transparency and efficiency in the spending of public resources;
- Improvement in the planning of the capital budget and monitoring, i.e. reporting on the implementation of projects of public interest;
- Better absorption of EU funds, which would relax spending in certain areas; and
- Full implementation of the ESA 2010 methodology in public finance statistics.

At the same time, Montenegro will continue implementing the already existing measures aimed at increasing public revenues, primarily through the reduction of the size of the grey economy, strengthening tax discipline and improving the tax system. It is expected that public finances at the local level will be stabilized further, primarily through a reduction in the level of liabilities that are not settled and through regular servicing of the liabilities defined in the law.

Table 3.2 provides an overview of the fiscal projections based on both of the macroeconomic scenarios that involve the above measures from the Plan for Rehabilitation of the Budget Deficit and Public Debt. They are explained further in this chapter, primarily in the section 3.3 on medium-term budget prospects.

Table 3.2 Medium-term macroeconomic and fiscal frameworks

Macroeconomic framework		*Implementation*	*Assessment*	*Basic scenario*			*Lower growth scenario*		
		2015	*2016*	*2017*	*2018*	*2019*	*2017*	*2018*	*2019*
Macroeconomic indicators	*GDP nominally (in € millions)*	*3,625.6*	*3,729.5*	*3,928.5*	*4,176.9*	*4,357.8*	*3,874.1*	*4,038.5*	*4.152.2*
	GDP, nominal growth	*4.9*	*2.9*	*5.3*	*6.3*	*4.3*	*3.9*	*4.2*	*2.8*
	GDP, real growth	*3.4*	*2.4*	*3.2*	*4.4*	*2.6*	*2.0*	*2.7*	*1.3*
	Inflation (at the end of the year)	*1.4*	*0.4*	*2.2*	*2.0*	*1.7*	*2.0*	*1.5*	*1.5*
	Employment growth (%)	*1.2*	*1.0*	*2.0*	*1.0*	*0.5*	*0.0*	*0.5*	*0.5*
	Current account deficit (% GDP)	*−13.3*	*−21.0*	*−20.8*	*−18.8*	*−16.9*	*−16.5*	*−13.3*	*-12.0*

Fiscal Framework (in % GDP)		*Implementation*	*Assessment*	*Basic scenario*			*Lower growth scenario*		
		2015	*2016*	*2017*	*2018*	*2019*	*2017*	*2018*	*2019*
Fiscal indicators	*Source public revenues*	*42.4*	*45.1*	*44.8*	*43.9*	*42.9*	*44.9*	*44.5*	*43.8*
	Public spending	*50.9*	*49.0*	*50.8*	*49.4*	*46.7*	*51.5*	*51.1*	*49.0*
	Deficit/surplus	*−8.4*	*−3.8*	*−6.1*	*−5.5*	*−3.8*	*−6.6*	*−6.7*	*−5.2*
	Deficit/surplus without the highway	*−2.5*	*−3.0*	*−1.1*	*0.0*	*0.3*	*−1.6*	*−1.0*	*−0.9*
	Interests	*2.4*	*2.2*	*2.6*	*2.3*	*2.4*	*2.6*	*2.4*	*2,5*
	Primary deficit/surplus	*−6.0*	*−1.7*	*−3.5*	*−3.3*	*−1.4*	*−4.0*	*−4.3*	*−2.7*

[14] This projection of the trend of the public debt is the projection from the Plan for Rehabilitation, i.e. it is not the projection prepared according to EDP methodology. Conversely, the projection of the trend of debt presented in Table 3.1 is done according to EDP methodology.

Public debt (% GDP)[15]	*62.8*	*66.6*	*71.6*	*74.9*	*77.5*	*73.1*	*78.8*	*84.0*
Public debt without the highway[16] (% GDP)	*60.9*	*61.7*	*60.5*	*57.3*	*54.9*	*61.3*	*59.4*	*57.8*

3.2 Public finances[17] in 2016

In the previous period Montenegrin fiscal policy was aimed at ensuring sustainability of pubic finances, improving the investment environment and conducting harmonization with the standards and methodology of the EU. In that respect, the conducted activities were aimed at rationalization of consumption, combating the grey economy, increasing fiscal discipline and keeping competitive tax rates.

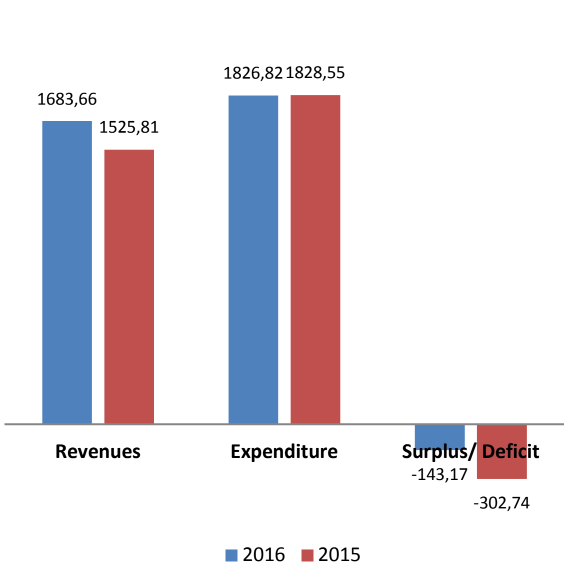
In 2016 public finances were characterized by pressure on public spending caused by amendments to the legal framework, in the part dealing with salaries and social benefits. This resulted in current budget spending reaching a record-high level of 45.0% of GDP.

In order to increase tax revenues and reduce the budget deficit and level of public debt in 2016, the measures of fiscal consolidation from previous years were implemented. They referred to:

- Taxation of personal income (applied on the part of the salary above the national average) at a rate of 11%, which had been 15% in 2014 and 13% in 2015;
- Continued application of a higher VAT rate of 19%. Lower tax rates (0% and 7%) remain for certain products;
- Taxation of trade in coffee;
- Taxation of the profits from the games of chance at a rate of 15%;
- A gradual increase in excise duties on cigarettes, according to the established "excise duties calendar";
- Implementation of the Law on Amendments to the Law on Property Tax which introduces new provisions aimed at increasing revenues from the property tax, which has a positive effect on local self-government budgets; and
- Harmonization of pensions according to the current and projected macroeconomic indicators that influence the amount of pensions (average salary and inflation).

On the other hand, tax exemptions and support to capital and development projects in the strategic development sectors (elite tourism, the energy sector and agriculture) strengthened the development component of fiscal policy.

Chart 3.1: Fiscal parameter trends in millions of euros



Source revenues were estimated at EUR 1,683.7 million in 2016, which is 45.1% of estimated GDP (EUR 3,729.5 million)[18]. They are EUR 24.4 million (1.5%) higher than the planned values and EUR 157.9 million (10.3%) higher than the values from 2015. The increase in revenues

re submitted to Eurostat

› methodology used to submit data to Eurostat

budget, with public funds and the budgets of local self-government
ɜnd 21 municipalities). Of public finances, 88% was in the central
nt budgets.

venues amounted to EUR 1,486.6 in 2016 (EUR 28 million or
ɜased in amount of EUR 159.8 million or 12% compared to

relative to the plan occurred primarily due to an increase in economic activity and implementation of fiscal policy measures. In that respect, the estimates show revenues increasing in 2016: by EUR 20.8 million from personal income tax; by EUR 6.4 million from value added tax (increased collection of VAT on imports) and by EUR 50.4 million from fees (one-time payments of the digital dividend). On the other hand, according to the estimates, revenues will be lower than planned: by EUR 18.8 million for contributions and by EUR 12.0 million for donations. The reason for this is uncertainty in the implementation of planned donations from the EU.

The estimates state that the public spending was EUR 1,826.8 million in 2016, which is 49.0% of GDP. It is estimated that the current spending will be above plan and capital expenditures significantly below plan, due to the slower pace in the implementation of the highway project. In that respect, the structure of public spending has changed – the share of mandatory expenditure has increased. In comparison to the previous year, the estimated expenditure is EUR 1.7 million lower, with current spending EUR 116.9 million (7.5%) higher, while capital spending is EUR 118.6 million (44.2%) lower. Within current expenditure, the highest growth was recorded in "Transfers for social protection" – by EUR 90.7 million. At the same time, the total fund for gross salaries for 2016 is EUR 53.7 million higher than in the previous year because of implementation of the Law on the Salaries of Public-Sector Workers, which came into force in March 2016 and which resulted in an increase in the salaries of all categories of employees in the public sector.

On the other hand, the expected realization of the capital budget was lower than in 2015, since in 2015 EUR 174.7 million was spent on construction of the highway, and the estimate is that in 2016 funds of EUR 32.5 million will be withdrawn for the same purpose.

In comparison to the plan for 2016, public spending will be EUR 106.3 million (5.5%) lower. The primary reason for this is that the realization of the capital budget was EUR 222.4 million lower than planned. That led to the adoption of a budget rebalance for 2016. In addition to this, Montenegro has identified that it lacks the funds for implementation of the Law on the Amendments to the Law on Social and Child Care, the fiscal effect of which is EUR 74.4 million, while the plan had set this amount at EUR 12 million. Montenegro also faces a lack of funds for implementation of the Law on the Salaries of Public-Sector Workers and the need to plan additional funds to settle the liabilities of the Health Insurance Fund from the previous period.

The consolidation of public finances at the local level continued in 2016. Local self-government units, for which the reprogramming of their tax debt has been approved, are settling their obligations in line with the pace defined in the Plan for the Reprogramming of Tax Debt. In this respect, the outstanding liabilities of local self-governments have been reduced, primarily due to the implementation of rehabilitation plans by eight local self-government units that took out loans with state guarantees in order to overcome their financial difficulties.

The deficit in public finances in 2016 was estimated at EUR 143.2 million or 3.8% of GDP. The deficit is EUR 130.8 million (47.7%) lower than planned. The primary deficit in public finances (deficit in public finances minus interest) is estimated at EUR 61.8 million or 1.7% of GDP. Repayment of the debt which, according to the estimate, at the end of the year amounted to EUR 440.9 million or 11.8% of GDP together with the deficit, was financed by borrowing made on the international market of EUR 446.9 million, borrowing made on the domestic market of EUR 112.4 million and by revenues from the sale of property amounting to EUR 6.8 million. Implementation of these transactions led to a reduction in deposits of EUR 15.2 million.

Table 3.3: Estimated results in public finances in 2016

Annual GDP (in millions of euros)	*3,729.5*		*3,625.0*				*3,660.7*			
Estimate of public finances in 2016	*2016*		*2015*		*Deviations*		*Plan 2016*		*Deviations*	
	€ millions	*% GDP*	*€ millions*	*% GDP*	*€ millions*	*%*	*€ millions*	*% GDP*	*€ millions*	*%*
Public revenues	*1,683.7*	*45.1*	*1,525.8*	*42.1*	*157.8*	*10.3*	*1,659.2*	*45.3*	*24.4*	*1.5*
Personal income tax	*153.9*	*4.1*	*135.7*	*3.7*	*18.2*	*13.4*	*133.1*	*3.6*	*20.8*	*15.6*
Value Added Tax	*494.4*	*13.3*	*457.1*	*12.6*	*37.3*	*8.2*	*488.1*	*13.3*	*6.3*	*1.3*

Excise duties	*182.5*	*4.9*	*170.0*	*4.7*	*12.5*	*7.4*	*183.1*	*5.0*	*−0.6*	*−0.3*
Local taxes	*76.5*	*2.1*	*76.0*	*2.1*	*0.5*	*0.7*	*76.9*	*2.1*	*−0.3*	*−0.4*
Contributions	*464.3*	*12.5*	*437.3*	*12.1*	*27.0*	*6.2*	*483.2*	*13.2*	*−18.8*	*−3.9*
Public spending	*1,826.8*	*49.0*	*1,828.6*	*50.4*	*−1.7*	*−0.1*	*1,933.2*	*52.8*	*−106.3*	*−5.5*
Gross salaries	*482.5*	*12.9*	*428.8*	*11.8*	*53.7*	*12.5*	*463.4*	*12.7*	*19.1*	*4.1*
Interests	*81.4*	*2.2*	*86.2*	*2.4*	*−4.9*	*−5.6*	*81.2*	*2.2*	*0.2*	*0.3*
Subsidies	*27.7*	*0.7*	*20.3*	*0.6*	*7.4*	*36.7*	*21.2*	*0.6*	*6.5*	*30.8*
Transfers for social care	*578.6*	*15.5*	*487.9*	*13.5*	*90.7*	*18.6*	*534.4*	*14.6*	*44.2*	*8.3*
Capital budget	*149.5*	*4.0*	*268.1*	*7.4*	*−118.6*	*−44.2*	*371.9*	*10.2*	*−222.4*	*−59.8*
Guarantees	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*
Surplus/deficit	*−143.2*	*−3.8*	*−302.7*	*−8.4*	*159.6*	*−52.7*	*−273.9*	*−7.5*	*130.8*	*−47.7*
*Primary surplus/deficit**	*−61.8*	*−1.7*	*−216.5*	*−6.0*	*154.7*	*−71.5*	*−192.8*	*−5.3*	*131.0*	*−68.0*
Repayment of debt	*440.9*	*11.8*	*568.7*	*15.7*	*−127.8*	*−22.5*	*422.2*	*11.5*	*18.7*	*4.4*
Financing	*−584.1*	*−15.7*	*−871.4*	*−24.0*	*287.3*	*−33.0*	*−696.2*	*−19.0*	*112.1*	*−16.1*
Borrowing (international)	*446.9*	*12.0*	*660.7*	*18.2*	*−213.8*	*−32.4*	*660.4*	*18.0*	*−213.4*	*−32.3*
Borrowing (domestic)	*112.4*	*3.0*	*219.1*	*6.0*	*−106.7*	*−48.7*	*20.1*	*0.5*	*92.3*	*459.2*

**cash deficit adjusted for the cost of interest*

3.3 Medium-term budget prospects

The main goal of medium-term fiscal policy in Montenegro is to reduce the public spending deficit and slow down the increase in public debt, i.e. bring about its progressive decline compared to GDP.

In line with the set goal, the Parliament of Montenegro, at the proposal of the Government, adopted in late December 2016 consolidation measures in the area of public finances – the Plan for adjusting the amount of the budget deficit and public debt of Montenegro – which accompanies the 2017 Budget Law. Fiscal consolidation measures are designed in a way which makes it possible to produce a surplus in current budget spending which will create conditions in which the borrowing is used exclusively for financing capital, i.e. development, projects, the implementation of which ensures long-term economic growth. In this way, conditions are created for a slow-down in the level of public debt as a share of GDP, bearing in mind that it cannot go below 60% in the projection period concerned due to implementation of the highway construction project.

The Plan for adjusting the amount of the budget deficit and public debt of Montenegro contains a set of measures, the aim of which is to accelerate the growth of public revenues and slow down and establish control over expenditure.

The fiscal consolidation measures set out in the Adjustment Plan refer to the following:

- Collection of outstanding tax liabilities;
- Strengthening the fiscal discipline of taxpayers;
- An increase in the excise tax on mineral oils;
- Abolition of tax exemptions for computer accessories;
- Centralization of fiscal cash registers (effects are expected from 2018);
- Taxation of personal income (which is applied to the part of the salary exceeding the national average) at a rate of 11% and in the coming three-year period;
- Reduction in the salaries of public officials by 8% (for jobs in groups A, B and C defined in the Law on the Salaries of Public-Sector Workers);
- Non-consolidation of the amount of gross salaries on the basis of years of service (years of work experience) for the period April–December 2017 and 2018 for all public-sector workers;
- Cutting the expenditure on social benefits, i.e. benefits for mothers with three or more children and postponing implementation of the provision of the Law Amending the Law on Social and Child Protection under which a child attending elementary or secondary school is entitled to receive child allowance as of 1 July 2017 provided that his/her parents do not receive any social or financial benefits on any grounds and that they are registered in the records of the Employment Office as being unemployed;

- Optimization of the capital budget in the part which does not refer to construction of the priority section of the Bar–Boljare highway;
- Legalization of informally built structures and granting of economic citizenship;
- Cutting other discretionary expenditure in the budget, which will not compromise the efficient operation of the spending units and fulfilment of obligations laid down in the law;
- Adjustment of pensions on the basis of valid and projected macroeconomic indicators that have an impact on the amount of the pension benefit (average wage and inflation); and
- Optimization of the number of public-sector workers, in line with the Public Administration Reform Strategy of Montenegro 2016–2020.

In line with the designed measures, fiscal adjustment is planned in 2017 of a nominal amount of EUR 126.9 million, which constitutes 3.2% of estimated GDP, of which the effect of measures on the revenue side amounts to EUR 59.3 million, i.e. 1.5% of GDP, while the effect of measures on the expenditure side amounts to EUR 67.6 million, i.e. 1.7% of GDP.

Fiscal adjustment will ensure that current public spending is financed from source public revenues in all the projected years, which is in compliance with one of the basic rules for fiscal policy planning. On the other hand, public debt will show a tendency to grow and will reach its peak in 2019, after which time it will decline continuously.

Public revenues, which include fiscal consolidation measures, are estimated at EUR 1,758.0 million or 44.8% of GDP in 2017 and compared to the 2016 projection they are EUR 74.4 million or 4.4% higher. In that regard, the highest growth is planned with regard to revenue generated from VAT on the basis of the collection of outstanding tax liabilities, an increase in the tax base for the calculation of VAT on mineral oils and a 19% increase in the VAT rate for the trade in computer accessories. At the same time, revenues generated from excise taxes will also increase as a result of the increase in excise tax on mineral oils amounting to €90/1000 litres, contributions, the expected collection of tax liabilities and more regular payment of liabilities on that basis, and also as a result of donations given the announced budgetary support for the Ministry of Interior, donations for financing cross-border cooperation projects and donations which will be disbursed through the capital budget.

The 2017 revenue projection was made on the basis of the trend of macroeconomic indicators which correlate with budget revenues and it was adjusted as a result of amended legislation on the basis of the current and planned fiscal consolidation measures set out in the Adjustment Plan. Beside the revenue increase resulting from the effects of measures proposed on the revenue side of the 2017 budget, a further revenue increase is also expected as a result of the expected GDP growth.

The total effect of fiscal consolidation measures on the projection of revenues in 2017 is planned to amount to EUR 59.3 million, through:

- Collection of outstanding tax liabilities, the planned amount of which is EUR 12.0 million. This will lead to an increase in revenues generated from personal income tax of EUR 1.3 million, from contributions of EUR 5.5 million and from VAT of EUR 3.1 million, while revenues generated from VAT, real property transfer tax, concessions and the like will cumulatively increase by EUR 2.2 million;
- More regular payment of liabilities and legalization of employment, which will lead to an increase in revenues generated from personal income tax of EUR 2.8 million and social insurance contributions of EUR 12.2 million;
- An increase in the excise tax on mineral oils amounting to €90/1000 litres will lead to an increase in revenues generated from excise taxes by EUR 25.0 million. In addition, the basis for VAT calculation will also increase, thus generating revenue of EUR 7.0 million;
- Revenue amounting to around EUR 1.5 million will be generated once a standard 19% VAT rate is introduced for trade in computer accessories; and
- A reduction of the salaries of public officials by 8% will lead to a reduction in taxes and contributions for salaries of EUR 1.2 million.

Public spending in 2017, which includes fiscal consolidation measures, is planned to reach EUR 1,996.2 million, i.e. 50.8% of GDP. The largest increase in expenditure, compared to its estimate in 2016, is planned in the capital budget, in relation to funds earmarked for construction of the priority section of the highway, and these are planned to reach EUR 194.3 million. Also, expenditure on interest will be EUR 20.0 million higher, and expenditure on gross salaries will be EUR 4.4 million higher.

A reduction in expenditure, compared to the estimate in 2016, resulted from fiscal consolidation measures whose effect on the expenditure side amounts to EUR 67.6 million, with regard to:

- Expenditure on gross salaries and contributions payable by employers, through a linear reduction of the salaries of public officials by 8% (job groups A, B and C) and of the non-consolidation of basic earnings on the basis of years of service (years of work experience) for all public-sector workers in the period April–December 2017 and 2018. In that regard, the total amount to be disbursed for gross salaries will be EUR 4.9 million lower compared to the amount which would have been allocated if the measures had not been taken.
- Expenditure on certain categories of social benefits. With this measure, the monthly amount of individual benefits for women with three or more children is reduced from EUR 336 to EUR 264, and from EUR 193 to EUR 144, which generates annual savings amounting to EUR 14.9 million. In addition, there will be a postponement in the implementation of the provision under which a child attending elementary or secondary school is entitled to a child allowance as of 1 July 2017 provided that his/her parents do not receive any social or financial benefits and that they are registered in the records of the Employment Office as being unemployed. This will generate savings in 2017 of around EUR 0.9 million.
- Rationalisation of the capital budget, by reducing expenditure from general revenues by EUR 10.0 million in 2017, EUR 6.0 million in 2018 and EUR 2.0 million in 2019, whereby 2016 is considered a baseline year.
- Rationalisation of other discretionary expenditure which will not compromise the efficient functioning of the spending units and regular fulfilment of legal obligations. The total adjustment on the side of other revenues is planned to reach EUR 37.0 million.

One of the main features of the budget of Montenegro is the low flexibility of expenditure due to the high share of mandatory expenditure in the total budget expenditure. The highest share of budget expenditure is determined by the legal framework which regulates their amount and coverage, which is why the planned fiscal consolidation measures required prior amendments to be made to the relevant legislation. Therefore, in order to implement these measures, the Parliament of Montenegro adopted in December 2016, in addition to the 2017 Budget Law, amendments to the following laws as well: the Law on the Salaries of Public-Sector Workers, the Law on Personal Income Tax, the Law on Excise Tax, the Law on Value Added Tax, the Law on Rescheduling Tax Liability and the Law on Social and Child Protection.

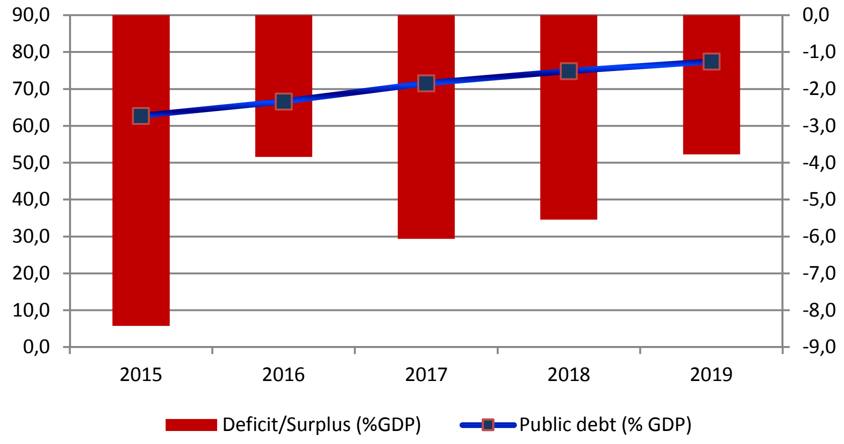
In line with the medium-term framework, public revenues will range from EUR 1,758.0 million in 2017 to EUR 1,868.6 million in 2019. Despite a nominal growth in revenues, such revenues are expected to decline from 44.8% of GDP in 2017 to 42.9% of GDP in 2019 as a result of the higher growth of GDP. The core pillars of the revenues are still VAT and contributions, which on average account for around 58% of public revenues. Value added tax will range from EUR 524.8 million in 2017 to EUR 574.8 million in 2019, while contributions will increase from EUR 492.2 million to EUR 515.6 million. Moreover, revenues generated from personal income tax will constitute a significant share of total revenues, while excise taxes will record growth which will be the result of the harmonization of Montenegro's excise tax policy with that of the European Union.

An increase in source revenues of local governments is also envisaged, from 5.25% of GDP in 2017 to 5.40% of GDP in 2019.

Public spending in the coming three-year period will remain at a relatively high level since construction of the priority section of the Bar–Boljare highway will be financed through the capital budget of the central government. Spending will range from 50.8% to 46.7% of the estimated GDP in 2017 and 2019 respectively. Expenditure has been placed under control, i.e. its growth has slowed down as a result of fiscal consolidation measures, which is why the remainder of the current spending has recorded downward trends from 2017 and the budget deficit is generated exclusively by capital spending.

The public finance deficit in the coming period will be relatively high and will range between 6.1% in 2017 and 3.8% in 2019. The level of the deficit is predominantly the result of the need to finance the highway project, which is why a public finance surplus is projected for after the highway is finished.

Chart 3.2: Trend of fiscal parameters in the medium term[19]



[19] The projection of public debt is made by following EDP methodology.

Table 3.4: Trend of public finances in the period 2016–2019

Annual GDP (in millions of euros)	3,625.0		3,729.5		3,928.5		4,176.9		4,357.8		3,874.1		4,038.5		4,152.2	
	Estimate				Base scenario						Lower growth scenario					
Estimate of public finances 2017–2019	2015		2016		2017		2018		2019		2017		2018		2019	
	€ millions	% GDP	€ millions	% GDP	€ millions	% GDP	€ millions	% GDP	€ millions	% GDP	€ millions	% GDP	€ millions	% GDP	€ millions	%
Public revenues, of which:	1,525.8	42.1	1,683.7	45.1	1,758.0	44.8	1,833.0	43.9	1,868.6	42.9	1,739.6	44.9	1,795.0	44.4	1,816.7	43.8
Personal income tax	135.7	3.7	153.9	4.1	161.2	4.1	165.1	4.0	168.7	3.9	158.8	4.1	160.8	4.0	163.0	3.9
Value added tax	457.1	12.6	494.4	13.3	524.7	13.4	556.5	13.3	574.8	13.2	520.1	13.4	545.1	13.5	558.9	13.5
Excise taxes	170.0	4.7	182.5	4.9	210.5	5.4	215.1	5.2	217.9	5.0	209.3	5.4	212.2	5.3	213.6	5.1
Local taxes	76.0	2.1	76.5	2.1	77.7	2.0	79.2	1.9	80.8	1.9	77.7	2.0	79.2	2.0	80.8	1.9
Contributions	437.3	12.1	464.3	12.5	492.2	12.5	504.6	12.1	515.6	11.8	482.9	12.5	487.7	12.1	493.4	11.9
Public revenues, of which:	1,828.6	50.4	1,826.8	49.0	1,996.2	50.8	2,064.5	49.4	2,033.2	46.7	1,996.2	51.5	2,064.5	51.1	2,033.2	49.0
Gross salaries	428.8	11.8	482.5	12.9	486.8	12.4	487.0	11.7	490.6	11.3	486.8	12.5	487.0	12.1	490.6	11.8
Interests	86.2	2.4	81.4	2.2	101.4	2.6	95.4	2.3	104.2	2.4	101.4	2.6	95.4	2.4	104.2	2.5
Subsidies	20.3	0.6	27.7	0.7	25.9	0.6	26.5	0.6	27.5	0.6	25.9	0.7	26.5	0.7	27.5	0.7
Social welfare transfers	487.9	13.5	578.6	15.5	574.2	14.6	581.1	13.9	590.9	13.6	574.2	14.8	581.1	14.4	590.9	14.2
Capital budget	268.1	7.4	149.5	4.0	318.1	8.1	378.4	9.1	330.9	7.6	318.1	8.2	378.4	9.4	330.9	8.0
Guarantees	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Surplus/deficit	-302.7	-8.4	-143.2	-3.8	-238.2	-6.1	-231.5	-5.5	-164.6	-3.8	-256.6	-6.6	-269.5	-6.7	-216.5	-5.2
Primary surplus/deficit	-216.5	-6.0	-61.8	-1.7	-136.8	-3.5	-136.1	-3.3	-60.4	-1.4	-154.9	-4.0	-174.1	-4.3	-112.3	-2.7
Debt repayment	568.7	15.7	440.9	11.8	253.4	6.5	221.2	5.3	585.6	13.4	253.4	6.5	221.2	5.5	585.6	14.1
Financing, of which:	-871.4	-24.0	-584.1	-15.7	-491.6	-12.5	-452.7	-10.8	-750.1	-17.2	-510.0	-13.2	-490.7	-12.2	-802.0	-19.3
Borrowing from international sources	660.7	18.2	446.9	12.0	363.2	9.2	376.3	9.0	627.7	14.4	363.3	9.4	414.3	10.3	679.6	16.4
Borrowing from domestic sources	219.1	6.0	112.4	3.0	110.0	2.8	60.0	1.4	110.0	2.5	110.0	2.8	60.0	1.5	110.0	2.6

3.4 Structural balance (cyclical component, deficit, one-off and interim measures, and fiscal attitude)

The structural balance of public spending shows actual misbalances in public spending which are dependent on the trends of economic activity, the current position of the economy in the business cycle, sources of revenues, as well as on expenditure excluding one-off effects. The structural balance is the difference between public spending revenues and expenditures, where revenues are reduced by one-off collections of revenues (collection of the digital dividend fee amounting to EUR 50.7 million and revenues generated from insurance premiums for the procurement of the fire-fighting aircraft worth EUR 2.2 million in the 2016 budget), adjusted to the cyclical position of the economy, while expenditure was reduced by one-off expenditures, subsidies and funds for redundancies (automatic stabilizers). The value of the potential growth rate and value of potential GDP required for calculation are explained and calculated in the chapter on macroeconomics by applying the *Hodrick–Prescott* filter. During periods of economic growth, revenues are higher than structural ones, whereas they are lower in the so-called lower side of the business cycle. Public revenues in periods of economic expansion grow at above the economy's growth rate and vice versa. The same goes for expenditure in periods of expansion, but one should emphasize that expenditure grows in periods of weaker economic activity, due to the activation of automatic fiscal stabilizers which serve as a support to the real sector of the economy in periods of worsened business conditions. The results of the model are limited due to the specificity of the country and frequent changes in fiscal policy measures, but they reflect the essential trends of the structural and cyclical components of the public finance balance. The results (shown in Chart 3.3) show that public finances excluding cyclical components and the position in the business cycle show high values in the medium-term. The high values of the deficit are influenced by the costs of construction of the priority section of the highway, which can be seen in Chart 3.3, since it is observed that the deficit in 2019, when the project finalization is planned for (mid-way through the year) amounts to 3.8%, whereas the structural balance moves into the surplus zone with a value of 0.2%. Bearing in mind the significant share of highway construction costs in the deficit of public finances during the observed period and in order to monitor the trend of public finances in the medium-term, the structural deficit was also calculated under conditions when the impact of the construction of the priority section of the highway is excluded from the estimate of structural expenditure (shown in Chart 3.4), since these are one-off expenditures in the medium-term.

Chart 3.3: Structural deficit

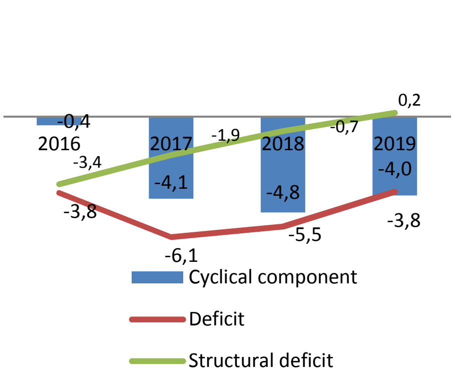
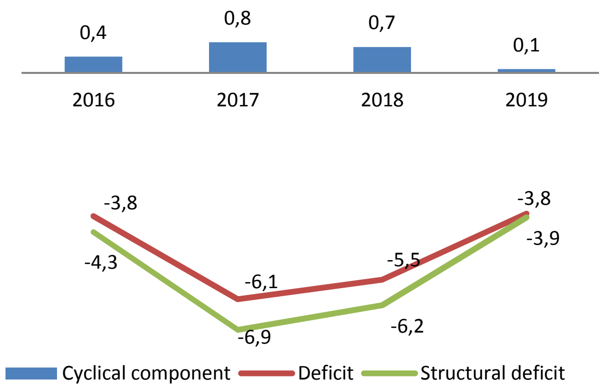


Chart 3.4: Structural deficit without highway costs



3.5 The level and trend of borrowing, analysis of activities "below the line" and stock-flow adjustment

3.5.1 Government debt and public debt in 2016

At the end of the third quarter of 2016, the government debt amounted to EUR 2,272.12 million or 60.92% of the estimated GDP. At the end of the same period, government deposits amounted to EUR 111.63 million or 2.99% of GDP, as a result of which the government debt amounted to EUR 2,160.49 million or 57.93% at the end of the third quarter. Compared to the previous year, at the end of 2015 the government debt amounted to EUR 2,239.78 million or 61.79% of GDP, or if deposits are included – 60.21% of GDP.

At the end of 2015, public debt amounted to EUR 2,381.96 million or 65.71% of GDP, while deposits amounted to EUR 57.25 million or 1.58% of GDP which resulted in public debt totalling EUR 2,324.71 million or 64.13% of GDP at the end of 2015. According to the latest projections of the Ministry of Finance, public debt at the end of 2016 will amount to EUR 2,485.4 million or 66.6% of GDP. The deposits of the Ministry of Finance will amount to around EUR 10 million, as a result of which public debt is expected to reach EUR 2,475.4 million or 66.4% of GDP at the end of 2016. The total amount of public debt at the end of 2016, compared to the end of the previous year, is expected to increase by around EUR 103.0 million.

Table 3.5: Trends of government debt and public debt, in millions of euros and as a percentage of GDP[20]

	31 December 2015	31 March 2016	30 June 2016	30 Septembe r 2016	31 December 2016**
GDP	3,625.00	3,729.50	3,729.50	3,729.50	3,729.50
TOTAL FOREIGN DEBT	1,956.35	2,223.59	2,034.57	1,995.97	1,993.48
TOTAL FOREIGN DEBT (% GDP)	53.97%	59.62%	54.55%	53.52%	53.45%
TOTAL INTERNAL DEBT	281.16	283.83	286.27	274.29	347.88
TOTAL INTERNAL DEBT (% GDP)	7.76%	7.61%	7.68%	7.35%	9.33%
State-owned enterprises	2.27	2.16	1.99	1.86	1.86
TOTAL GOVERNMENT DEBT	2,239.78	2,509.58	2,322.83	2,272.12	2,343.22
TOTAL GOVERNMENT DEBT (% GDP)	61.79%	67.29%	62.28%	60.92%	62.83%
Deposits in millions of euros	57.25	297.88	54.72	111.63	10.00
Deposits (% GDP)	1.58%	7.99%	1.47%	2.99%	0.27%
TOTAL GOVERNMENT DEBT (including deposits)	2,182.53	2,211.70	2,268.11	2,160.49	2,333.22
TOTAL GOVERNMENT DEBT (% GDP) (including deposits)	60.21%	59.30%	60.82%	57.93%	62.56%
Local government debt*	142.18	142.18	142.18	142.18	142.18
TOTAL PUBLIC DEBT in millions of euros	2,381.96	2,651.76	2,465.01	2,414.30	2,485.40
TOTAL PUBLIC DEBT (% GDP)	65.71%	71.10%	66.09%	64.74%	66.64%
TOTAL PUBLIC DEBT (including deposits)	2,324.71	2,353.88	2,410.29	2,302.67	2,475.40
TOTAL PUBLIC DEBT (% GDP) (including deposits)	64.13%	63.12%	64.63%	61.74%	66.37%

*Amount of the local government debt according to the projections of the Ministry of Finance, since the government does not prepare quarterly reports on public debt.

**According to the latest projections of the Ministry of Finance.

The total public debt at the end of the third quarter of 2016 increased by around EUR 32.0 million, compared to the end of 2015. The reason for such a substantial increase in the debt is the issuing of Eurobonds on the international market of around EUR 300.0 million, for a five-year period and at an interest rate of 5.75%, as well as the withdrawal of funds of EUR 21.0 million. During the first three

[20] The data is aligned with EDP methodology.

quarters of 2016, external debt increased by EUR 39.62 million compared to the end of 2015, while internal debt fell by EUR 7.28 million.

During the first three quarters of 2016, around EUR 21.56 million of loan proceeds were disbursed for the implementation of other infrastructural projects, such as: World Bank (WB) projects for the improvement of land administration, agriculture, energy efficiency and education; those of the European Investment Bank (EIB) for the construction and repair of the road infrastructure; the German Development Bank (KfW) for construction of the system of water supply, discharge and treatment of wastewater, and energy efficiency; and the Council of the Europe Development Bank (CEB) for the Social Housing Project 1000+.

During the same period, repayment of external debt amounted to EUR 274.94 million, whereby the remainder of the Eurobonds issued in 2011 was also repaid, amounting to EUR 141.79 million. As for the breakdown of external debt by creditors, loans under facilities with international financial institutions (WB, Paris Club of Creditors, EIB, EBRD, CEB and EU) account for 14.53% of GDP; "soft" loans (liabilities towards the governments of other countries) amount to around 1.7% of GDP; loans for budget financing needs (Credit Suisse, Deutsche Bank and Erste Bank) amount to around 3.57% of GDP; liabilities arising from the issuing of Eurobonds amount to around 29.22% of GDP; while liabilities arising from the Chinese loan for highway construction amount to around 4.51% of GDP.

BAR–BOLJARE HIGHWAY CONSTRUCTION PROJECT

A loan facility was signed in October 2014 with the Chinese Exim Bank worth USD 943,991,500.00 for the financing of construction of the Bar–Boljare highway, the priority section of which is Smokovac–Mataševo. This amount of the loan constitutes 85% of the total project value, which is around EUR 809.0 million. The remaining 15% will be allocated in the budget from generated revenues, or by obtaining funds through the facilities of financial institutions, or by the issuing of bonds or treasury bills. The repayment period for the loan mentioned above is 20 years, the interest rate is 2% and the grace period is 6 years.

In order to meet the needs of the construction of the Bar–Boljare highway's Smokovac–Uvač–Mateševo priority section, two drawdown payments were disbursed in 2015 representing two advance payments of the loan proceeds provided by the Chinese Exim Bank, totalling EUR 172.8 million[21] (USD 188.0 million). The amount of EUR 2.0 million (USD 2.1 million) was withdrawn in November 2016 for the purpose of this project, while the amount of around EUR 8.37 million (USD 8.73 million) was withdrawn at the end of 2016.[22]

During the first three quarters of 2016, domestic debt fell by EUR 7.28 million and now stands at EUR 276.15 million. The debt was reduced predominantly due to repayment of the debt arising from old foreign currency savings amounting to EUR 12.95 million, repayment of domestically issued bonds worth around EUR 10.78 million and repayment of the bonds of the labour fund worth around EUR 1.29 million. Domestic debt increased in the fourth quarter of 2016 predominantly due to the issuing of domestic bonds amounting to EUR 80.4 million and the withdrawal of revolving loans amount to EUR 20 million. Such an increase in domestic debt, despite the repayment of domestic and foreign debts, in the last quarter of 2016, amounting to around EUR 55.0 million, will lead to an increase in the government debt and public debt at the end of 2016.

As for the current debt stock, around 88.29 % of the debt is expressed in the local currency, i.e. the euro, which is why there is no currency risk at the moment, i.e. no significant increase in liabilities can occur as a result of currency fluctuations in the market *(Table 3.6).*

[21] Exchange rate as on 31 December 2015.

[22] Exchange rate as on 22 December 2016.

Table 3.6: Loans in foreign currencies calculated in millions of euros[23]

CREDITOR	Amount in millions of euros
Paris Club of Creditors	28.76
IDA	55.71
Eurofima	13.33
Chinese Exim Bank	168.25
Total loans in other currencies	266.05
Share of other currencies in total government debt	11.71%
Share of other currencies in total public debt	11.02%

In terms of the further trend of debt in other currencies, bearing in mind future disbursements of loan proceeds for the highway construction from the loan extended by the Chinese Exim Bank, the amount mentioned above is expected to change, which is why the funds stated in other currencies will make up a higher share of the debt stock. Due to the risk this may pose to the debt trend, as well as to the repayment of liabilities, activities will be undertaken in the coming period to ensure the best possible safeguards against currency risk by means of signing hedging arrangements.

In accordance with the Law on the Budget and Fiscal Responsibility, definitions of government debt and public debt have been introduced into reporting since the end of 2014. Government debt does not include local government debt, while the debt of state enterprises has now become an integral part of the government debt. Public debt, besides government debt, also includes the debts of local governments and municipal enterprises. Under this law, the Ministry of Finance is obliged to report on the government debt on a quarterly basis, while public debt is reported once a year, within 90 days of the end of the fiscal year. Moreover, this law also sets out fiscal rules in the area of public debt, i.e. it prescribes that the budget will be planned and executed in such a way that ensures that public debt does not exceed 60% of GDP. The law also specifies which activities are to be undertaken should public debt exceed 60% of GDP.

In April 2015, the Government of Montenegro adopted the Public Debt Management Strategy, which is based on the macroeconomic and fiscal policy guidelines for the period 2015-2018. This Strategy covers the Central government of Montenegro and municipal debt. It also includes the analysis of the existing debt, projections of the debt trend for the period 2015-2018, analysis of costs and risks accompanying the borrowing, as well as guidelines for further policy for managing borrowings and debt. The preparation of the new Public Debt Management Strategy, for the period 2018-2021, is expected in the first quarter of 2018.

3.5.2 Base scenario for the government debt trend in the period 2017–2019

The 2017 Proposal for the Budget Law envisages borrowing of EUR 454.3 million. Of that amount, EUR 220.4 million will be needed to finance debt repayments, while around EUR 200.0 million will have to be secured for financing highway construction costs (of which 85% are secured from the Exim Bank loan and 15% from the budget). Of the planned borrowing which amounts to EUR 454.3 million, around EUR 33.9 million will be needed for financing the deficit and building up fiscal reserves.

Besides the borrowing in 2017 mentioned above, the amount needed for debt repayment in 2018 according to the liabilities repayment plan is considerably lower and is equal to EUR 187.2 million, while such an amount will increase in 2019 to EUR 549.5 million. The increase in liabilities in 2019 is primarily the result of repayment of the 2014 Eurobonds, amounting to EUR 280.0 million. However, bearing in mind the high level of funds planned for financing of the capital budget for these years, the shortfall of funds needed for budget financing will amount to around EUR 416.0 million in 2018 and EUR 719.0 million in 2019. Of that amount, around EUR 230.0 million in 2018 and around 178.0 million in 2019 will be needed for financing the highway construction and this has already been secured through the loan facility extended by Exim Bank.

[23] Balance as on 30 September 2016.

Bearing in mind the needs for budget financing in 2017, the funds for debt repayment, the building up of fiscal reserves and the payment of liabilities arising from the highway construction will be secured from the facility extended by the Chinese Exim Bank and through the issuing of bonds on the international market, as was the case in 2016. In 2017, consideration will be given to the way in which funds will be secured for 2018 and 2019, since the deficit in those years will mainly consist of expenditures for financing capital spending.

In the period 2017–2019, the loan extended by Exim Bank will be disbursed up to the level of completed works, i.e. dependent on the pace of project implementation, and each withdrawal of funds during the year will be recorded in the debt stock. Withdrawal of around EUR 315.1 million is expected in the period 2017–2019 for the purpose of financing infrastructural and other projects. Withdrawal of funds for implementation of the Bar–Boljare project during the period 2017–2019 will have the most profound effect on the trend of public debt. According to the projection, the average amount of funds to be withdrawn will reach EUR 200.0 million per annum.

Table 3.7: Trend of government debt and public debt in the period 2016–2019 in millions of euros – base scenario[24]

Year	2016	2017	2018	2019
GDP	3,729.50	3,928.50	4,176.90	4,357.80
Domestic debt	347.88	274.75	243.74	216.28
Foreign debt	1,993.48	2,394.25	2,741.72	3,017.65
State-owned enterprises	1.86	1.86	1.86	1.86
Total government debt	2,343.22	2,670.86	2,987.32	3,235.79
Total government debt (% GDP)	62.83%	67.99%	71.52%	74.25%
Local government debt	142.18	142.18	142.18	142.18
Total public debt	2,485.40	2,813.04	3,129.50	3,377.97
Total public debt (% GDP)	66.64%	71.61%	74.92%	77.52%

Note: An additional EUR 20 million for a revolving loan was agreed in December 2016, which will be repaid in 2019, while the borrowing totalling EUR 20 million for the revolving loan, which was planned to be repaid in 2016, will actually be repaid in 2018. According to the latest projections, the amount of domestic debt includes borrowing amounting to EUR 3 million in 2017, EUR 15 million in 2018, EUR 14 million in 2019, EUR 8 million in 2020 and EUR 9.5 million in 2021.

As shown in Table 3.7 above, government debt excluding deposits at the end of 2016 is expected to amount to 62.8% of GDP and if deposits, which are estimated at around EUR 10 million, are included, government debt will amount to around 62.6% of GDP. At the end of the observed period, public debt will amount to 66.6% of GDP, excluding deposits, and if deposits are included, public debt will amount to 66.4% of GDP.

A further increase in debt is expected in 2017 due to the costs of the highway construction, which is why government debt is expected to amount to 68.0% of GDP at the end of the period, while public debt will amount to around 71.6%.

As for the debt stock in 2018 and 2019, according to projections which take into account high expenditure on highway construction, government debt will amount to 71.5% and 74.3% of GDP respectively, while public debt will amount to 74.9% and 77.5% of GDP respectively. Moreover, the presented trend of public debt is, in addition to the abovementioned reasons, also caused by the following:

- Repayment of interest on loans with a variable interest rate was also planned according to the margins applicable at the end of 2016, and for loans with fixed interest rates the most recent interest rate of those financial institutions which extended the loans was used.
- The most recent applicable foreign exchange rate was used for loans in currencies other than the euro.

[24] Projection of the government debt is presented in the EDP tables submitted to Eurostat.

– The plan is to maintain deposits at a level of around EUR 20 million during the period mentioned above.

As a result of the significant increase in debt, the period 2017–2019 will require implementation of fiscal policy focused on borrowing only for the needs of capital projects, and all that with the aim of fostering economic growth. As already mentioned, the Law on the Budget and Fiscal Responsibility sets out numerical fiscal rules. Since debt exceeded the amount of 60% of GDP, the document entitled "Measures for adjusting the amount of the budget deficit and public debt 2017–2021" was adopted in December 2016 and constitutes an integral part of the 2017 Budget Law.

Due to the potential risks, the price of borrowing may increase, which would raise the costs of issuing bonds by some 1–2 percentage points, but that would not compromise the provision of funds in the market. In order to reduce exposure to the international market, negotiations are simultaneously being conducted with international banks regarding the conclusion of bilateral arrangements, while analysis of the domestic market has been carried out as a back-up plan in the event that access to the market becomes impossible.

*Table 3.8: Trend of debt in the period 2015–2019 in millions of euros – base scenario – excluding the highway**

	2015	2016	2017	2018	2019
GDP	3,625.00	3,729.50	3,928.50	4,176.90	4,357.80
Domestic debt	282.95	347.88	274.75	243.74	216.28
Foreign debt	1,783.56	1,808.09	1,956.42	2,007.78	2,030.49
State-owned enterprises	1.86	1.86	1.86	1.86	1.86
Total government debt	2,068.37	2,157.83	2,233.03	2,253.38	2,248.63
Total government debt (% GDP)	57.06%	57.86%	56.84%	53.95%	51.60%
Local government debt	142.18	142.18	142.18	142.18	142.18
Total public debt	2,210.55	2,300.01	2,375.21	2,395.56	2,390.81
Total public debt (% GDP)	60.98%	61.67%	60.46%	57.35%	54.86%

** The report is consistent with the EDP tables submitted to Eurostat.*

*** The amount of government debt includes the debt of state-owned enterprises, whereas the amount of public debt also includes local government debt.*

Table 3.8 above shows the trend of debt in the period 2015–2019, in the event that there is no borrowing for the project for financing the construction of the highway's Smokovac–Mateševo priority section. According to this projection, the trend of debt would differ considerably from the base scenario and at the end of the observed period, in 2019, public debt would amount to EUR 2,390.8 million, i.e. 54.8% of GDP.

3.5.3 Lower growth scenario

If economic development slows down and the level of revenues decreases, in line with the lower growth scenario, these changes will also affect the trend of public debt. A decline in revenue will lead to the need for additional borrowing so as to provide the shortfall of funds required for deficit financing.

*Table 3.9: Trend of debt in the period 2016–2019 in millions of euros – lower growth scenario**

Year	2016	2017	2018	2019
GDP	3,729.50	3,874.10	4,038.50	4,152.20
Domestic debt	347.88	274.75	243.74	216.28
Foreign debt	1,993.48	2,411.25	2,794.72	3,126.65
State-owned enterprises	1.86	1.86	1.86	1.86
Total government debt	2,343.22	2.687.86	3,040.32	3,344.79
Total government debt (% GDP)	62.83%	69.38%	75.28%	80.55%
Local government debt	142.18	142.18	142.18	142.18
Total public debt	2,485.40	2.830.04	3,182.50	3,486.97
Total public debt (% GDP)	66.64%	73.05%	78.80%	83.98%

** The report is consistent with the EDP tables submitted to Eurostat.*

*** The amount of government debt includes the debt of state-owned enterprises, whereas the amount of public debt also includes local government debt.*

In the event that there is no borrowing for the project of financing the construction of the highway's Smokovac–Mateševo priority section, according to the lower growth scenario, despite a decrease in the level of revenues and slower economic growth, the trend of debt for the period 2015–2019 will not differ considerably from the base scenario[25]. According to this projection, public debt in the observed period would reach its peak in 2017, at which point it would amount to 61.3% of GDP, after which it would follow a downward trajectory, reaching the level of 57.8% of GDP in 2019.

*Table 3.10: Debt trend in the period 2015–2019 in millions of euros – lower growth scenario – excluding the highway**

	2015	2016	2017	2018	2019
GDP	3,625.00	3,729.50	3,874.10	4,038.50	4,152.20
Domestic debt	282.95	347.88	274.75	243.74	216.28
Foreign debt	1,783.56	1,808.09	1,956.42	2,010.78	2,038.49
State-owned enterprises	1.86	1.86	1.86	1.86	1.86
Total government debt	2,068.37	2,157.83	2,233.03	2,256.38	2,256.63
Total government debt (% GDP)	57.06%	57.86%	57.64%	55.87%	54.35%
Local government debt	142.18	142.18	142.18	142.18	142.18
Total public debt	2,210.55	2,300.01	2,375.21	2,398.56	2,398.81
Total public debt (% GDP)	60.98%	61.67%	61.31%	59.39%	57.77%

** The report is consistent with the EDP tables submitted to Eurostat.*

*** The amount of government debt includes the debt of state-owned enterprises, whereas the amount of public debt also includes local government debt.*

3.5.4 State of government guarantees

As of 30 September 2016, the total value of government guarantees amounted to EUR 337.21 million or 9.04% of GDP. Of that amount, foreign guarantees accounted for approximately EUR 285.06 million (7.64% of GDP), whereas domestic guarantees accounted for EUR 52.14 million (1.40% of GDP).

Even though the 2016 Budget Law envisaged the issuing of guarantees totalling EUR 26.0 million, of which EUR 20.0 million was envisaged for a loan facility between the Montenegrin Electric Transmission System (CGES) and the German Development Bank (KfW) for a project involving construction of the electrical power infrastructure on the Luštica Peninsula and EUR 6.0 million was envisaged for a loan facility between the Montenegro Railway Infrastructure Joint Stock Company and the European Investment Bank for projects involving reconstruction and improvement of the railway infrastructure, these facilities were not signed in 2016.

The 2015 Budget Law set out the issuing of bonds worth of EUR 107.0 to the municipalities in order for certain municipalities to be able to repay their liabilities and settle their debts, refinance current loan liabilities and streamline their administration, as follows: 1) for the Municipality of Kolašin, amounting to EUR 7.0 million; 2) for other municipalities benefiting from financial resources of the Equalization Fund, amounting to up to EUR 100.0 million. Of that amount, EUR 42.9 million was secured in 2015, while no guarantees were issued in 2016.

The 2017 Budget Law sets out the issuing of guarantees totalling EUR 48.0 million, as follows:

1) For a loan facility between the Montenegro Railway Infrastructure JSC and European Investment Bank (EIB) for projects involving reconstruction and improvement of the railway infrastructure, for which a loan facility of EUR 20.0 million has been envisaged, of which a total of up to EUR 7.0 million will be effective in 2017.

[25] *Debt trend in the period 2015–2019 – base scenario – excluding the highway*

2) For a loan facility between the Montenegrin Power Transmission System (CGES) and the German Development Bank (KfW) for a project involving construction of the electrical power infrastructure on the Luštica Peninsula, amounting to EUR 20.0 million.
3) For a loan facility between the Regional Water Supply System for the Montenegrin Coast and Erste Bank, of EUR 8.0 million, for the purpose of substituting the existing guarantee issued to the Abu Dhabi Fund for the loan facility between the Regional Water Supply System for Montenegrin Coast and the Abu Dhabi Fund.

3.6 Sensitivity analysis and comparison with the previous programme

3.6.1 Sensitivity of public finance projections to alternative scenarios and risks

The main risks to the fulfilment of fiscal projections, whether political or economic, may be reflected in positive or adverse implications on public finances. The overview of risks to the fulfilment of fiscal projections is presented in Table 3.11 below:

Table 3.11: Overview of fiscal risks in the medium term

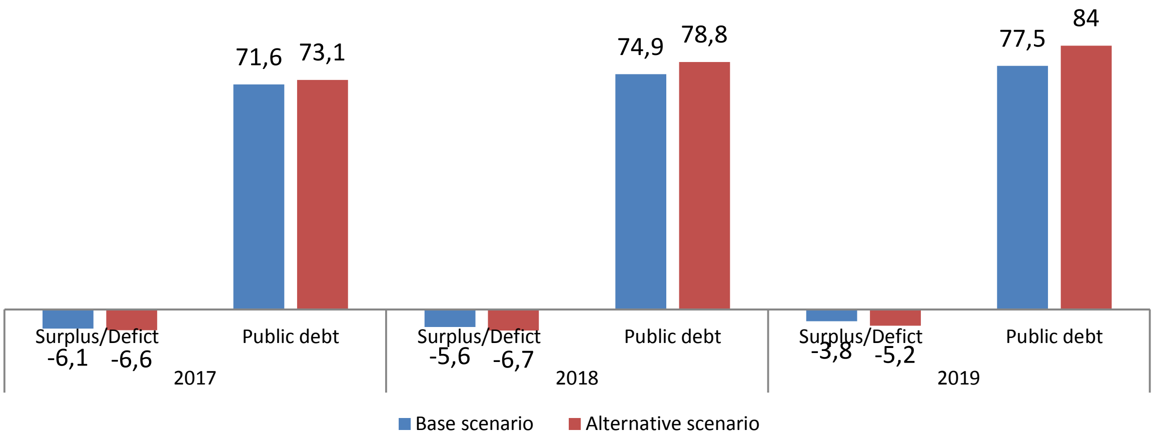
	Positive	Adverse
Political	• *NATO membership of Montenegro will increase confidence among investors and tourists, which will have a positive impact on all economic parameters of the national economy, which will then lead to better access to sources of funding* • *Progress along the path of accession to the European Union will lead to an increase in investors' confidence, a more stable business environment and access to EU funds*	• *Political instability in the South-East Europe region may have an adverse impact on Montenegro's economy, and particularly on the tourist sector*
Economic	• *Fiscal adjustment measures, the aim of which is to consolidate core fiscal parameters* • *Greater multiplicative effects from highway construction and completion of the announced investments pose a risk to the positive adjustment of revenue projection* • *Continuation of efforts to reduce the grey economy and achievement of results in that area will expand the tax base, which may lead to an increase in budget revenues* • *Rescheduling the tax debt of municipalities and the obligation to pay gross salaries will have a positive effect on budget revenues* • *The Public Finance Management Reform Programme 2016–2020 contributes to an increase in the credibility and transparency of public finances*	• *Change to the schedule for the implementation of investment projects may compromise the projected macroeconomic framework and medium-term fiscal projections* • *Failure to implement fiscal consolidation measures within the planned scope may deteriorate the projected amounts of the deficit and public debt* • *Increasing the burden of the pension system on public finances* • *An increase in liabilities in the healthcare sector may lead to a rise in the projected amount of spending* • *An increase in the cost of highway construction, potentially up to 10%* • *The amount of the government debt constitutes an adverse economic pressure on the fulfilment of the projections, while an increase in government debt has an adverse impact on borrowing conditions on the international market* • *An adverse impact of social benefits on public finances and the labour market* • *Implementation of the ESA 2010 methodology will expand the existing institutional coverage of budgetary accounting by including public enterprises, which should, based on the qualitative and quantitative criteria laid down in ESA 2010, be presented within the general government sector. Accordingly, there is the possibility of an increase in the deficit and debt of the sector mentioned above.*

The alternative fiscal scenario is based on a macroeconomic scenario projecting lower growth, which starts from the assumption that the level of investments will be lower than that projected in the base scenario, as a result of the possibility of a change occurring in the schedule of the implementation of major investment projects, as elaborated in Chapter 2. Should these risks materialize, budget revenues would not be generated at the level planned in the base scenario and expenditures would remain at the same level, which would then result in a higher level of public finance deficit in the medium term.

Fiscal coefficients of elasticity show that the revenue side in the fiscal scenario is susceptible to impacts from the macroeconomic environment, while macroeconomic trends do not have a major impact on the expenditure side of the budget, particularly in Montenegrin conditions in which the budget predominantly serves the purpose of financing mandatory expenditures, such as wages, pensions and social benefits.

Should the macroeconomic scenario projecting lower growth materialize, revenues would decline on average by 2% per annum in comparison to the base scenario. At the same time, the deficit would be adjusted, which is why the public finance deficit in the lower economic growth scenario would amount to around 6.6% of GDP in 2017, 6.7% in 2018 and 5.2% in 2019. In addition, public debt would be higher than that projected in the base scenario, as shown in Chart 3.5 below.

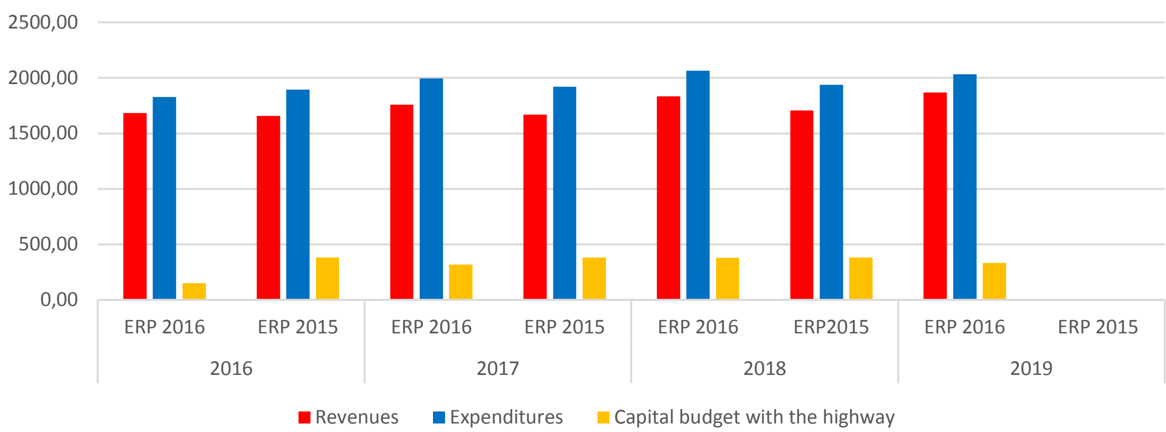
Chart 3.5: Comparison between base and lower growth scenarios



3.6.2 Comparison with the previous programme

Compared to the revenue projection made in the previous year's programme, the public revenues generated in 2016 were above the projected level of EUR 26.1 million, which was predominantly the result of the collection of revenue based on "digital dividends", which was twice as high as planned.

Chart 3.6: Sensitivity analysis and comparison with the previous programme



As shown in Chart 3.6 above, the amount of source public revenues in all years was considerably higher than had been previously projected, which means that a conservative approach had been taken in their projection. Projections of expenditures differ from the previous programme with regard to current budget spending, which was a result of the adoption of new legislation whose fiscal impact was higher than had been planned. Likewise, the amount of the capital budget is lower compared to the previous year's projection as a result of a change made to the schedule of the completion of works in the highway construction.

3.7 Fiscal management and budgetary frameworks

Responsible public finance management still remains the strategic commitment of the Government of Montenegro. Public finance policy is being continuously improved and adjusted to EU legislation.

The Law on the Budget and Fiscal Responsibility, which came into force in 2014, is a basic piece of legislation which regulates budget planning and execution, fiscal responsibility and other matters related to the government budget and the budgets of local government units. This law also lays down the criteria for fiscal policy planning, the medium-term budgetary framework, numerical fiscal rules and other norms which are aimed at improving public finance management.

Formal introduction of the medium-term budgetary framework led to an improvement in the projections of the core elements of public finances, particularly with regard to public revenue planning, where thresholds are set for the budgetary spending of all the spending units of the budget of Montenegro. Nevertheless, the medium-term framework still needs to be improved so that it can even better reflect strategic goals and policies, increase their transparency and the efficiency of use of public resources. In doing so, a strong focus should be placed on improvement of the assessment of the fiscal impact of legislation on public finances in order to avoid the adoption of certain legislation for which a prior fiscal impact assessment has not been conducted or has been conducted inadequately. Likewise, the regulatory framework governing public procurement should be improved, particularly with regard to monitoring and reviewing their economic justifiability.

The numerical fiscal rules for the amount of the budget deficit and public debt, laid down in Article 21 of the Law on the Budget and Fiscal Responsibility, were breached, which is why the measures for adjusting the amount of the budget deficit and public debt for the period 2017–2021 were drawn up. Assessments focusing on the criteria of fiscal responsibility and enforcement of the numerical fiscal rules are carried out by the State Audit Institution (SAI) and published in its Annual Report on Completed Audits and Activities.

In accordance with the Law on the Budget and Fiscal Responsibility, preparation of the Fiscal Strategy covering the entire period of the government's term is under way, while its adoption is planned for the first quarter of 2017. The Strategy will form the basis of adoption of the annual guidelines on macroeconomic and fiscal policy.

The Public Finance Management Reform Programme 2016–2020 was adopted on the basis of the situation analysis and weaknesses identified in various subsectors of public finance management. The Programme sets out priority objectives and groups them into the following reform areas: 1) the sustainable fiscal framework, public spending planning and budgeting; 2) budget execution; 3) development of a system of internal financial controls; 4) financial reporting and accounting; and 5) the capacities of the SAI to meet INTOSAI standards.

The reform activities mentioned above aim to ensure more efficient public finance management, which is aligned with European Union legislation, while they also constitute a requirement for the withdrawal of funds of direct budgetary support within IPA programmes.

As for the budgeting process, activities will be undertaken for the purpose of ensuring full implementation of programme-based budgeting, the aim of which is to establish an efficient system to measure the performance of budgetary programmes and improve the planning of and reporting on capital projects.

With a view to opening negotiations on Chapter 17 – Economic and Monetary Union, the European Commission gave the recommendation to introduce ESA 2010 methodology into the public sector. In fact, Montenegro is obliged to harmonize its legislation, processes and capacities with the requirements set out in Directive 2011/85/EU which refer to budgetary accounting and statistical reporting, forecasts, numerical fiscal rules, the medium-term budgetary framework and the clear division of competences.

To reach that objective, it is necessary to introduce ESA 2010 methodology into the public finance system, while ensuring appropriate institutional coverage.

Therefore, the Statistical Office, in cooperation with the Ministry of Finance and Central Bank of Montenegro, is implementing activities to introduce ESA 2010 methodology into public finance statistics with a view to improving the transparency and credibility of public finances. In order to ensure alignment of the process with the methodology mentioned above, the Agreement on Cooperation in the area of statistics on the national accounts of general government sectors and related statistics was signed in May 2016 by the Statistical Office, the Ministry of Finance and the Central Bank of Montenegro. As a result of the increased workload and complexity of the tasks, the working team for implementation of ESA 2010 methodology in public finance statistics, which was set up by the Ministry of Finance, was expanded to include new members from the three institutions mentioned above. Together with an expert in this area, the members of the working team are working on institutional classification and identification of the sectors of general government within it, while its adoption has been set as the main goal for the coming period. Representatives of the Ministry of Finance examined all units of the public non-financial sector by applying both qualitative and quantitative criteria. At the same time, implementation tables were created from the national chart of accounts by using ESA 2010 codes and the main sources of data were identified.

3.8 Sustainability of public finances

In order to ensure sustainability of public finances in the long term, it is necessary to continue the implementation of reforms in the areas that have a significant impact on the state of public finances, these being the pension, healthcare and social welfare systems.

Unfavourable demographic trends and the labour market situation and the resulting significant growth of the total number of pensioners and level of pension benefits led to a deficit in the Pension and Disability Insurance Fund thus causing a risk to the sustainability of the pension system. To reduce this risk, Montenegro carried out two reforms of the pension system: the first was systemic and parametric reform, implemented since 2004, and the second was parametric reform, implemented since 2011. The latter progressively increased the retirement age to 67 and changed the formula for the adjustment of pensions. The results of this reform are not visible in the short term due to the long period of the progressive rise of the retirement age at which one can exercise the right to an old-age pension (for men by 2025 and for women by 2041). In 2016, pensions were adjusted twice, whereby a regular adjustment (based on the average wage and inflation) was carried out at the beginning of the year and an extraordinary adjustment was carried out in July, leading to a 3% rise in the level of pension benefits and other entitlements in the area of pension and disability insurance, and a 20% rise in the nominal amount of the lowest pension.

In 2017, pensions will be adjusted in line with the valid and projected macroeconomic indicators which influence the amount of pension benefits. Given that the legislation governing pension and disability insurance amended by the previous Parliament of Montenegro without a prior fiscal impact assessment, under which insured individuals whose employment in a business organization in which the state has an ownership share was terminated as a result of bankruptcy are entitled to an old-age pension if they have 30 years of pensionable service for men or 25 years of pensionable service for women, one of the risks that could further undermine the pension system is the early retirement of employees, i.e. an early exit from the labour market.

The healthcare system, or more precisely its financing, is hugely important for the long-term sustainability of public finances. In the previous period, the high level of outstanding liabilities of the Health Insurance Fund, more precisely of public healthcare institutions, have undermined the financial stability of the healthcare system, thus constituting a major challenge to the budget of Montenegro. Based on this, outstanding liabilities from the previous period amounting to EUR 46.0 million were paid in 2016, which created the conditions for the Health Insurance Fund to make regular payments for the planned liabilities in the coming period. In order to continuously monitor the state of play in this area, the Government of Montenegro adopted the Analysis of healthcare system financing in Montenegro in June 2016 and the Programme for adjusting the finances of the healthcare system in December. The

Programme contains an analysis of the current condition and proposes measures and activities for overcoming financial difficulties and establishing the financial sustainability of the healthcare system.

The sustainability of public finances in Montenegro is largely influenced by the trends in the costs for social welfare, particularly due to the fact that the increased risk of public finance instability in 2016 was largely linked to the need to finance new entitlements set out in the Law amending the Law on Social and Child Protection. Namely, the 2015 amendments to this Law introduced a benefit based on giving birth to three or more children, the original fiscal impact of which was estimated at EUR 12 million, but which was exceeded many times over, thus increasing social welfare entitlements by almost 50% compared to the year before. To halt this trend and adjust the amount of this benefit to the other entitlements in the area of pension, disability and social insurance, the Government of Montenegro proposed amendments to the law in December 2016, which included measures for reducing certain benefits, thus partly disburdening this category of expenditures. In line with the objectives set in this area, implementation of the Social Card – Social Welfare Information System project will continue, since it is creating a consolidated database on the beneficiaries of rights in the social welfare system, thus better targeting budgetary funds allocated for these purposes, standardizing the process of making decisions on social welfare rights, reducing abuse and ensuring more efficient planning of the measures and programmes intended for the socially disadvantaged category within the population.

The condition and trends of local government finances constitute an important segment of the overall fiscal system. The trend of stabilization of local government public finances is expected to continue in the coming medium term. The Law on Public Utilities and the Law on the Regularization of Informal Structures were adopted in 2016, introducing new revenues for local government units. The Law on Public Utilities introduced a utility fee as a revenue generated by local government units intended for financing common consumption of utilities and current and investment maintenance of the equipment and means needed for the performance of this activity. Under this law, a utility fee can be collected by local governments as of 1 January 2017. The Law on the Regularization of Informal Structures, the implementation of which will begin on 1 March 2017, prescribes the procedure for the regularization and legalization of informal structures and introduces new revenues for municipalities: a fee for the provision of utilities on construction land for informal structures, a fee for the legalization of informal structures and a fee for using the space for informal structures. A more significant effect on municipal revenues on this basis is expected in 2018. These revenues are earmarked and can be used exclusively for investments in infrastructure, i.e. for capital expenditures, which is why they will increase in the period to come.

Apart from what has been mentioned above, the sustainability of public finances is largely influenced by the amount of funds allocated for public administration financing, which is why activities will be undertaken in the coming period to reduce, or optimize, the number of employees in public administration, while ensuring that the efficiency of the performance of affairs of public interest is not compromised.

Table 3.12: Public finances 2016–2019

Annual GDP (in millions of euros)	*3,729.5*		*3,928.5*		*4,176.9*		*4,357.8*	
	Estimate		*Projection*		*Projection*		*projection*	
	2016		***2017***		***2018***		***2019***	
Public finances 2016–2019	*millions of euros*	*% GDP*	*millions of euros*	*% GDP*	*millions of euros*	*% GDP*	*millions of euros*	*% GDP*
Source revenues	*1,683.7*	*45.1*	*1,758.0*	*44.8*	*1,833.0*	*43.9*	*1,868.6*	*42.9*
Expenditures	*1,826.8*	*49.0*	*1,996.2*	*50.8*	*2,064.5*	*49.4*	*2,033.2*	*46.7*
Current budgetary spending	*1,677.3*	*45.0*	*1,678.1*	*42.7*	*1,686.1*	*40.4*	*1,702.3*	*39.1*
Capital budget	*149.5*	*4.0*	*318.1*	*8.1*	*378.4*	*9.1*	*330.9*	*7.6*
Highway	*32.5*	*0.9*	*194.3*	*4.9*	*230.0*	*5.5*	*177.5*	*4.1*
Interest	*81.4*	*2.2*	*101.4*	*2.6*	*95.4*	*2.3*	*104.2*	*2.4*
Surplus/deficit	*−143.2*	*−3.8*	*−238.2*	*−6.1*	*−231.5*	*−5.5*	*−164.6*	*-3.8*

Surplus/deficit excluding the highway	*−110.6*	*−3.0*	*−43.9*	*−1.1*	*−1.5*	*0.0*	*12.9*	*0.3*
Primary surplus/deficit	*−61.8*	*−1.7*	*−136.8*	*−3.5*	*−136.1*	*−3.3*	*−60.4*	*-1.4*
Debt repayment	*440.9*	*11.8*	*253.4*	*6.5*	*221.2*	*5.3*	*585.6*	*13.4*
Shortfall of funds	*−584.1*	*−15.7*	*−491.8*	*−12.5*	*−452.7*	*−10.8*	*−750.1*	*-17.2*
Public debt	*2,485.4*	*66.6*	*2,813.0*	*71.6*	*3,129.5*	*74.9*	*3,378.0*	*77.5*

4 STRUCTURAL REFORM PRIORITIES 2017–2019

Chapter 4 of the 2017–2019 ERP provides an overview of the priority reform measures in Montenegro, which are closely related to the overall priorities of macroeconomic and fiscal policy laid down in Chapters 2 and 3 and which, *inter alia*, impact the overall fiscal and macroeconomic framework. The Chapter is organized in such a way that Section 4.1 presents the key obstacles to faster economic growth and increased competitiveness.

Section 4.2 lays down the development objectives in the nine reform areas defined in the EC's Guidance on ERP, as well as the key obstacles that hinder competitiveness and the achievement of development objectives. To remove or reduce these obstacles, Section 4.3 presents the reform processes in the nine areas defined in the EC's Guidance on ERP, providing basic information on each of the 20 priority reform measures. Details on each of those measures are presented in Table 11 of the Annex. In choosing the "priority reform measures" the following criteria were applied, which involved answering several questions. Firstly, the measure had to be broad enough to be able to affect the country's competitiveness, and on the other hand to be "specific" enough so that its impact can be quantified. Secondly, the question of whether and how much the measure contributes to the pursuit of the priorities defined within the framework of this year's EPR. Thirdly, does the measure contribute to the implementation of the recommendations given to Montenegro at the ministerial meeting in May 2016, and if so, how much? Fourthly, the measure should respond to some of the key obstacles to higher competitiveness and faster economic growth of Montenegro. Fifthly, is the measure ready – in substantial and financial terms – so that its implementation may commence or continue in 2017?

4.1 Identification of the key obstacles to competitiveness and inclusive growth

Montenegro defined its strategic objectives in the area of economic development for the coming medium-term period in the Development Directions for Montenegro (DDM) for the period 2013–2016 – the Government's document which has as its objective economic growth that will contribute to the improvement of citizens' quality of life. The DDM has identified tourism, energy, the manufacturing industry, agriculture and rural development as priority sectors for Montenegro's development. Apart from the DDM, the second important development document is the South-East Europe 2020 Strategy, which has the goal of achieving high and sustainable economic growth, and by doing so to contribute to higher economic growth in the region, increase prosperity and create new jobs, all by heightening regional cooperation and links with the EU. In addition, the development vision of Montenegro is defined by the Sustainable Development Strategy 2030, according to which "the social and economic development of the country is based on a harmonious relationship between humans and nature in the efficient management of human, social, natural and economic resources". Apart from these strategic development documents, there is also a series of sectoral strategies and policies, such as the Industrial Policy 2020, that are linked to the structure of the umbrella documents.

Besides Montenegro's sectoral priorities contained in its strategic documents, EU documents are the key inputs for defining the priorities in this segment of the Economic Reform Programme 2017–2019. Of them, the especially important ones are the Conclusions of the Joint Ministerial Dialogue of May 2016 and the European Commission's Montenegro Report for 2016. These documents provide a set of assessments on the present state of Montenegro's economy.

The 2015 and 2016 ERPs diagnosed in detail the obstacles to competitiveness and further economic growth and development. Bearing in mind the structural nature of these obstacles, overcoming them is a long-term issue.

The above obstacles include: an underdeveloped physical infrastructure (transport, utilities, energy, etc.); a low level of added value in production and undiversified exports; limited access to financing for SMEs and a lack of advisory support for the SME sector; slow growth of bank lending, important for stimulating real-estate-sector activity, as a consequence of, *inter alia*, a still-high share of non-performing loans (NPLs) in banks' portfolios; the relatively high level of the informal economy; a mismatch between the education system and labour market needs; the labour market's inflexibility and high costs; a tax policy that lacks predictability; an inefficient public administration; the need to further improve the rule of law; a low level of innovation; insufficient tools to maintain and reinforce fiscal stability, etc.

In its Montenegro 2016 Report, the EC concluded that Montenegro is "moderately prepared in its capacity to cope with competitive pressure and market forces within the Union. Some progress has been achieved in improving the quality of the infrastructure, the energy market and digitalization of the economy. SME support is modest but developing gradually. However, substantial efforts are still required to develop human capital and a competitive export-oriented industry."

With a view to the faster removal of obstacles to better competitiveness, within the framework of the 2016 ERP assessment at the ministerial meeting held in May 2016, the EU gave six recommendations for drafting the 2017 ERP. Out of the six recommendations, the first two (Recommendations Nos. 1 and 2) are related to the country's fiscal position and public debt, which are explained in detail in Chapter 3 of the 2017–2019 ERP. The remaining four recommendations (Recommendations Nos. 3–6) concern different areas of structural reforms and are addressed in this chapter. These refer to the following recommendations:

- Develop a comprehensive strategy to further foster the disposal of non-performing loans by banks, including participation by all relevant stakeholders, while establishing a bank lending survey to better gauge underlying credit dynamics. (Recommendation No. 3).
- Ensure effective, efficient and independent regulatory and safety authorities to implement the full opening of rail and energy markets. (Recommendation No. 4).
- Continue to facilitate the provision and range of financial and non-financial support services for SMEs with a view to foster participation in global value chains. Support the development of the private consultancy market. (Recommendation No. 5).
- Prolong working lives and reduce disincentives to work through strengthening the link between activation measures and social assistance, in order to improve the labour market participation of the long-term unemployed, women and youth. Implement strategies to align education and skills policies with labour market needs.(Recommendation No. 6).

In addition to the EC, the competitiveness of the Montenegrin economy and the obstacles to its growth are dealt with in reports by relevant international organizations, such as the World Economic Forum (WEF) and the World Bank (WB). According to the WEF's 2016–2017 Global Competitiveness Report, Montenegro's competitiveness deteriorated compared to the previous report, and the country received low scores for its market size, followed by the macroeconomic environment and business sophistication. Other obstacles which, according to this Report, adversely affect the competitiveness of the economy are a lack of innovation and an inefficient labour market (Montenegro ranks 83rd out of the 138 countries covered). According to the qualitative indicators of the above-mentioned Global Competitiveness Report, the greatest barriers to doing business on the Montenegrin market are: inadequate access to financing, an inefficient public administration, inadequate infrastructure, corruption, high tax rates and restrictive labour regulations.

According to the WB's 2016 Doing Business Report, the greatest obstacles to improving the business climate and increasing competitiveness refer to: starting a business; obtaining building permits; registering property; getting connected to power supply grid, etc.

Bearing in mind Montenegro's lack of progress according to the most recent international competitiveness reports, this year's ERP strongly focuses on priorities aimed at removing the identified obstacles to better competitiveness. These Government priorities, presented in Chapter 1 of this document are based on national development documents and are harmonized with the recommendations adopted at the ministerial meeting held in Brussels in May 2016, and the EC Montenegro 2016 Report. These are also aligned with the findings related to the largest obstacles to competitiveness in the above-mentioned international competitiveness reports. In the course of preparation of the 2017–2019 ERP, based on the obstacles to better competitiveness and the EU recommendations, priority reform measures are defined in Chapter 4. These measures are linked with the ones defined in Chapters 2 and 3, and should in the medium-term create a positive macro-fiscal effect, as well as improve the country's competitiveness.

4.2 Overview of reform priorities

This section briefly presents in tabular form the priority reform measures intended to reduce or remove the diagnosed obstacles to competitiveness and growth in the nine reform areas defined in the EC Guidance on EPR. The table below presents the link between the priority reform measures in this chapter and the four EC recommendations adopted at the ministerial meeting held in Brussels in May 2016 related to structural reforms. As mentioned above, the response to the two recommendations concerning public finance (related to the budget and public debt) is provided in Chapter 3.

Table 4.1: Overview of priority reform measures of Montenegro in ERP 2017 and their link with recommendations adopted at the ministerial meeting held in Brussels in May 2016 related to structural reforms

Title of the priority reform measure as stated in the 2017–2019 ERP within the given reform area	*Specific EU recommendations of the ministerial meeting from May 2016*
Area 1: Public Finance Management *Priority reform measure No. 1: Introduction of the e-procurement system* *Priority reform measure No. 2: Strengthening of managerial responsibility in the public sector*	
Area 2: Energy, transport and telecommunications markets	
Sub-Area 2.1. Energy *Priority reform measure No. 3: Construction of the undersea cable between Montenegro and Italy with transmission infrastructure in the country and interconnection with Serbia* *Priority reform measure No. 4: Construction of Block 2 of the Thermal Power Plant in Pljevlja*	*Ensure effective, efficient and independent regulatory and safety bodies to implement the full opening up of the rail and energy markets (Recommendation No. 4).*
Sub-Area 2.2: Transport *Priority reform measure No. 5: Construction of the Smokovac–Mateševo priority section of the Bar-Boljare highway* *Priority reform measure No. 6: Modernization of the Bar–Belgrade railway (Vrbnica–Bar section in Montenegro)*	
Area 3: Sectoral development	

Sub-Area 3.1: Industrial sector development *Priority reform measure No. 7: Boosting of investments in the industrial sector focusing on processing industries* *Priority reform measure No. 8: Support to the industrial sector development and modernization*	
Sub-Area 3 .2: Development of the agricultural sector *Priority reform measure No. 9: Support for investments in the food production sector in view of achieving EU standards*	
Sub-Area 3.3: Service sector development *3.3.1: Tourist service development* *Priority reform measure No. 10: Improvement of the tourist product in the north of Montenegro through construction of the required infrastructure at ski resorts*	
3.3.2: Financial service development	*Develop a comprehensive strategy to further foster the disposal of non-performing loans by banks, including the participation of all the relevant stakeholders, while establishing a bank lending survey to better gauge the underlying credit dynamics (Recommendation No. 3).*
Area 4: The business environment and reduction of the informal economy *Priority reform measure No. 11: Introduction of e-services into the land registration system* *Priority reform measure No. 12: Introduction of electronic fiscal invoices to reduce the informal economy* *Priority reform measure No. 13: Improvement of financial support for SMEs* *Priority reform measure No. 14: Improvement of non-financial support for SMEs*	*Continue to facilitate the provision and range of financial and non-financial support services for SMEs with a view to fostering their participation in global value chains. Support the development of the private consultancy market (Recommendation No. 5).*
Area 5: Research and innovation *Priority reform measure No. 15: Establishment of the Science and Technology Park (STP) in Podgorica*	
Area 6: Foreign trade and investment facilitation *Priority reform measure No. 16: Development of business zones with the aim of encouraging direct investments and increasing employment*	
Area 7: Education and skills *Priority reform measure No. 17: Development of qualifications in line with labour market needs* *Priority reform measure No 18: Alignment of higher education with labour market needs*	*Prolong working life and reduce disincentives to work through strengthening the link between activation measures and social assistance, in order to improve participation in the labour market of the long-term unemployed, women and young people. Implement strategies to align education and skills policies with labour market needs. (Recommendation*

Area 8: Employment and the labour market *Priority reform measure No. 19: Amendments to statutory provisions related to the labour market* *Area 9: Social inclusion, poverty reduction and equal opportunities* *Priority reform measure No. 20: Amendments to the Law on Social and Child Protection*	*No. 6).*

4.3 Analysis by areas and structural reform priorities

4.3.1 Public finance management

4.3.1.1 Public procurement

Diagnosis: The share of public procurement in terms of GDP, which has amounted to 10.2% over the past five years, illustrates its importance for overall social and economic development. The public procurement system in Montenegro is underpinned by the principles of transparency, equal treatment, free-market competition and non-discrimination, and is continuously being improved and harmonized with EU legislation and principles. The key public procurement policy objectives, defined in the 2016–2020 Strategy for the Development of the Public Procurement System, with the Action Plan for its implementation, are: (i) improvement of the procurement system through constant monitoring and implementation of necessary regulatory changes; (ii) strengthening of access to public finance; (iii) the increasing of transparency and efficiency and information flows; (iv) the following of current trends (green procurement, socially responsible procurement, innovative procurement, e-procurement, support for SMEs etc.); (v) further development of human resources involved in public procurement; further harmonization with the EU directives.

Notwithstanding the significant results achieved, challenges still persist, as well as obstacles that may have an adverse impact on the overall competitiveness of the economy. This primarily applies to the implementation of obligations concerning harmonization of the public procurement legal system with the EU acquis from 2014 in all fields (conventional sector and sectoral), especially focusing on concessions and public–private partnerships (*23/EU/2014*)[26]. Furthermore, the achievement of greater efficiency, the shortening of the procedure and a reduction of the costs of public procurement are still not at the desired levels. In addition, adequate administrative and institutional capacities need to be established at all levels, and the enforcement of laws ensured prior to EU accession.

Priority reform plans: In order to fulfil the objectives and achieve specific results in the field of public procurement in the period ahead, in accordance with the legislative harmonization plan, activities will be carried out, aimed at full harmonization with the EU Directives on public procurement, especially in the field of concessions. In that respect, the new Public Procurement Law will be adopted in 2017. Its alignment with GPA WTO standards will be considered as well. Aimed at increasing transparency, efficiency and information flows, as well as shortening procedures and lowering the cost of the public procurement process, efforts will be made to strengthen administrative capacities, develop and establish the e-procurement system, strengthen monitoring of the procurement system, raise public awareness through education and training, and better assess the success of the procurement process, the risks of irregularities and factors that reduce the competitiveness and efficiency of procurement.

Priority reform measure No. 1: Introduction of the e- procurement system

[26] The approved draft of the PPP Law was submitted to the European Commission for its opinion. The Government plans to adopt the PPP Law in 2017

Brief description of the measure: The measure applies to a project lasting many years, which should result in the implementation of e-procurement, with the aim of increasing efficiency or shortening procedures and lowering the costs of public procurement, as identified obstacles in the public procurement process. It will significantly improve and add new functionalities to the existing Montenegrin public procurement portal, which is an effective platform for the electronic announcement of tenders and related public procurement documents. The introduction of the e-public procurement system is foreseen in the 2016–2020 Strategy for the Development of the Public Procurement System in Montenegro with the Action Plan for its implementation in the 2016–2020 and Public Finance Management Reform Programme 2016-2020.

Timetable by year: As this measure is continued from the previous year, activities on its implementation in the previous period are presented in the table 12 of the annex of this document.The competitive procedure for the selection of the most advantageous tender for introducing the e-procurement system will be finalized in 2017, and then system development will begin. The trial version of the system will be finished in 2018, as well as training of the Public Procurement Administration staff and removal of potential system shortfalls. In parallel to these activities, the Training Plan and materials for system users (the contracting authorities and bidders) will be prepared. The system is expected to be in use in late 2018, and user training should begin at the same time.

Fiscal impact: The project is worth €1.65 million. An amount of €1.50 million will be funded from IPA 2014, and an amount of €165,000 will come from annual budgets (co-financing.). Out of this amount, EUR 70,000 will be provided from the budget. The direct impact of the measure on reducing budgetary expenditures will be significant once it becomes fully operational.

Expected impact on competitiveness: The e-procurement system, once in place, will increase efficiency and transparency, decrease irregularities and improve monitoring, which will boost competitiveness, shorten procedures and cut costs. Given that the state enters the market directly through public procurement procedures, its conduct has a great impact on the overall social and economic activities. Improvement of public governance in general, and of the procurement system in particular, is vital for achieving macroeconomic stability, increased competitiveness and economic growth and development.

Expected social outcome of the measure: Using public procurement as a tool to promote sustainable development, while respecting high social and environmental criteria, increases accessibility of the public procurement process, especially for SMEs. This fosters entrepreneurship as one of the models for increasing employment and social inclusion, as well as respect for gender-equality principles.

Potential risks in implementing the measure: Actual development of the e-procurement system depends on successful completion of the tendering procedure for selecting the system developer.

4.3.1.2 Public Internal Financial Control (PIFC)

Diagnosis: The PIFC legal framework has been completed, but it is not fully implemented. The main objective of the reforms in this area is sound management of taxpayers' money in pursuit of the public institutions' goals in an efficient, economical, effective and transparent manner, which should, among other things, influence the overall budgetary expenditure trends as projected in Chapter 3 of this document. The third Action Plan for implementing the Strategy on Further PIFC Development was adopted in June 2016. Despite the implemented activities, some weaknesses still persist: a lack of awareness of the importance of financial management and control (FMC) and internal audit (IA); a lack of managerial responsibility in the public sector; FMC focuses primarily on compliance, and not on results; and some IA units have only the most basic capacities (in terms of the number of auditors and their professional competences). The Ministry of Finance has strengthened supervision over implementation of the PIFC system in public-sector institutions, which are at varying levels, by monitoring the quality of IA work and the FMC system in place. PIFC training designed for managers, people in charge of and included in the FMC system and for internal auditors, is delivered in continuity. Sound public finance management and purposeful spending will influence the achievement of public entities' goals and the optimal use of budgetary resources. This will contribute to building trust in the institutions and will increase the efficiency of the state administration, as one of the obstacles to higher competitiveness, which will in turn lead to a more conducive business environment for attracting investment and development of the real economy.

Priority reform plans: Reforms will be conducted towards full implementation of the principle of managerial accountability, which includes: setting clear objectives, systemic implementation of risk management processes through the entire public sector, strengthening the role of institutions' financial units that would provide support to other organizational units through data analysis and preparation of detailed reports, and ensuring the functioning of the internal audit. The main precondition for the reform is the raising of awareness of the importance of PIFC, which will be provided through continuous training.

Priority reform measure No. 2: Strengthening of managerial responsibility in the public sector

A brief description of the measure: This measure aims to address the noted problem of a lack of managerial responsibility in organizational units of the state administration. The key challenges in implementing the reform measure will be related to the removal of deficiencies in the formal delegation of responsibilities for the achievement of the different objectives of state bodies.
So far, financial management decisions have not been delegated below the level of the ministry secretary. At the same time, it is noteworthy that in most cases managers either did not attend the training organized for managers and people in charge of FMC at all, or else sent lower-level officers to attend this training.

Timetable by year: Based on a situation analysis regarding managerial responsibility in the public sector in Montenegro with the emphasis on the legal framework and obstacles to its introduction, recommendations were given for further reforms in this area. The methodology for delegating responsibilities and powers will be prepared in 2017. Training for managers will be delivered in continuity.

Fiscal impact: Preparation of the methodology for delegation of responsibilities and powers in 2017 will require EUR 25,000, which will be provided from IPA 2014, and with 10% from the 2017 Budget. The PIFC training will continue in 2018 and 2019, with a special emphasis on managers. The funding needed for this purpose amounts to EUR 10,000 a year and will be provided from the IPA 2014 and from the budget (10%). The effects of this measure on cutting budgetary expenditures are difficult to quantify at the moment, but it is expected to contribute to a decrease in budgetary expenses in the medium term.

Expected impact on competitiveness: Sound public finance management and purposeful spending will influence the achievement of public entities' goals and, consequentially, optimization of budgetary expenditures in institutions, an increase in the efficiency of the state administration and improvement of the overall business environment as an instrumental factor in increasing competitiveness.

Expected social outcome of the measure: Improvements in the efficiency, effectiveness and economy of public finance management will provide services to citizens with minimum costs to the functioning of the public sector.

Potential risks in the implementation of the measure: A lack of understanding of the importance of managerial responsibility among managers can cause delays in the implementation of certain activities, which would slow down the foreseen pace of implementation.

4.3.1.3 External audit

Diagnosis: The State Audit Institution (SAI) functions in accordance with international standards concerning the SAI's independence, powers and organization. The SAI is faced with a shortage of auditors, and there is room for further improvement of the auditors' professional skills required for performance of different types of audits, particularly in following up on the implementation of recommendations from individual audit reports. The main objective of reforms in this area is the standardization of the financial audit process and the auditing of regularity and of performance in line with the International Standards of Supreme Audit Institutions (ISSAI).

Priority reform plans: The use of manuals for different audit types will provide a sound basis for a coordinated programme of strengthening the institution and its capacities. Guidelines for the auditing of budget year-end accounts and guidelines for evaluation of the application of fiscal responsibility criteria should be developed as well. The SAI will focus on strengthening human resource management and improving the professional skills of auditors for performing different types of audits. The focus should be on strengthening their communication policy with the Parliament of Montenegro, especially when it comes to monitoring how recommendations from audit reports are implemented.

4.3.2 Energy, transport and telecommunications markets

For further development of the energy and transport markets, new regulations need to be adopted and the existing energy and transport infrastructure is in need of modernization. The telecommunications market is liberalized, but needs further advancement of competition and development of the telecommunications infrastructure.

4.3.2.1 Energy

Diagnosis: According to Montenegro's Energy Development Strategy to 2030, in 2015 Montenegro's energy dependency was 52%, and with the intended major hydropower plants and TPP Pljevlja Block 2, this was to go down to 25.5%. The power supply sector is one of the most important parts of Montenegro's energy sector. Montenegro was a relatively large electricity importer, but during recent years imports have gone down due to reduced consumption by Podgorica Aluminium Plant (KAP) and Nikšić Steel Factory, as the largest electricity consumers in the country. Interconnections with neighbouring power systems are relatively good, but reinforcement is needed through a 400 kV interconnection with Serbia and/or Bosnia and Herzegovina. The legal prerequisites for a free energy market are in place. Compared to the EU and some other developed countries, Montenegro's energy sector is characterized by high energy intensity. The share of renewable energy in the total final energy consumption is quite substantial.

The main goals in the area of energy are: i) a well-functioning energy market; ii) full energy connectivity; and iii) increased use of domestic energy resources. To achieve these goals, it is necessary to eliminate all obstacles to the competitiveness of Montenegro's energy sector, which include a still underdeveloped infrastructure and insufficient generation capacities. There is a need to valorize domestic energy resources as much as possible and to fully transpose the Third Energy Package by adopting a number of implementation regulations.

Report on the implementation of policy guidance from May 2016: Montenegro is very active in the implementation of activities in the energy and transport sectors, as defined in the Connectivity Agenda of the Berlin Process. In the recent period, the new Law on Energy and the Law on Cross-Border Exchange of Electricity and Natural Gas have been adopted, which transposed the EU's Third Energy Package. The legislative solutions significantly strengthened the role of sector regulator and clearly defined, in compliance with directives and regulations, the obligations and responsibilities of all stakeholders in the energy sector. In addition, legal unbundling of the electricity distribution system operator from the energy undertaking engaged in the generation and supply of electricity has been completed, thus putting in place the conditions for transparent and fair electricity market development. The national electricity market is being set up. The above activities are directly related to Recommendation No. 4 of the ministerial meeting from May 2016.

Priority reform plans: In order to achieve the set objectives, the following activities will continue in the coming period: i) transposition of the Third Energy Package by adopting a number of implementation regulations at the beginning of 2017, thus addressing Recommendation No. 4 of the ministerial meeting from May 2016; ii) construction of the undersea cable between Montenegro and Italy with transmission infrastructure in the country and interconnection with Serbia; and iii) construction of generating facilities to valorise the domestic energy potential. The 2017–2019 ERP recognizes two priority measures: construction of the undersea cable between Montenegro and Italy with transmission infrastructure in the country and interconnection with Serbia and construction of Block 2 of the Thermopower plant in Pljevlja.

Priority reform measures in this sub-area are given below.

Priority reform measure No. 3: Construction of the undersea cable between Montenegro and Italy with transmission infrastructure in the country and interconnection with Serbia

Brief description of the measure: This measure constituted part of the previous 2016–2018 ERP and has largely been implemented, but with certain delays. For details on this see Table 12 in the Annex of the document. The measure involves investment in the construction of the transmission infrastructure in the country (SS 400/110/35 kV Lastva and the 400 kV Lastva–Pljevlja transmission line) and the 400 kV interconnection with Serbia. It is compatible with the project of construction of the undersea cable between Montenegro and Italy, for the implementation of which the Italian transmission system operator (TERNA) is responsible. This reform measure will improve energy connectivity with neighbouring countries, put in place the preconditions for the increased use of domestic energy resources and effective functioning of the energy market, in response to one of the identified obstacles to energy-sector competitiveness. The measure is foreseen by Montenegro's Energy Development Strategy to 2030 as a strategic document in this field, included in the list of projects of interest for the Energy Community, and it is a project on the Single List of Priority Infrastructure Projects of Montenegro. The implementation of this measure will increase the reliability of the power system and put better conditions in place for the taking of electricity generated from renewable sources. This will positively impact the current and foreseen construction of hydropower, wind and solar power plants and other capacities generating electricity from renewable sources, as well as meeting international targets and honouring relevant international commitments.

Timetable by year: While 2013 and 2014 were the years when the necessary loan funds were secured, tender documentation prepared and construction licences obtained, in 2015 the intensive activities on the construction of the above transmission infrastructure were realised. In 2015, grant funds of EUR 25 million were secured for the interconnection with Serbia and investment in strengthening the transmission network linked to the project to connect the power systems of Montenegro and Italy. In July 2016, a Financing Agreement was signed between the State of Montenegro, as the recipient of the grant, CGES as the end-beneficiary, and the German Development Bank KfW. The intensive efforts made in 2016 involved land acquisition for the needs of the project, development of the project documentation, equipment procurement, development of access roads and other preparatory activities.

The 400/110/35 kV Lastva substation is planned to be completed by the end of 2017, as well as continuation of the equipment procurement for the 400kV Lastva–Pljevlja transmission line, foundation construction, installation of transmission towers etc. Intensive construction works on the Lastva–Pljevlja transmission line are planned for 2018, to be completed by the end of 2018.

Fiscal impact: The value of the part of the project implemented by CGES, including interconnection with Serbia, is approximately EUR 127 million, while the part of the project implemented by TERNA (comprising infrastructure facilities in Italy, the undersea cable and the plant in Montenegro) is worth over EUR 800 million. CGES, in cooperation with the Government of Montenegro, ensured loan funds for its part of the project with KfW (EUR 25.0 million) and the EBRD (EUR 60.0 million), EUR 25.0 million (or EUR 24.5 million after deductions for the financial institution services) from the WBIF grant, and the rest from its own resources. For these loans, the Government issued sovereign guarantees for a total of EUR 85.0 million.

According to CGES's plans and the situation on the ground, the funds envisaged for project implementation in 2017 and 2018 amount to EUR 47.0 million (EUR 29.0 million in 2017, and EUR 18.0 million in 2018). Investments are related to the performance of works on all three parts of the project, as follows: the 400/110/35 kV Lastva substation; the Lastva–Čevo section of the 400 kV Lastva–Pljevlja transmission line; and the Čevo–Pljevlja section of the 400 kV Lastva–Pljevlja transmission line.

Expected impact on competitiveness: The interconnection project between Montenegro and Italy by an undersea direct-current cable is envisaged to contribute to: 1) construction of a better and stronger transmission network in Montenegro; 2) having a direct connection with the electricity market in the EU; 3) positioning Montenegro as an important energy hub in the region; and 4) encouraging investments in new energy sources, particularly renewables. This project will contribute to increased competitiveness and represents an incentive for investments in the energy sector, not only of Montenegro, but also of the entire region. Also, this represents an extremely significant infrastructural project in Montenegro, given that its implementation will ensure a significantly more reliable and stronger transmission network, a 400 kV network ring will be created which is very significant for system stability, Montenegro will get 20% of the transmission capacity and revenues from cable congestion, and a more reliable electricity supply to the Montenegrin coast will be ensured, eliminating the risk of the transmission network being a bottleneck for the development of the coastal region.

The construction of the transmission infrastructure in the country and the interconnection with Serbia enables the full use of the interconnection with Italy and better connectivity with the region and the EU energy market, thus contributing to competitiveness.

Expected social outcome of the measure: Bearing in mind that this priority reform measure refers to the construction of important infrastructure in Montenegro, it will have a significant impact regarding the engagement of construction and transport companies, and other SMEs providing services.

Potential risks in implementation of the measure: Potential risks in the implementation of this priority reform measure are related to unforeseeable circumstances that the contractor may encounter in the field or those linked with resolving property issues. In cooperation with the contractor, CGES will handle any unforeseen circumstances, while property issues will be resolved with the support of the relevant institutions and in compliance with the law.

Priority reform measure No. 4: Construction of Block 2 of the Thermal Power Plant in Pljevlja

Brief description of the measure: This priority measure refers to an investment in the construction of Block 2 of the Thermopower Plant in Pljevlja, with a planned capacity of 254 MW and an annual generation of 1,600 GWh. The project also envisages the construction of a thermal district heating station for Pljevlja. The new block will respond to all the requirements of the best available technology (BAT) for thermopower plants, good practice of European countries and environmental protection according to EU directives. The measure is foreseen by Montenegro's Energy Development Strategy until 2030and the Action Plan for implementation of the Strategy for the period 2016–2020. If Block 2 is not built, it would not be feasible to invest in the existing block, given the high costs of environmental remediation (approximately EUR 70–100 million) for the few years of the remaining service lifecycle, which would lead to the closing down of both Pljevlja Coal Mine and TPP Pljevlja, leaving some 2,000 people jobless.

Timetable by year: The following activities were implemented in 2016: On 12 July 2016, the Governments of Montenegro and the Czech Republic signed the Protocol on Cooperation in the Energy and Infrastructure Sectors, and on 29 September 2016, they signed the Agreement on the Development of the Master Design for the Construction of Block 2 of TPP Pljevlja (worth EUR 9.89 million) and the Agreement on the Execution of Works on Construction of Block 2 of TPP Pljevlja (worth EUR 314.6 million).

The following is planned for 2017: provision of funding; the entry into force of the agreements; development of the master design, purchase and delivery of equipment; and the beginning of construction works.

In the subsequent years, the planned activities are: development of the master design (continued); purchase and delivery of equipment (continued); construction works (continued); assembly of equipment, pre-commissioning tests, commissioning and the beginning of trial operation.

Fiscal impact: The estimated required investment in Block 2 of TPP amounts to EUR 324.5 million, i.e. EUR 1.28 million per MW of installed capacity. The project will be financed up to 30% with the EPCG's (National Power Utility Company) own resources and up to 85% from financial institutions, which should be provided by Škoda Praha as the selected bidder. Negotiations regarding financing are under way. The estimated amount to be financed from the loan provided by Skoda Praha as well as the EPCG's fund in 2017 is around EUR 58.0 million.

Expected impact on competitiveness: With the construction and commissioning of Block 2 of TPP Pljevlja, the total annual power generation in Montenegro will increase by around 50% compared to the present level. The structure of power generation from the country's own sources will improve, which will greatly influence an increase in Montenegro's competitiveness on the electricity market, especially with the connection of Montenegrin transmission network to the Montenegro–Italy undersea cable.

Expected social outcome of the measure: The project will enable continued operation of Pljevlja Coal Mine and TPP Pljevlja, and ensure an optimal number of jobs in these two energy plants. Also, the project foresees the introduction of district heating for the city of Pljevlja from the Thermopower Plant, which will lead to additional job creation (maintenance, handling the heating system, etc.). With the introduction of district heating, the air quality in the Pljevlja basin should be improved and it will have multiple positive social impacts. It is estimated that around 70–100 new jobs will be created during the implementation of this project, and that upon project completion, around 50 jobs will be created in the Thermopower Plant, and around 40 jobs in district heating and other related activities.

Potential risks in implementation of the measure: Potential risks concerning this measure are: provision of financial resources for the project, restructuring the TPP-Coal Mine complex, the price of coal, the relatively high depreciation of the basic joint infrastructure of TPP-1 and TPP-2, the transport of heavy components of the equipment to the installation site, exceeding of TPP-2 construction deadlines, and CO_2 emission fees.

Risk reduction measures are:

a) Financing: In case Škoda Praha fails to provide financing, the EPCG has done an analysis for alternative options for financing the project: analysis of the financial potential of the EPCG to finance the project from its own funds and from loans from local banks, analysis of the possibility of borrowing on the international market through the issuing of bonds, as well as the impact of alternative options of financing the project profitability.
b) Restructuring the TPP-RUP complex (*Thermopower Plant Pljevlja and Pljevlja Coal Mine*): In order to optimize the business of RUP and reduce the price of coal and provide a positive business of RUP and TPP, the Government has established a working team for the restructuring of RUP. As the best model of optimization of RUP's business, capital increase of RUP is proposed, which would ensure the sustainability both of RUP and TPP and the fastest reduction in coal prices.
c) High amortization of the basis for the joint infrastructure of TPP-1 and TPP-2: For the extension of the service lifecycle of the basic common infrastructure of TPP-1 and TPP-2 and the achievement of its functionality and security for the purposes of TPP-2, part of the measures planned was carried out regarding its maintenance, while the other measures are planned to be carried out in the coming period.
d) Transport of heavy equipment components in the assembly location: Preliminary and detailed analysis of planned transport routes for the transport of the equipment to the location of TPP was carried out, and security measures are also planned.

e) Exceeding of the deadlines of TPP-2 construction: In order to eliminate this risk, good organization and management of the project is planned.
f) CO_2 fees: In the framework of the project feasibility analysis, conservative scenarios of changes in the level of the CO_2 fees are used. Feasibility of the project is achieved in these scenarios.

4.3.2.2 Transport

Diagnosis: A developed transport infrastructure is an important precondition for connectivity between countries and stronger economic growth. One of the limitations faced by Montenegro is an underdeveloped and poorly connected high-quality transport infrastructure (roads, railways and airports). Its topography itself is a major financial challenge, not only for new investments, but also for infrastructure maintenance, primarily in the areas of road and railway transport. An insufficiently developed transport infrastructure results in high transportation costs, inadequate quality of transport services, relatively high maintenance costs and an inadequate level of traffic safety, which consequently has adverse impacts on economic growth. In addition, an inadequate transport infrastructure is one of the key factors behind regional differences in Montenegro, limited exports to the region and weak integration into global value chains. Air connectivity is limited, particularly during the off-season, with negative effects on Montenegrin tourism.
Better connectivity would attract investment and support job creation, facilitate access to regional markets and reduce transportation costs.

The report on the implementation of the policy guidelines from May 2016: Recommendation No. 4 from the ministerial meeting in Brussels in May 2016, which relates to the railway market is a closing benchmark for Chapter 14, reads as follows: "Montenegro must provide a competent, independent and effective regulatory authority and railway safety authority and ensure compliance with EU standards on safety and interoperability". To that end, Montenegro will amend the Law on the Railway during 2017 in order to align the new model of functioning of the regulatory authority and the railway safety authority with EU regulations as of the beginning of 2018. In the context of amendments to the Law, two models will be considered to address the closing benchmark for Chapter 14 of negotiations, which are also a response to Recommendation No. 4 from the meeting in Brussels in May 2016. The first model involves investment-related affairs being transferred from the Directorate of the Railways to another state authority that performs similar tasks, while the Directorate would continue working as a regulatory and safety authority in accordance with Directive 2012/34. The second model is the same with regard to the transfer of the investment-related affairs, however the regulatory tasks would be transferred to one of the existing autonomous agencies. The safety authority would continue operating independently, like the Directorate of the Railways, with the aim of increasing safety in railway transport, boosting Montenegro's economic growth and competitiveness.

Priority reform plans: In addition to the reform measure concerning the amendments to the Law on the Railways in 2017, an important reform measure, which is included in the 2016 ERP, is an update of the Transport Development Strategy in order to contribute to the full opening up of the railway market. This will be financed through the Regional Development Operational Programme (RDOP) 2012–2013, IPA III, Priority Axis 3, Technical Support. The funds required for the Transport Development Strategy amount to EUR 300,000. The plan is to update the Strategy during 2017 provided that the following activities have been completed: the final version of the terms of reference for the Strategy, development and adoption of the identification form and the tender procedure through a framework contract. Accordingly, this is a continuation of the 2016 ERP priority reform measure, but this year, due to the limited number of measures to be presented in the ERP, as well as due to the fact that activities on realization of this measure are being implemented as planned, this measure is not selected as a priority reform measure in the 2017 ERP. This year's ERP priorities are related to strengthening of road and railway transport infrastructure as well. It should be noted that the start of implementation of the joint feasibility study is expected for the Adriatic-Ionian corridor through Montenegro and Albania, which is supported by the Western Balkans Investment Framework (WBIF). Development of infrastructure at airports (Tivat Airport) as well as infrastructure for maritime transport, are no less important.

In addition to investment in its physical infrastructure, Montenegro, as well as all the countries of the Western Balkans 6, is focused on the activities related to the management plan for connectivity reform measures, which is implemented in cooperation with the European Commission and the SEETO Secretariat.

The projects of interest for Montenegro, which are included in the List of Prior Identified Projects for the Indicative Extension of the Trans-European Transport Core Network (TEN-T) in the Western Balkans will have absolute priority in the coming period, including the projects on the Mediterranean and Orient–East Med Corridor.

In accordance to the above-mentioned, priority measures in this sub-area are developed below.

Priority reform measure No. 5: Construction of the Smokovac–Mateševo priority section of the Bar-Boljare highway

Brief description of the measure: The Bar–Boljare highway crosses the whole of Montenegro north–south and it will represent an integrational link within the country. It will facilitate the exploitation of natural resources in Montenegro, thus increasing the economy's productive potential. The Bar–Boljare highway is included in the SEETO comprehensive regional transport network, as SEETO Route 4[27]. It is a priority for the Government of Montenegro and one of the elements of the strategy for the country's integration into the European Union, which will enable the more efficient and safer mobility of people, goods and services. Last year, the Bar–Boljare–Belgrade transport corridor became an integral part of the main transport network of the Western Balkans. It represents an extension of the Orient–East Med corridor within the framework of the Trans-European Transport Network (TEN-T). The Regional Development Strategy of Montenegro for the period 2014–2020 provides for the implementation of key capital projects, the most important being the Bar–Boljare highway. The importance of the Bar–Boljare highway for traffic, economic integration and for the stronger economic development of Montenegro and the region was recognized in the State Road Development and Maintenance Strategy of Montenegro and Montenegro Development Directions 2015–2018, as well as in the SEE 2020 Strategy. The Bar–Boljare highway is included in the single *list* of priority infrastructure *projects approved by the Government of Montenegro in December 2015.* After the relevant legal and contractual preconditions had been fulfilled, it was determined that works on the Smokovac–Uvač–Mateševo priority section of the Bar–Boljare highway would commence on **11 May 2015**, when the period of 48 months for completion of the project as defined in the contract would start to run. So far, the Contractor has been developing the design, conducting preparatory works and part of the permanent works. Given that this measure is contained in the 2015 ERP and 2016 ERP, details on its implementation in the previous period are provided in Table 12 of the Annex.

Timetable by year: The contractor is conducting works in accordance with the Implementation Programme (design and construction works on the site) on the 19 sub-sections along the Smokovac–Uvač–Mateševo priority route of the Bar–Boljare highway.

Table 4.2 : Description of the works carried out by the contractor by year

2016	2017	2018	2019
1. Preparatory works 2. Design 3. Part of the permanent works	1. Preparatory works 2. Design 3. Part of the permanent works	1. Permanent works 2. Part of the design activities	1. Permanent works 2. Part of the design activities

[27]SEETO Route 4: Vršac (border with Romania) – Belgrade (Serbia) – Podgorica (Montenegro) – Bar (Montenegro).

Fiscal impact: The contracted price for the design and construction amounts to EUR 809.6 million during the period 2015–2019, of which 85% is provided from the preferential loan from Exim Bank from China, while the remaining 15%, as well as the associated costs of the project implementation, is funded from the budget of Montenegro. The aforementioned loan was made for a period of 20 years, with an annual interest rate of 2.0% and a grace period of six years. It is expected that the construction of the highway, through new employment possibilities, new investments and better use of natural resources, will significantly contribute to the growth of fiscal revenues.

For the implementation of this project, the capital budget for 2017 envisages funds of EUR 194.3 million, of which EUR 153.7 million refers to funds from the Exim Bank loan. From the beginning of project implementation to the end of 2016, the Contractor was paid EUR 171,206,656.52 of the contracted price, of which the Contractor was paid the sum of EUR 9,291,185.30 on the basis of the defined methodology for measuring the payment elements and for the scope of actually performed works in 2016.

Expected impact on competitiveness: Upon completion of construction, the following is expected once the exploitation of the project results begins: better connectivity with the network of pan-European corridors; reduced travel times and costs as a result of the increased operating speed of vehicles; stronger investments; increased competitiveness of companies, due to the improved access to the (regional) market and reduced transport costs; better exploitation of the economy's potential in the field of agriculture, forestry and water management; development of tourism (in particular, better use of natural potentials in the north of Montenegro); and better use of the potential of the Port of Bar and the container terminal and their connection with the catchment area – the Bar–Boljare highway will connect ports on the Adriatic Sea with ports on the River Danube (Corridor VII and Corridor X) and further afield with the entire network of Pan-European corridors. At the same time, it will be the shortest connection from Hungary and Romania, via Serbia and Montenegro, to the south of Italy and Albania. Therefore, this project will significantly contribute to mitigating one of the biggest barriers to competitiveness of the economy, and that is a quality road infrastructure. During the construction phase, the engagement of local construction operators, equipment, materials and workforce will have a multiplicative effect on overall economic growth.

Expected social outcome of the measure: The following impact is expected: more balanced development of the country; a significant reduction in the number of traffic accidents and vehicle operating cost savings; cost savings due to the reduction of traffic accidents and reduced pollution; increased accessibility to hard-to-access regions; increased mobility; increased investments; a reduction in the depopulation from the northern region of Montenegro and the achievement of a more balanced demographic growth of Montenegro; increased employment; and changes in the structure of employment. During the period of construction, the social impact will be reflected in the employment of the local labour force through the engagement of local companies in the construction, as well as the employment of the local labour force in related sectors (trade, storage, transport services, etc.).
Potential risks in implementation of the measure: Risks may be associated with a change in the volume of work in relation to the maximum guaranteed price of the Contract due to the changes in geological, hydrological and ecological conditions.

Priority reform measure No. 6: Modernization of the Bar–Belgrade railway (Vrbnica–Bar section in Montenegro)

Brief description of the measure: The Vrbnica–Bar railway is part of the Belgrade–Bar international railway line, which connects the Port of Bar and Montenegro with the Western Balkans and Central Europe. This railway route has been identified as Route 4 of the South-East Europe Rail Network (SEETO Comprehensive Network). As part of the Berlin Process, Montenegro has been approved a grant from WBIF 2015 for the implementation of this reform measure, amounting to EUR 20 million, with an additional EUR 20 million to be co-financed by Montenegro (through a loan from the EBRD). These funds, together with loans previously granted by the international financial institutions, the EBRD and the EIB, with IPA funds and WBIF funds, are intended for the reconstruction and modernization of the mentioned railway line in order to increase rail traffic security and safety, to fully meet the requirements of interoperability on reconstructed sections, to increase the speed of trains and at the same time reduce the duration of passenger and cargo transport, to increase the competitiveness of the railway in comparison to other competitive rail routes and other modes of transport, as well as exploitation of the capacity of the Port of Bar. This measure is in accordance with Development Directions for Montenegro and the SEE 2020 Strategy, as well as the 2014–2020 Regional Development Strategy.

Timetable by year:
2017:

- Overhaul of the railway in the Kolašin–Kos section – EUR 5,898,315.30 (EIB)
- Dismantling of the existing rail traction substation (RTS) and procurement and installation of a new RTS at Trebješica – EUR 3,140,000.00 (IPA III)
- 106 tunnels and the development of detailed designs for priority rehabilitation – EUR 2,500,000.00 (WBIF)
- Rehabilitation of the Morača Bridge – EUR 886,713.47 (EIB)
- Overhaul of the railway in the Virpazar–Sutomore section in Sozina Tunnel – EUR 4,500,000.00 (IPA III)
- Rehabilitation of six gradients – EUR 4,500,000.00 (EIB and WBIF – new loan 20+20)
- Replacement of signalling and safety devices in Podgorica station – EUR 6,000,000.00 (EIB and WBIF – new loan 20+20)
- Emergency measures for the rehabilitation of five concrete bridges – EUR 500,000.00 (EIB and WBIF – new loan 20+20)

2018:

- Overhaul of the railway line in the Kos–Trebešica section – EUR 4,140,000.00 (IPA 2014)
- Urban-technical development of the border station at Bijelo Polje – EUR 1,375,000.00 (IPA 2016 (programmed))

2019:

- Rehabilitation of priority concrete bridges and tunnels. Development of the detailed designs is planned for 2017 and early 2018.

Fiscal impact: This measure will be implemented during the period from 2016 to 2018 through projects based on the signed contracts and the programmed funds, following the signing of the agreement between the European Investment Bank, the WBIF fund and the operators of the railway infrastructure in Montenegro. The projects financed from IPA funds will not require a guarantee (85% of funds for works and services are financed from IPA funds, and the state provides co-financing totalling 15% from the capital budget). The total funds for implementation of these measures in 2017 is around EUR 24.4 million, of which EUR 7.0 million is expected in 2017 after the signing of a Loan Agreement with the EIB (EIB and WBIF – new loan 20+20). The estimate of the total fiscal impact for the period 2016–2018 amounts to EUR 34.4 million of which EUR 10.0 million was spent in 2016.

Expected impact on competitiveness: The implementation of these projects would be of direct benefit to around 1.2 million passengers, who use this mode of transport on an annual basis, and for about 1 million tons of transported cargo. Tourists from Serbia are also very frequent users of rail transport during the summer and winter tourist seasons. The project will have benefits for the broader economy by supporting trade, regional integration, sustainable growth and tourist flows. The improved quality of railway transport services will reduce the transport duration of passengers and goods. In addition, the safety of railway traffic will be enhanced and the requirements of interoperability on the reconstructed sections will be fully met, which will increase the attractiveness of rail transport for passengers and cargo. The improvement of the rail network will also have a strong positive impact on the business of the Port of Bar.

Expected social outcome of the measure: An increased number of passengers and higher mobility of people, especially from the less developed northern part of Montenegro, who use the railways as a practical and cost-effective link with Podgorica and the Adriatic coast. The student population is also a frequent user of this mode of transport, thus its improvement facilitates access to higher education. Better exploitation of railway transport also reduces CO_2 emissions, thus supporting environmental sustainability.

4.3.3 Sectoral Development

4.3.3.1 Development of the industrial sector and manufacturing

Diagnosis: Certain reform measures regarding improvement performances of manufacturing industry resulted in a mild growth of its share of GDP in 2015 of 4% and a real growth rate of 6%, and the share of the manufacturing industry of total industry increased from 53.9% to 59.9% in 2015. In addition, in the last three years, the manufacturing industry showed a slight increase in the Gross Value Added, whereby in 2015 it registered a growth of 11.3% compared to 2014.
The contribution of the manufacturing industry is especially important for exports, as it accounts for 75.1% of total goods exports. Around one-third of these exports relate to the metal industry, which shows that the key export products – base metals – are still the core of the manufacturing industry. Bearing in mind the planned investments in production diversification and the increase of the value added in production, a further increase in aluminium and steel production is expected, or in other words, strengthening of the manufacturing industry with multiplicative effects on the economy.

Notwithstanding the above, the trend of the increasing share of services compared to the decreasing share of industry has dominated the structure of the Montenegrin economy in the last 15 years. The share of total industrial production in GDP dropped to approximately 11%, while the available statistical data for the first 11 months of 2016 also does not record any positive indices in industrial production.
The reason for this is the industry's low competitiveness, and the key obstacle to improving industrial competitiveness is the low level of production diversification with a predominant lower processing phase products, then low labour productivity and underinvestment in modernization (total investments in fixed assets in processing industries in 2015 accounted for 6.4% of total investments), as well as a lack of linkages with science and research. In 2014, total investment in research and development amounted to 0.36% GDP, and of this, only 0.14% was from the private sector.

In an effort to support industrial development via targeted measures, the Government adopted Montenegro's Industrial Policy by 2020[28] on 30 June 2016, including the multi-year Action Plan for its implementation. For the purpose of reindustrialization, implementation of the policy seeks to facilitate high-tech manufacturing and the making of products tailored to market requirements.

Priority reform plans*:* In order to create conditions for increased competitiveness of the Montenegrin economy, industrial policy measures will strive, in the next four years, to eliminate structural imbalances, address the issue of the narrow manufacturing base and direct the industry towards higher added-value production. Within the implementation of the Industrial Policy Action Plan to 2020, the measures to encourage investment in the industrial sector will continue as envisaged by the Decree on Incentives for Direct Investments and activities on implementation of the Decree on Business Zones, then through favourable credit lines from the Investment and Development Fund (IDF) of Montenegro to encourage the development of the processing industry, enhance competitiveness through harmonization with international standards, improved capacity for innovation of enterprises in the processing industry, with the launch of new programmes aimed at co-financing investment in technical and technological equipment. In addition, linking of the industry with related sectors and strengthening of the links between business and research will allow for the diversification of the production base in

[28] http://www.mek.gov.me/ResourceManager/FileDownload.aspx?rId=244851&rType=2

the industry, increased industrial output and better export performance, as the basis for sustainable economic development. Accordingly, two priority reform measures are developed in this sub-area of the 2017 ERP.

Priority reform measure No. 7: Boosting of investments in the industrial sector focusing on processing industries

Brief description of the measure: This is an ongoing measure introduced with the Government Decree on Incentives for Direct Investments adopted in 2015, as continuation of the ERP 2016 measure, with the report on its implementation in the Annex, table No 12. It involves financial incentives for investments based on public calls for investment projects with a minimum value of EUR 500,000 which will generate at least 20 new jobs within three years of the date of contract signing. In addition, to address the issues of underdeveloped municipalities in Montenegro, the Decree was amended in late 2015 in the parts related to the amount of required investment and the number of new jobs for the projects to be implemented in the local self-government units in the northern and the central regions, with the exception of the Capital City of Podgorica (the minimum value of the investment is EUR 250,000, generating at least 10 jobs). According to the Decree, the incentives are granted according to the set criteria including investor references, investment project economic impacts, human resource impacts, research and development, regional development, the environment, etc., while the amount of funds allocated on the basis of the subject criteria ranges between EUR 3,000 and EUR 10,000 per new employed person, based on the points in each criterion. The aim is to put in place an environment more conducive to domestic and foreign investments in all areas of Montenegro, to boost the competitiveness and export potential of industry by introducing new technologies and knowledge, and to enable job generation. The measure is linked to the documents Development Directions for Montenegro 2015–2018, the SEE Strategy 2020, Industrial Policy 2020 and the Regional Development Strategy 2014–2020.

Timetable by year: In the course of implementation of an approved investment project, funds are disbursed in phases, according to the established project schedule. Thus, payments can be made over a period of three years. With regard to the activities which began in 2016 (see Annex, table No. 12), incentives will continue to be provided in 2017 and 2018, depending on the investment schedule. During 2017, at least one public call for incentives for direct investments is intended. Depending on the availability of funds and interest among investors, it is possible to have more public calls. Over the period 2018–2019, in addition to continued implementation of activities from the previous period, further activities will be planned based on the effects and implementation of the concluded contracts on incentives.

Fiscal impact: The 2017 budget allocates EUR 1.3 million for incentives for direct investments. Taking into account the phased disbursement for the approved investment projects, i.e. in three instalments (one after the conclusion of the contract, one after submission of the report on the utilization of more than 50% of the investment value, and one after achieving the full employment envisaged by the project and its final implementation), the 2017 budget allocation will be used for disbursements related to the 2017 calls and for the instalments due from previous calls.

Expected impact on competitiveness: The provision of incentives to investors directly contributes to the increased share of the industrial sector (i.e. processing industry) in creating gross added value, by increasing employment, output and exports. With incentives, the implementation of ongoing investment projects (six projects worth EUR 7.2 million) will enable the improvement of production capacities in terms of quality and quantity, increased output and the volume of exports, the reduction of imports and the overall growth of competitiveness. By the end of the investment cycle, it is not realistic to expect, in the short term, any major results, but rather the gradual strengthening of industrial capacities in the field of wood processing, food processing, the pharmaceutical industry and tourism, with the multiplicative effects of investments in other fields.

Expected social outcome of the measure: As already pointed out, the Decree on Incentives to Direct Investments applies to projects financing that, among other things, generate new jobs. During the implementation period, the projects will enable the creation of 253 jobs. At the same time, the amendments to the Decree, which take less developed municipalities into account, help, to a certain degree, in the social inclusion of the population in the area.

Potential risks in implementation of the measure: The interest level among local and foreign investors to invest/respond to the public call, a lack of an appropriate amount of funds necessary for the implementation of the public calls and failure by the investor to fulfil the contractual obligations according to the schedule of investment projects are the main risks in the implementation of this measure. Continuous efforts by all the relevant institutions to provide information generate interest among prospective investors and monitor the investment projects that receive the incentives will aim to mitigate the above risks.

Priority reform measure No. 8: Support to the industrial sector development and modernization

Brief description of the measure: In order to overcome major obstacles to competitiveness of Montenegrin companies, such as outdated equipment, low flexibility and productivity and a lack of good-quality manufacturing systems, the Government adopted a pilot programme in mid-2016 to support industrial modernization. In accordance with the state aid rules, the support involves co-financing of up to 20% of the eligible equipment costs (depending on the size of the undertaking), while the remainder of the required funds of up to 70% (the total amount), in accordance with the maximum intensity of state aid, is provided through a credit arrangement with the Investment and Development Fund (IDF). The amount of approved grants up to 20% of the equipment value may not be less than EUR 5,000 or more than EUR 20,000. Accordingly, the value of purchased equipment ranges from EUR 25,000 to EUR 100,000. The programme includes the Ministry of Economy making decisions on applications and awarding grants according to the sequence in which they were submitted to the IDF.

The subsidy is intended for co-financing a part of the eligible equipment costs: new manufacturing equipment and/or machinery, used production equipment and/or machinery (no older than five years) and new parts, special tools for machinery and other capital goods to be used to put the unused machinery into operation. This type of support is focused on the processing sector, the most important and largest industry sector in Montenegro, in which 70% of the companies operate. The support is primarily aimed at strengthening the competitiveness of companies, improving their operation, productivity and profitability through investment in technical equipment.

The measure is in line with Development Directions for Montenegro 2015–2018, the SEE Strategy 2020, Industrial Policy 2020 and the Regional Development Strategy 2014–2020.

Timetable by year: All preparatory work for implementing the Programme, including a comprehensive analysis of the structure and the type of equipment in companies, in respect of the current situation and the pace of production changes in the market, as well as the development of the Pilot Support Programme for Industrial Modernization, was done in 2015 and 2016. To that end, one public call was announced in 2016 to offer incentives for equipment purchase.

In order to implement the Pilot Support Programme for Industrial Modernization, a public call is planned in 2017 to award grants/subsidies for equipment purchase. It is planned that the ongoing activities will continue in the period 2018–2019 and the programme will be implemented continually.

Fiscal impact: The 2017 budgetary allocation for this purpose is EUR 100,000. If the programme proceeds as envisaged, projections indicate that the IDF should allocate at least EUR 700,000 for this purpose[29].

[29] The support programme for the modernization of industry specifies the maximum amount of the incentive (EUR 20,000) and the maximum amount for equipment procurement (EUR 100,000). If the total cost of equipment procurement exceeds the amount of EUR 100,000, the

Expected impact on competitiveness: Investment in equipment is a major step towards development of enterprises and modernization of the Montenegrin economy. In particular, investment in modern technology, followed by the upgrading of skills, leads to an optimal utilization of resources, raising the competitiveness of companies and their integration into global value chains. Provision of this type of incentive will directly contribute to an increase in industrial output and exports, and in turn will boost the competitiveness of the Montenegrin economy.

Expected social outcome of the measure: Investment in equipment in the long run leads to business development and, consequently, to an increase in the number of workers. Social inclusion is partly encouraged, especially of the population from the less developed regions (participating companies include companies involved in the production of food and beverages, as well as companies in the timber industry located in the north of Montenegro).

Potential risks in implementation of the measure: A low level of interest among domestic companies is the main risk in the implementation of this measure.

4.3.3.2 Sectoral development (agriculture)

Diagnosis: Gross added value in current prices in the sector of agriculture, forestry and fisheries amounted to EUR 294.6 million in 2015, which is 5.2% higher than in 2014.

The main objective of Montenegro's agricultural policy is to improve the competitiveness of agricultural production and living conditions in rural areas. The main obstacles to the improvement of competitiveness are: fragmented parcels, low productivity, a lack of qualified labour, an unfavourable age structure of farmers, obsolete mechanization, low modern technology input, a lack of awareness of the need for cooperation, unfavourable credit terms, unresolved property-rights issues and an underdeveloped rural infrastructure.

Priority reform plans: The 2015–2020 Strategy for the Development of Agriculture and Rural Areas defines measures and activities for adjustment of Montenegrin agriculture to the EU Common Agricultural Policy. The new Food Safety Law sets down the legal grounds for gradual compliance with food safety standards, i.e. it enables the continuation of operations until the set standards are met, in accordance with improvement plans.

The new law improved the existing food safety system, and the Administration for Food Safety, Veterinary and Phytosanitary Affairs was established as the central body in charge of food safety, veterinary and phytosanitary policy. Also, the IPA-funded project titled "Development of Food Safety and Phytosanitary Services in Montenegro" started on 20 April 2015, aimed at strengthening the administrative capacities in the food safety sector.

The IPARD like 1 project "Support for Investments in Primary Agricultural Production" is currently being implemented. In 2017 it is expected to have projects worth EUR 5.0 million within the framework of this measure, of which EU funding will amount to approximately EUR 2.7 million.

In late 2016, 33 contracts were signed with food producers under "Investments in physical assets concerning the processing and marketing of agricultural and fishery products – IPARD like 2". The total amount of these investments is approximately EUR 5.0 million. The total amount of planned support is EUR 2.5 million, of which EUR 1,875,000 will be provided from EU funds, and EUR 625,000 from the national budget. The measure will continue in 2017, with an expected EUR 5.0 million worth of investments, EUR 2.5 million of which is grant funding.

In addition to the measures above, the Agro-budget supports and other measures aimed at improving agricultural production and greater utilization of agricultural land, including that of state-owned.

beneficiary may finance the difference or increase the credit request to the IDF accordingly. This means that the IDF can allocate more funds than the amounts projected/stated.

Priority reform measure No. 9: Support for investments in the food production sector in view of achieving EU standards

Brief description of the measure: This measure supports –establishing of plantations of crops, the increase of livestock, the purchase of equipment for processing, the construction and reconstruction of facilities for processing of agricultural and fishery products for the purpose of improving food safety standards, animal welfare and plant health, through gradual alignment with the EU food safety and quality standards, in order to be competitive on the EU market. This measure is in line with the 2015–2020 Strategy for the Development of Agriculture and Rural Areas and the 2016–2020 Programme for the Development of Agriculture and Rural Areas (IPARD).

Timetable by year: The measure will be implemented in 2017, 2018 and 2019. It is divided into two activities: Investments in the Physical Assets on Agricultural Holdings and Investments in the Physical Assets concerning processing and marketing of agricultural and fishery products, which will be implemented through IPARD like, IPARD and the national budget.

IPARD like is already in its implementation stage, while the implementation of support from the IPARD programme is expected in mid-2017.

Fiscal impact: The total planned support in 2017 amounts to EUR 24.0 million, of which EUR 14.0 million is funded through IPA, and EUR 10.0 million from the national budget. EUR 24.6 million is planned for 2018, of which EUR 11.0 million is from IPA, and EUR 13.6 million is from the national budget. EUR 30.0 million is planned for 2019, of which EUR 15.0 million is from IPA, and EUR 15.0 million is from the national budget.

Expected impact on competitiveness: The measure will contribute to increased primary production, which will ensure a continuous supply of domestic inputs to the processing sector and thus contribute to the better competitiveness of domestic produce.

Expected social outcome of the measure: The social outcome of the measure is reflected in providing incentives to women and young people by assigning more points to projects implemented by them during project evaluation, thus encouraging them to start their own businesses in the food industry.

Potential risks in implementation of the measure: Should the Payment Agency fail to receive accreditation, this would jeopardize the IPARD programme.

4.3.3.3 Sectoral development (services)

The share of the service sector of Montenegrin GDP and overall employment is over 60%. Tourism and financial services, trade and construction services account for a particularly large share of the total services. Further development of the service sector requires the elimination of specific barriers to increased competitiveness, both in the aforementioned service sectors and in ICT, transport, etc., aimed at the further contribution of this sector to overall economic growth.

Bearing in mind their significant share of total services, this sub-area of the 2017 ERP is focused on the development of tourist and financial services.

4.3.3.3.1 Development of tourist services

Diagnosis: The tourist sector is one of the leading branches of the Montenegrin economy. The primary objective of the Tourist Development Strategy to 2020 is for Montenegro to become a high-quality year-round tourist destination. In order to achieve this objective, it is necessary to further strengthen the competiveness of tourism, i.e. to remove the key obstacles to raising the competitiveness of this sector by improving the tourist infrastructure, accommodation structure, the accessibility of the destination, overcoming seasonality, reducing the balance gap between the regions, and by reducing the deadlines for a return on investments in tourism through tax and other breaks and incentives for the investors. Tourism generates significant income for Montenegro – this was around EUR 850 million or 22% of GDP (15% of net GDP) in 2016. According to the WTCC report for 2016, the contribution of tourism and travel in 2016 amounted to 20.5%, and Montenegro was ranked as the eighth most successful country according to growth development in 2016.

Priority reform plans: In order to increase the competitiveness of the tourist sector as one of the most important generators of budget income, GDP growth and employment, the reform measure “Improving the tourist offer in the north of Montenegro by building the necessary infrastructure in ski resorts” has been planned to be implemented for several years. This measure is included in the Montenegrin Economic Reform Programme for 2016, and also for 2017, as an important measure for the strengthening of the tourist infrastructure.

Priority reform measure No. 10: Improvement of the tourist product in the north of Montenegro through construction of the required infrastructure at ski resorts

Brief description of the measure: Development Directions for Montenegro 2015–2018 and other strategic documents such as the Tourist Development Strategy to 2020 foresee several measures for encouraging diversification and improvement of the tourist product, and consequentially the competitiveness of the destination as well, reducing regional disparities in Montenegro, and increasing the number of SMEs and jobs available. One of these measures relates to the construction of the required infrastructure at ski resorts. The proposed measure comprises several independent projects aimed at the provision of infrastructural conditions for winter tourism in the north of Montenegro. The implementation of infrastructural requirements will create the conditions to attract private investment in tourism and other related activities. This measure has been contained in the economic reform programmes from the previous two years, and the report on its implementation is contained in Table 12 of the Annex.

Timetable by year: In 2017 investment activities are planned at six locations in six municipalities – Kolašin 1600 (Kolašin), Cmiljača (Bijelo Polje), Žarski (Mojkovac), Savin Kuk (Žabljak), Vučje (Nikšić) and Hajla (Rožaje). The activities at Kolašin 1600, Cmiljača and Žarski relate to the solving of property-rights issues, construction of access roads, tenders for the procurement of ski lifts and the design of ski slopes with a system of artificial snowmaking, while at some locations new ski slopes will be built. For Savin Kuk an international tender will be announced for the valorization of the site, the construction of ski slopes and the designing of new ski slopes, around 20 km in length, a project for the reconstruction of the access road. Works at Vučje will be to implement a project of an artificial snowmaking system. For Hajla, the planning document will be developed to define the guidelines for further development of the ski resort and other amenities. During the stage when the basic infrastructure is realized, the projects shall be financed from the state budget, in order to attract private investment in other important resort facilities later – hotels, restaurants, tourist infrastructure and other amenities, in accordance with the planning documentation.

Fiscal impact: The planned investment from the state budget in 2017 amounts to EUR 10.04 million, distributed in the following manner: Kolašin 1600 – EUR 4.30 million, Cmiljača – EUR 1.60 million, Žarski – EUR 1.03 million, Savin Kuk – EUR 1.03 million, Hajla – EUR 2.00 million and Vučje – EUR 80,000.

Through the Special Purpose Plan for the region of Bjelasica and Komovi, covering six municipalities and eight ski resorts (including Kolašin 1600, Cmiljača and Žarski), an macroeconomic evaluation was made that shows the long-term macroeconomic balance for a period of up to 20 years: investment in the first 3–4 years, amounting to EUR 349 million, of which EUR 274 million is in tourism, which will reach a total of EUR 1,186 million over a period of 11–20 years; in the first 3–4 years, the income in various sectors of economy will reach EUR 281 million, of which EUR 250 million is in tourism, making a total of EUR 926 million in the following 11–20 years; during the first 3–4 years, the newly created value will amount to EUR 62.0 million, of which EUR 50.0 million is in tourism, and in the following 11–20 years it will reach a total of EUR 204 million. The number of beds in the entire area is 21,738, and the capacity of the ski resorts 19,500 skiers/day. Within the Special Purpose Plan for Durmitor (which includes Savin Kuk), the analysis of the macroeconomic effects shows the following – investment in the construction and remediation of structures for tourism, hospitality, mixed purposes and sports will amount to

EUR 74.3 million, while the total investment will amount to EUR 99.24 million (including water supply, electrical installations and similar infrastructure, and also including project documents and the furnishing of structures); the planned number of accommodation units in hotels and mixed-use structures is 1,184 beds. It has been projected that, with a 50% occupancy, the income in the first year from accommodation and hospitality will amount to EUR 25,798,794.17, and over the first five years will amount to EUR 138,838,205.13. The ski resorts will have a capacity of 3,800 skiers/day.

Expected impact on competitiveness: It is expected that the realization of these projects will cause an increase in the number of tourists and overnights in the north, new jobs will be opened, the north's seasonality will be overcome and the regional gap will be reduced. Analyses show that the largest income in tourism is achieved by high-category hotels, and that a lot of money is spent outside the hotels, including at ski slopes and other amenities, which allow a high level of occupancy throughout the year. Tourism, as one of the main branches of the economy, has a significant effect on the growth of the foreign trade balance. According to the prognoses of the WTTC to 2026, Montenegro is included among the 28 fastest growing tourist destinations. It is projected that by 2026, the total contribution (direct and indirect) of travel and tourism to GDP will reach EUR 1,521.9 million (29.9% of total GDP), the total contribution of travel and tourism to employment will be 54,000 jobs (27.7% of total employment) and investment in tourism and travel will amount to EUR 487.5 million (50.1% of total investment).

The expected social outcome of the measure: Within the planning documentation for the region of Bjelasica and Komovi the creation of 13,900 jobs is projected. Within the planning documentation for Durmitor, 500 jobs are expected to be created at the Savin Kuk site. Also, in the construction of these facilities, many workers will be engaged for construction and other similar jobs.

Potential risks in implementation of the measure: Public procurement procedure and administrative capacities for public procurement implementation; a lack of planning documentation (Hajla) being prepared in 2017; and adequate long-term planning of the required budget funds.

4.3.3.3.2 Development of financial services

Diagnosis: The banking sector makes up the dominant share of the financial sector in Montenegro, with 15 banks, of which nine banks have majority foreign capital. The total balance-sheet sum of the banks amounted to EUR 3.74 billion at the end of September 2016 or approximately 100% of GDP. At the end of the same month, loans amounted to EUR 2.5 billion or around 67% of GDP. In the post-crisis period, the banking sector in Montenegro is facing numerous internal and external challenges, and lending activity has not reached the critical pre-crisis level, which would be a strong driving force for economic growth. Until the end of 2008, the Montenegrin banking sector was among the fastest growing in Europe and Central Asia, but it was followed by a strong lending activity downturn. Low lending activity of banks has marked the entire period since 2009. The impact of the crisis on the economy, particularly on the construction sector, real-estate sector and household sector resulted in an increase in non-performing loans out of the total loan portfolio. Thus, non-performing loans reached a maximum level of nearly 26% of total loans in mid-2011, which was followed by an increase in loan loss provisions and capital write-offs. The prescribed solvency standards and risk profiles of some banks required recapitalization of a large number of banks, which preserved the stability of the system. Caution is still strong in banks' lending policies, which is why their contribution to solving the problem of insufficient liquidity of the economy and the speeding up of economic growth is far smaller than expected. The banks' focus on solving the high level and share of non-performing loans (NPL)[30] out of total loans resulted in a significant drop in NPLs. NPLs at the end of September 2016 amounted to EUR 254.9 million or 10.2% of total loans. Notwithstanding the substantial decrease of 27.5% annually, NPLs are still under continuous enhanced supervisory control.

Implementation of specific recommendations given to Montenegro: At the ministerial meeting held in May 2016, Montenegro was given a recommendation to "develop a comprehensive strategy to further

[30]This amount does not include interest rates and prepayments, deferred expenses or accrued income.

foster the disposal of non-performing loans by banks, including participation by all relevant stakeholders, while establishing a bank lending survey to better gauge the underlying credit dynamics".

Aimed at a reduction of the NPL share of the total loans of the banking sector, under the project "The Podgorica Approach", the *Law on Voluntary Financial Restructuring of Debt to Financial Institutions* was adopted ("Official Gazette of Montenegro", No. 20/15) and its application commenced on 1 May 2015 with validity period of two years. However, according to the available data, despite all the activities and foreseen legal advantages, more than a year after the beginning of implementation, the project did not yield the desired results at the final implementation stage of "The Podgorica Approach" with respect to voluntary loan restructuring. Still, the effect of raising the awareness of the need to solve this problem instead of constantly delaying it and other measures implemented by the Central Bank of Montenegro (CBCG) resulted in a decline in NPLs. Gradual growth in overall lending activity due to increased competition in the banking sector, alongside the continued process of clearing banks' balance sheets, is expected to contribute to a further decrease in NPLs in the forthcoming period.

Under the same project, in order to control and decrease the aggregate level of NPLs, the CBCG adopted amendments to the *Decision on minimum standards for credit risk management in banks* ("Official Gazette of Montenegro" No. 57/13), committing the banks to develop comprehensive three-year strategies for handling non-performing loans and define annual operational objectives for the reduction of the NPL level. Banks are to prepare and submit to the Central Bank quarterly reports on the implementation of operational objectives. In case of significant differences between the actually implemented activities and defined operational objectives, the Central Bank requires banks to take additional organizational or other measures, which are required for the purpose of improving credit risk management.

Apart from the other factors that contributed to the decrease in NPLs, strict application of this decision and the Central Bank's permanent supervision over the implementation of the banks' defined strategies resulted in a substantial decline in NPLs compared to the period prior to the beginning of implementation of the decision, with a strong tendency towards further decreases.

Plan of reforms related to specific recommendations given to Montenegro: Aimed at compliance with the new EU *acquis* in the field of financial services, significant reforms of the regulatory framework governing banking operations will be implemented. The new *Law on Banks* will be developed and adopted in 2017, and a set of implementation legislation, transposing Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, and Regulation (EU) 575/2013 on prudential requirements for credit institutions and investment firms onto national legislation.

In addition, in December 2016 the Central Bank drafted the amendments to the Law on Voluntary Financial Restructuring of Debt to Financial Institutions in order to prolong the deadline for its implementation until May 2018 and provide a wider range of loans which could be the subject of Voluntary Financial Restructuring. In consultations with all the relevant stakeholders, the draft will be finalized so that it can be approved by the Government in 2017. All of the above is directly relevant to Recommendation No. 3 from the ministerial meeting in Brussels in May 2016.

Also, the *Law on the Recovery and Resolution of Banks* will be developed; it will regulate the conditions and methods for the resolution of banks of systemic importance, and its implementation should provide conditions for maintaining the stability of the financial system, including cases when problems appear in important banks in the system.

In addition, a law will be developed in 2017 which will govern, apart from factoring companies, the establishment, operations and control of the operations of a number of other financial institutions (leasing companies, microcredit financial institutions and legal entities performing lending-guarantee activities.) By regulating and supervising these financial institutions, prerequisites will be created for further development of this segment of financial services, provision of a more comprehensive database of the operations of financial service providers, which will be used for statistical and other purposes, improvement of the Credit Registry maintained by the Central Bank, as well as the improvement of consumer protection – the protection of the users of the services provided by these financial institutions.

In the forthcoming period, the Central Bank's intensified supervision over the implementation of banks' obligations arising from the *Decision on minimum standards for credit risk management in banks* will continue, which will additionally contribute to a further decline in NPLs.

4.3.4 Business environment and reduction of the informal economy

4.3.4.1 Improvement of the business environment

Diagnosis: Apart from the evident economic growth that has been recorded in Montenegro for years, reforms concerning the business environment contribute to the improvement of economic frameworks for the development of entrepreneurship, time-saving and the reduction of operating costs for existing and new businesses. According to the Doing Business Report for 2016–2017 (Doing Business 2017), Montenegro ranks 51st out of the 190 countries covered. The main obstacles to further improvement of the business environment that are included in the Doing Business Report are: company registration, the work of cadastral services, the issuing of construction permits and the enforcement of contracts, and they will be the focus of further reform measures.

Report on the implementation of policy guidelines from May 2016, if relevant for the given area: Implementation of measures in this reform area is directly related to the recommendations that were made to Montenegro at the ministerial meeting in Brussels in 2016, and especially to Recommendation No. 5 (Continue to facilitate the provision and range of financial and non-financial support services for SMEs to foster their participation in global value chains). Additionally, Recommendation No. 2 also addresses the measure relating to electronic fiscal invoicing in order to reduce the informal economy.

Priority reform plans: Given the identified obstacles for improving the business environment in Montenegro, the Ministry of Justice has prepared Analysis of the efficiency of the enforcement system, which showed benefits of the new system seen in relieving the burden on the courts, faster implementation of enforcement procedures in the business sector, but also some shortcomings and dilemmas which have arisen from the practice so far. Thus, in order to have in place faster, more reliable and efficient enforcement, the Government approved the draft amendments to the Law on Enforcement and Security of Claims, which is now before Parliament.

The efficiency of cadastral services is also a priority in the part concerning the business environment. The Ministry of Finance and the Real Estate Administration are in the process of creating prerequisites for the IT-linking of the cadastral base with other government bodies, local self-government bodies, notaries and other market participants before which citizens and businesses initiate legal actions which require data from the cadastre. In this way, citizens and businesses will no longer have to go to the cadastre in order to obtain the necessary documents for certain legal dealings. This significantly simplifies the real estate registration process as well, in view of the fact that a notary who registers real estate for citizens and businesses can access the documents in the database electronically, with no need to go to the cadastre office on behalf of their clients. This also reduces procedural costs, i.e. payments of administrative fees and other parafiscal levies for participants in procedures. Also, one of the obstacles identified in the work of cadastral services is not only the availability of a database, but also its contents because in most municipalities, land-based registry is still being maintained instead of an inventory based registry which makes it difficult to obtain building permits, divide into different floors etc. It is necessary to overcome the above-mentioned outstanding issues in the coming period.

To ensure more efficient issuing of construction permits, the reform is foreseen to continue through the adoption of the Law on Spatial Planning and Construction which will define electronic operations at the level of spatial planning and construction. Therefore, extensive planning documents and technical documentation will no longer be produced in paper form, which will contribute to cost reduction, improved efficiency and a simplification of procedures. In addition, by avoiding contact between investors and the administration staff the procedure will be more transparent. An upgrade of the existing systems will consolidate all data concerning spatial planning and development and make it available to the public, potential investors, etc. Also, in cooperation with local self-government units, efforts are being made to reduce the costs for issuing permits for citizens and business entities. In the previous period, local fees for the provision of utility infrastructure for buildable land were different for residential and commercial buildings, but these are now aligned by reducing the fee for business entities. At the same time, the line Ministry of Sustainable Development and Tourism and the Ministry of Finance are continuing their efforts to reduce this levy, which burdens investments significantly.

In addition, several measures are being implemented within the framework of the action plan to reduce the informal economy.

Moreover, the Ministry of Finance, with its partners from the UNDP Montenegro office, and as supported by the UK Embassy in Montenegro, have continued implementation of the project *Cutting Red Tape – Public Administration Tailored to the Needs of Citizens and Businesses*. The second phase of this project will be implemented by the end of March 2017, and it includes the implementation of recommendations submitted by citizens and businesses via the "bezbarijera.me" online platform. This part of the project will be supported by the American Chamber of Commerce in Montenegro as well.

In order to improve the business climate at the local level, Montenegro officially joined the Regional Network for Certification of Business-Friendly Municipalities (BFC SEE) in May 2016. Apart from Montenegro, the regional network includes Croatia, Serbia, Former Yugoslav Republic of Macedonia and Bosnia and Herzegovina, and the joining of new partners from the region has been announced. This regional initiative was launched in order to include local self-governments in the regional partnership and thereby create better conditions for their economies and further development of local communities. The certification process, which implies fulfilment of a range of criteria and reform measures, covers six Montenegrin local self-governments: the Capital City of Podgorica, the Old Royal Capital of Cetinje, Budva, Danilovgrad, Žabljak and Bijelo Polje.

The priority reform measures in this sub-area, presented in the 2017 ERP are as follows:

Priority reform measure No. 11: Introduction of e-services into the land registration system

Brief description of the measure: Under the *Cutting Red Tape* project, implemented by the United Nations Development Programme (UNDP) in cooperation with the Ministry of Finance, with the financial support of the UK Embassy in Podgorica, the implementation of the measure for improvement of the integrated information system of the Real Estate Administration will commence, in order to provide banks, local self-governments and state bodies with access to the integrated information system, thereby alleviating the burden and expediting the process of issuing relevant documents by cadastral offices.

Timetable by year:

2017: Preparation of regulatory and technical prerequisites for the introduction of e-services of the Real Estate Administration which will be accessible to other state bodies, local self-governments and notaries

2018: The system up and running.

Fiscal impact: Funds for the measure implementation are provided by the UK Embassy in cooperation with the NDP, and amounts to EUR 50,000.

Expected impact on competitiveness: The proposed measure, along with the set of measures that are being continually implemented on strengthening the human resources and IT capacities of cadastral offices, will contribute to the improvement of the quality, efficiency and accessibility of public cadastral services. The main objective of the measure is to reduce the burden on and accelerate the issuing of documents by the Real Estate Administration. In this segment, strengthening of the business environment will eventually improve the competitiveness of Montenegro, especially with respect to an improvement in its ranking in global reports, such as the Doing Business Report and the Global Competitiveness Report.

Expected social outcome of the measure: A reduction of the burden on the economy and on citizens by introducing the new principle in obtaining documents from the cadastre. For certain legal affairs before state authorities, with the introduction of this system, citizens and businesses will no longer have to obtain documents from the cadastre themselves and submit them to another authority or to the notary. This is particularly important for real estate registration, for example, because the notary will be able to obtain proof of ownership for a client via the e-service from his office, without going to the cadastral office in person.

Potential risks in implementation of the measure: The risk for efficient implementation of this measure may include potential problems with the software developed to provide access to data for authorities, notaries and other interested parties.

Priority reform measure No. 12: Introduction of electronic fiscal invoices to reduce the informal economy

Brief description of the measure: The introduction of electronic fiscal invoices as one of the measures to reduce the informal economy would ensure provision of information about sales of goods and services in real time, which would lead to significant progress in the control of the registration of sales paid in cash. Introduction of electronic fiscal invoicing would contribute both to the improvement of business environment and the suppression of the informal economy, while Montenegro's budget revenues would rise.

This measure was set to commence in 2016, but the actions planned for 2016 were not carried out because there was a need to examine whether the total coverage of the country with a mobile telephony signal for data transfer had been provided, and to agree on the technical possibilities and prices of services provided by mobile telephony operators.

Timetable by year: In 2017, a combined team will work on the implementation of technical solutions (purchase of software and the required hardware equipment) and the development of adequate legislation (law and regulation) at the same time. The electronic fiscal invoicing project will be implemented in 2018.

Fiscal impact: According to estimates, approximately EUR 500,000 should be allocated in 2017 for adjustment of the Tax Administration's information system, which includes procurement of software and the required hardware equipment. The introduction of electronic fiscal invoicing will result in an increase in Montenegro's budget revenues of at least EUR 10.0 million in 2018.

Expected impact on competitiveness: Introduction of electronic fiscal invoicing will contribute to a significant increase in the competitiveness of Montenegro's economy. A competitive economy implies the introduction of a high level of tax discipline, and this project's contribution in that respect would be significant.

Expected social outcome of the measure: No specific social impacts have been identified.

Potential risks in implementation of the measure: No identifiable risks.

4.3.4.2 Development of small and medium-sized enterprises

Diagnostic: The sector of small and medium-sized enterprises is one of the main drivers of economic development, considering the fact that it includes 25,595 companies, accounts for 76% of total turnover and for 67% of total added value, and employs almost two-thirds of the total number of employed people. Measures of financial and non-financial support to the SME sector are implemented for the purpose of starting new companies, increasing production quality and volume, accessing new markets, strengthening innovation and thereby increasing share in GDP, exports, employment levels and living standards.

Problems are reflected in the supply of financial products that are insufficiently adjusted to SMEs' needs, alternative financing sources are not fully implemented and enterprises have limited capacity to access finance, i.e. they do not have a high-enough credit worthiness and very often do not have collateral. Financial literacy is not at the required level and enterprises do not have the appropriate knowledge to present the project to financing institutions, and their ability to manage finances in order to regularly pay financial and credit commitments are often limited. Apart from that, companies are not introducing the standards necessary for accessing new markets appropriate, do not sufficiently use services from the consulting market and the possibilities of networking, which imply a low level of competitiveness of SMEs, a regional development imbalance and insufficient exploitation of possibilities for exports.

Report on the implementation of policy guidelines from May 2016, if relevant for the given area: At the ministerial meeting in Brussels in May 2016, Montenegro received the recommendation to continue to facilitate the provision and range of financial and non-financial support services to SMEs with a view to foster participation in global value chains and to support the development of the private consultancy market (Recommendation No. 5). In that respect, as a response to the recommendation from the ministerial meeting in Brussels in May 2016, the Montenegro 2017 ERP envisages two priority measures related to financial and non-financial support to the SME sector.

Priority reform plans: Improvement of both financial and non-financial support to the SME sector is being continuously implemented in accordance with Development Directions for Montenegro, the SME Development Strategy, the Women's Entrepreneurship Development Strategy 2015–2020, the Lifelong Entrepreneurial Learning Strategy 2015–2019 and the recommendations from the Small Business Act.

According to the aforementioned, the 2017 ERP envisages two priority measures in this sub-area. The first measure – "*Improvement of financial support to the sector of small and medium-sized enterprises"* will be the continuation of the reform from the 2016 ERP, while the measure titled "*Improvement of non-financial support to the sector of small and medium-sized enterprises"* will be included in the 2017 ERP, both of which are in order to contribute to the dynamism of the private SME sector.

The priority reform measures are described below.

Priority reform measure No. 13: Improvement of financial support to the sector of small and medium-sized enterprises

Brief description of the measure: Improvement of financial support to the sector of small and medium-sized enterprises represents the implementation of measures and activities defined in strategic documents by the Government of Montenegro in this field: Development Directions for Montenegro and the Industrial Policy of Montenegro, 2020 SEE Strategy, and of the recommendations from the EU Small Business Act. The main obstacles to the enhancement of SMEs' competitiveness include insufficient access to financing due to the fact that the available financial instruments and procedures are not fully appropriate to the needs and capacities of all users, which results in an insufficient ability to obtain loans for SMEs' different needs and categories. Therefore the improvement of financial support to the SME sector is a measure proposed this year as well, and the report on its implementation in the previous year is presented in Table 12 of the Annex.

In order to provide more favourable access to financing for SMEs, the Investment and Development Fund (IDF) of Montenegro will intensify activities on encouraging entrepreneurship through the improvement of financial support with the availability of short-term and long-term loans for investments and liquidity. Apart from the implementation of credit lines for existing businesses for young people, women in business, start-up companies, clusters, innovative companies, tourism, production, agriculture and services, it is planned to implement new credit lines for companies that plan to access new markets, realize greenfield investments, for industrial modernization, buying agricultural products, etc. From the perspective of the terms of financing, it is planned to lower the interest rate by 0.5 of a percentage point compared to 2016[31] with an additional decrease in the interest rate for the northern region and municipalities of below-average development, to provide subsidies for interest on loans in tourism, co-finance costs for industrial modernization, etc. A particular financial facility is interest-free loans for students in higher education, women with the potential to do business and redundant technological workers who are willing to run businesses. The Investment and Development Fund's financial offer will strive to remain competitive and thereby accessible to beneficiaries with respect to loan repayment schedules of up to 15 years and grace periods up to five years, but also through the organization of training in the establishment of start-ups and in managing finances in order to facilitate access to finance. Regarding to factoring arrangements, it is planned to further develop factoring without regression, with regression and supplier factoring and to implement new categories of factoring which envisage a decrease in the interest rate of 1 percentage point, as well as fees for the purchasing of receivables.

Measures focused on the simplification of financial support to the SME sector also include the continuation of further promotion of financing through the model of a loan guarantee facility for financial intermediaries under the COSME programme for existing and new users. OTP CKB bank, the financial intermediary in the COSME programme, will continue the financing of SMEs' needs for working capital and investments in material goods and non-material investments, without the need to provide collateral. The WB EDIF programme's[32] Enterprise Innovation Fund[33] (ENIF) envisages the start of implementation of the instrument for investments in equity capital for innovative start-ups and SMEs in the development stage. Additionally, support will be provided for the more efficient functioning of innovative clusters and their better promotion by providing grants.

Timetable by year:

2017

- Improvement of the IDF's financial support for business beginners and the SME sector by offering more favourable terms and procedures for existing and new credit lines (interest-free for students in higher education, women who start businesses, redundant technological workers, then support for accessing international markets, decrease in the interest rate for existing credit lines, interest-rate subsidies, co-financing costs, etc), introducing new categories and a decrease in the interest rate of factoring arrangements, as well as the facilitation of credit line procedures by organizing training.
- Financial support for the establishment of new clusters and improved functioning of the existing ones through a model of grants for material and non-material investment and operational costs.
- Further implementation of the COSME loan guarantee facility (LGF) for SMEs by CKB bank in order to increase the number of beneficiaries which do not need collateral.
- The start of the implementation of the financial instrument of investments in equity capital via the WB EDIF–ENIF fund for start-ups and innovative SMEs.

2018

- Improvement of the existing credit lines in procedures and terms, opening up new ones and improvement of the provision of factoring services for broader target groups and provision of grants for cluster development;
- Full implementation of the COSME loan guarantee facility by CKB bank and the signing of new agreements by new financial intermediaries;
- Further implementation of investments in equity capital through the WB EDIF–ENIF fund.

[31] The interest rate on IDF Fund credits in 2017 will be between 0% and 4.5%.

[32] The Western Balkans Enterprise Development & Innovation Facility.

[33] The IDF joined the ENIF fund for innovative enterprises as a partner in April 2016.

2019

- Continuation of the activities from 2018 in providing credit support to SMEs, grant support, investment in equity and accompanying training to access finance.

Fiscal impact: The Investment and Development Fund of Montenegro, as an institution in majority state ownership, will provide EUR 120 million (around 2.5% of GDP) in 2017 for the improvement of financial support to SMEs from international sources based on the agreement with the EIB, and of repayment of loans and income based on interest and fees, for start-ups and existing SMEs in the area of services, tourism, catering, production, etc. An amount of EUR 100,000 from the state budget is planned for support to clusters in 2017, which is implemented by the Ministry of the Economy.
Expected impact on competitiveness: More favourable financing terms for SMEs will result in the greater availability and accessibility of financial services and access to credit, the opening up of new companies, more efficient operations and development of SMEs, a higher proportion of GDP, turnover and overall investments, more even regional development, higher export competitiveness of the domestic economy and participation in global value chains.
Expected social outcome of the measure: The opening up of new companies and improved operations of existing ones will result in new employment and higher labour-market demand, better working conditions in the SME sector and increased participation of young people and women in business. It will be related to all regions in the country with special incentives for the northern region and less developed municipalities.
Potential risks in implementation of the measure: An insufficient level of interest and insufficient financial readiness of the SME sector, loan approval procedures, inadequate collateral, insufficient capacities of financial institutions to use EU funds, an insufficient level of knowledge and the non-existence of a regulatory framework for implementation of the financial instruments pertaining to investments in equity capital.

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

Brief description of the measure: The improvement of non-financial support and of financial support to the sector of small and medium-sized enterprises represents the implementation of the measures and activities defined in strategic documents of the Government of Montenegro in this area: Development Directions for Montenegro, Industrial Policy 2020, the SEE 2020 Strategy and the recommendations from the EU Small Business Act.
One of the obstacles to the growth of competitiveness and overall development of the SME sector is the fact that business beginners in Montenegro do not have a sufficient level of knowledge or potential to obtain funding for their idea or project. Also, there is an evident lack of knowledge about management, finance and business planning, marketing and business communication among the existing SMEs and business beginners who are using loans, which leads to poor business results and problems with loan repayment and approval of loans for new beneficiaries. In addition, it is evident that companies are not able to provide advisory and consulting services independently, due to their relatively small size and economic strength or else do not see any benefit from their use.

Due to the above-mentioned obstacles, the Ministry of the Economy/Directorate for SME Development is continuously offering a whole range of non-financial support services and information (informative and advisory services, entrepreneurship training, mentoring services, services of linking businesses and organizing fair participation). The Enterprise Europe Network (EEN) is also active in Montenegro, and it is enabling SMEs to obtain the required information and services of importance for the development of their operations on the EU market, for finding business partners, for innovations, technology transfer and participation in EU programmes. Moreover, the support from Chamber of Commerce and business entrepreneurs` associations in Montenegro is also significant.

Therefore, in order to eliminate the aforementioned obstacles and achieve business success, the need has arisen to provide support and assistance to SMEs through a process of training and provision of business counselling services and assistance in preparation for access to finance, which is a key instrument for opening up companies and stimulating their business competitiveness. The following activities will be implemented in the forthcoming period: intensifying training in financial literacy and investment readiness for companies; providing the required advisory and business services, strengthening the consulting market and supporting SMEs to better use the opportunities offered by the single market. Also, implementation of the support mechanism for cluster operations will continue, for the purpose of achieving a better competitive position for SMEs on national and international markets.

Activities on implementation of the measure per year:

2017

- Improvement of financial literacy and investment readiness
  - Organization of at least two five-day entrepreneurial training sessions for business beginners with the emphasis on women and young people (training on starting up and running businesses, development of business plans, financial and tax systems and legislation – at least 50 participants who are beginners in business or existing SMEs which have been doing business for up to one year);
  - Continued implementation of the project “Mentoring services for SMEs” – at least six enterprises are being provided with mentoring services.
- Development of the private consultancy market
  - Establishment of an electronic database on providers of consulting services – mapping at least 100 consultants.
- SME internationalization
  - Provision of advisory services on the international market within the EEN for at least 80 companies;
  - Organization of business meetings, organisation of at least five B2Bs (business-to-business);
  - Organization of training for the improvement of the export performance of enterprises with the aim of enhancing the competitiveness and participation of SMEs in international value chains (organization of at least two training sessions with 20 participants).
- Cluster development support
  - Technical support for the development of project applications for international funding sources; support for the preparation and implementation of projects for the cluster support programme for grant application purposes.

2018

- Implementation of the Financial Literacy and Investment Readiness Programme from 2017;
- Development of an on-line database on business counselling (consulting service providers);
- Implementation of SME internationalization activities (business advisory services, organization of business forums and training);
- Strengthening of the capacities, managerial abilities and marketing activities of clusters.

2019

- Implementation of the programme of financial literacy, investment readiness and mentoring;
- Update of the on-line database of business service providers;
- Continued implementation of activities in the area of SME internationalization;
- Continued support for the improvement of the performance of clusters and the establishment of new clusters.

Fiscal impact: The Ministry of the Economy will provide EUR 132,457 for 2017 for the improvement of non-financial support to SMEs from the state budget for training and mentoring, a contribution to the

COSME EEN project, technical support for cluster development and a contribution for participation in the COSME programme. Additional sources will be provided from EU-funded programmes (EEN, HORIZON 2020 and Interreg Danube Transnational) in amount of EUR 40,756. At least the same amount is planned for 2018 and 2019 as well.

Expected impact on competitiveness: The measure implementation will enable the opening up of new companies, development and increase of SME productivity, and improved export performance by companies, which will be reflected in an increase in exports and participation in global value chains.

Expected social outcome of the measure: The potential of people ready for entrepreneurial endeavours and of employees with entrepreneurial capacities who start their own businesses will improve, and the level of expertise and competency, and thereby employment opportunities, will increase, especially for young people and women in all regions.

Potential risks in implementation of the measure: An insufficient level of interest among potential business beginners and business entities and an inability to provide additional funding sources for implementation of the measure.

4.3.4.3 Privatization

Diagnosis: In 2016, privatization-related activities were carried out in line with the Decision on the 2016 Privatization Plan, approved on 28 December 2015. The 2016 Privatization Plan envisages the privatization of nine companies through sale of shares and assets through public competitions; public calls have already been issued for four of them: the Dr Simo Milošević Institute AD – Igalo, the Ferrous Metal Institute AD – Nikšić, AD Montecargo – Podgorica and the Port of Bar AD – Bar. For the Dr Simo Milošević Institute AD – Igalo and the Ferrous Metal Institute AD – Nikšić, the tenders failed, while the ones for AD Montecargo – Podgorica and the Port of Bar AD – Bar are still pending.

Priority reform plans: As regards the development of prospective tourist sites or putting to use existing companies through public–private partnerships, tenders will be invited for the following sites: Buljarica, VTK Mediteran, Žabljak, Donja Arza – Herceg Novi, the Ecolodge Tourist Resort – Vranjina, and Kolašin 1600 – Bjelasica and Komovi, while the site of Lastavica Island with Mamula Fortress – Herceg Novi will be handed over to the developer.

The respective tender commissions will continue with their regular activities of situation analysis and development of tender dossiers following the procedure for the selection of developers for long-term lease. The Government will adopt the 2017 Privatization Plan in Q1 of this year at the proposal of the Council for Privatization and Capital Projects. In this regard, the main aim of privatization in 2017 will be to increase the competitiveness and efficiency of the given companies, boosting foreign investments and entrepreneurship in all areas and increasing the standard of living.

4.3.5 Research and innovation

Diagnosis: Montenegro has focused special attention on developing an environment conducive to innovation and knowledge sharing, as well as strengthening ties between scientific-research institutions and the business sector.

The key obstacles to increasing competitiveness and economic growth are related to the fact that there are a small number of companies whose activities are based on innovation, knowledge and modern technologies in Montenegro. In addition, cooperation between the business sector and research institutions are insufficient and insufficient demand for consulting services, innovative products and services, business processes, organization and marketing still persist.

Accordingly, the legal and strategic framework for the area of scientific research and innovative activities has been established in accordance with European guidelines and objectives. In addition, the establishment of an adequate institutional framework will give a stimulus for innovation and it will facilitate the absorption of technologies that can directly affect the competitiveness of the economy.

Along these lines, the establishment of the first Centre of Excellence in Montenegro, started in 2014, enables strong connection between knowledge, research and innovation. Having in mind the positive experience from the first Centre of Excellence that is currently under implementation, Montenegro will establish another Centre of Excellence in the period 2018–2020, after which we expect these centres to achieve sustainability and initiate the establishment of new centres.

The institutional framework will be fully implemented by setting up the first Science and Technology Park in Montenegro (2017–2020), to establish strong connections between local and regional business centres, incubators, clusters and voucher schemes and thereby enable the commercialization of innovative ideas into new, market-ready products and services. This was followed by establishing the Science and Technology Park – the first Innovative Entrepreneurial Centre, Tehnopolis, in Nikšić, which is opened on 17 September 2016.

Based on the latest available MONSTAT statistics for 2014, total national spending on R&D in 2014 amounted to 0.36% of GDP, of which 46% was allocated from the state budget, 33% came from businesses and 21 % came from abroad (mainly from the EU and international organizations).The goal is to increase the total national I&R consumption to 0.6% of GDP until 2020.

Priority reform plans: For the further development of scientific research and the innovation system, and society at large, the following is envisaged: Establishment of the Science and Technology Park in Podgorica.

Priority reform measures in this field are given below:

Priority reform measure No. 15: Establishment of the Science and Technology Park (STP) in Podgorica

Brief description of the measures: The main objective of the STP is to bring together entrepreneurial, innovative, scientific and economic capacities and achieve a strong relationship between local and regional business centres, incubators, clusters and voucher schemes. This measure is connected with the implementation of the Strategy of Innovation Activity 2016-2020, Industrial Policy of Montenegro till 2020, Montenegro Developments Directions 2015-2018 and South East Europe 2020 Strategy.

The Science and Technology Park in Montenegro is designed as a cross-linked structure which will have its headquarters in Podgorica and three decentralized units – Impulse Centres – in Nikšić, Bar and Pljevlja.

It is planned that STP will be established in cooperation with the University of Montenegro (UoM) as a key partner, with the involvement of all Montenegrin universities, scientific and higher education institutions, as well as 40-50 micro, small and medium enterprises from the high technologies area.

Having the STP in place will enable linkages between scientific-research and higher education institutions and businesses to create new value that will directly impact economic growth and reduce unemployment. The STP will thus provide a conducive environment, cherishing and boosting commercial use of research and provide support for technologically oriented businesses.

The STP will provide specialized infrastructure and services, an IT system, expertise and consultancy in different fields of science to boost multidisciplinarity; to encourage and manage knowledge and high-tech transfer; better internationalization and commercialization of research; to create new innovative businesses; to encourage, develop and apply new technologies, procedures, products, services and market processes, or improve existing ones, based on the best scientific results, to be put to the use of the economic development of the region and of the country.

Timetable by year:

- Preparation:
- Drafting the main design for reconstruction and adaptation of the STP facility with costing, negotiations with the World Bank regarding conclusion of the loan agreement for the continuation of the project “Higher Education and Research for Innovation and Competitiveness of Montenegro” (HERIC) in order to finance the establishment of the STP in Podgorica, in the period 2017–2020 (until the end of 2017)
- Implementation:
- Tendering for selection of the best bidder for the works regarding reconstruction and adaptation of the STP facility, Conclusion of the contract with the selected tenderer, start of construction works, Completion of construction works and technical acceptance of the facility, Equipping of the STP.

Public call for STP occupants Opening of the STP facility (till the end of May 2020).

Fiscal impact: The amount for the implementation of this measure of EUR 60,000 in 2017 are provided from the World Bank loan.

Expected impact on competitiveness: Linking science and research with innovation and business through support to the STP will enable: the setting up and attracting of new SMEs, start-ups and spin-offs of innovative entities; consolidation of existing businesses; the creation of strong linkages with local and regional business centres, incubators, clusters and voucher schemes; stimulation of knowledge and high-tech transfers from research institutions to businesses; better commercial use of research; encouragement for the development and application of new or improved technologies, procedures, products, services and market processes based on the best scientific knowledge, and employment in existing and new companies and contribute achieving the objective of investment in R&D.

Expected result of the social measures: This measure will involve the recruitment of 15 members of STP staff between 2018 and 2019, while through STP activities, new SMEs will be set up, which will increase the level of employment, particularly among young people, through setting up their own spin-offs and start-ups.

Potential risks when implementing the measures: Tendering for the selection of the best bidder regarding works on reconstruction and adaptation of the STP facility and construction works on the STP facility, for the implementation of reform measures.

4.3.6 Foreign trade and investment facilitation

Diagnosis: Despite significant potential for strengthening exports and reducing external economic imbalance, Montenegro is characterized by the existence of a narrow export base, a low level of export diversification, as well as a low level of added value in production. The structure of Montenegro’s exports changed significantly over the last 10 years in favour of exports of services, whose share of total exports grew from 48% in 2006 to over 70% in 2015. Although the growing export of services contributed to a reduction in the current account deficit, it is still high as a percentage of GDP (estimated at around 21% of GDP in 2016). In that respect, apart from strengthening the competitiveness of service exports as the largest export category, for Montenegro it is very important to diversify exports of goods and to increase added value in export-oriented production. This would, in turn, contribute to a greater coverage of imports by the exporting of goods, and to a decrease in the extremely high foreign trade deficit (around 40% of GDP).

In this regard, investments are an important prerequisite, particularly investments in processing capacities that will increase the level of processing in production intended for export, and thereby, its competitiveness level. Further improvement of the business environment and trade and economic integration should be conducive to that. In other words, for a return on investments in export-oriented production in Montenegro, free trade agreements and trade and economic integration are vital, since they facilitate the placement of products that meet the demanding international standards onto wider international markets, especially the EU market. A conducive business environment is also important, i.e. relevant business zones that will make production for both the domestic and export markets more competitive.

Hence, trade facilitation greatly affects the removal of barriers to trade, better competitiveness and economic growth, which has also been recognized on a multilateral level. The Law ratifying the Protocol amending the Marrakesh Agreement Establishing the World Trade Organization was adopted in 2016, and published in the Official Gazette of Montenegro – International Treaties series 5/2016 of 8 April 2016. The ratification instrument was submitted on 10 May 2016; to date 94 WTO members have ratified the Agreement, and Montenegro was the 79th country to do it. The main benefits of the Agreement implementation are: simplification of customs procedures, greater transparency and a reduction of transaction costs. Namely, research shows that if the time required to process exports is shortened by 1%, exports will rise by 0.4%. Also, one additional day in transit corresponds to a distance increase of 70 km between trading partners, and shortening of transport times in the country by one day results in a 7% increase in exports.

When it comes to CEFTA countries, it is important to note that negotiations on the conclusion of the Additional Protocol 5 to CEFTA 2006 are in their final stage. The aforementioned Protocol is actually a Trade Facilitation Agreement between CEFTA countries. When it enters into force, export and import procedures will be largely harmonized and simplified, and average time required for goods release will be shortened, which are some of the key problems identified by businesses. Implementation of the Protocol will encourage the linking of information systems of all border inspection services, will simplify customs procedures, increase transparency and reduce transaction costs, and thereby increase the competitiveness of companies and of the economy in general.

Given that foreign direct investments should be the main source of financing of the current account deficit of payment balance and of creating knock-on effects important for competitiveness, economic growth and employment in the future as well, the key challenge is how to change the structure of foreign direct investments towards an increased share of investments in increasing added value and diversifying the export base.

Priority reform plans: In view of the aforementioned obstacles to increasing the competitiveness of Montenegro's exports, the Government of Montenegro is implementing a range of reform measures in industry, agriculture and services, focusing on compliance with the requirements of international quality standards, an increase in the level of processing, etc. Apart from the aforementioned measures and measures concerning the introduction of trade facilitations through international agreements, in 2017 special attention will be paid to the further attracting of direct investments as a precondition for export growth, which is why the following priority reform measure has been proposed: Development of business zones with the aim of encouraging direct investments and increasing employment.

Priority reform measure No. 16: Development of business zones with the aim of encouraging direct investment and increasing employment

Brief description of the measure: This measure is of an administrative and investment nature. Its implementation is for the purpose of realization of: Development Directions for Montenegro 2015–2018; the Industrial Policy of Montenegro 2020; and the SEE 2020 Strategy.

Business zones represent a single entity within the territory of a local self-government with the infrastructure partially or fully provided, and apart from the shared space, it provides additional tax and administrative reliefs granted by the central or local governments. They are one of the tools for attracting direct investments and thereby stimulating SME development and job creation. In November 2016, the Government of Montenegro adopted the Decree on Business Zones, which defines the model of the establishment, incentives, management and functioning of business zones at the national and local levels. In this regard, the first business zone of strategic importance will be proclaimed, and a company will be established to operate it.

On the basis of classification according to the strategic importance, business zones are divided into business zones of strategic importance and business zones of local importance. The first business zone at the local level was established in 2012 in Berane. Namely, the strategic zone will be established and will be managed by the Government of Montenegro, while the local business zones will be managed by the local government. The evaluation of realized activities is planned every six months, where the founder's obligation is to submit reports to the Ministry of Economy.

So far, local business zones have been declared by nine local governments in Montenegro, and therefore investors have the opportunity to invest according to favourable conditions in Berane, Bijelo Polje, Kolasin, Mojkovac, Niksic, Cetinje, Ulcinj, Podgorica and Rozaje. All of these local governments have to align business operations with the Decree on Business Zones by 21 June 2017 in order to maintain the existing status. The practice of European countries shows that it takes 10 to 15 years for the establishment and functioning of business zones. In administrative terms, in Montenegro the basics have been put in place, but in the sense of production, there is still a lot of potential that can be exploited.

Timetable by year:

2016 – Based on the Study identifying business zones of strategic importance, the Decree on Business Zones was adopted, which provides the classification of business zones by the level of strategic importance, and the type of its foundation, establishment and management, selection of occupants, incentives, method of providing the infrastructure and gaining or losing the status of business zone.

2016–2017 – Proclamation and establishment of the first business zone of strategic importance in Montenegro.

2017 – Establishment of a company that will manage the business zone of strategic importance.

2017 – Development of activity plan for the establishment and smooth functioning of the business zone of strategic importance.

2017–2018 – Phased provision of infrastructure for the first business zone of strategic importance, in line with prospective investors' needs.

Fiscal impact: The funding required for the implementation of the third phase of the business zones project in 2017 totals EUR 101,000 allocated from the central budget, and EUR 50,000 form local budgets, the UNDP and GLOC.

Expected impact on competitiveness: Establishment of business zones should be conducive to greater direct investments focused on untapped resources in industries with the highest growth potential.

Expected social outcome of the measure: Together with the measure related to alignment of education profiles with market needs, it is expected that the business zone will contribute to the creation of new jobs, professional training for staff and social inclusion.

Potential risks in implementation of the measure: Insufficient financial support from local government is defined as one of the key challenges. Thus, local infrastructure and financial support in this regard is seen as one of the risks and challenges, in terms of the construction of local roads and infrastructure equipment. So, in the future it is planned to make further efforts to find adequate solutions. A very important aspect is stimulation of regional development, which will be further encouraged by the construction of the highway and will have a positive impact on the activities planned in the framework of the mentioned measure.

4.3.7 Education and skills

Diagnosis: In order for Montenegro to have a competitive labour force, it is essential, that continuous education, from earliest age, to be provided. A structural mismatch between supply and demand and the rising number of students at vocational schools continuing education, along with the increased number of unemployed university graduates are the main characteristics of the labour market situation and the main obstacles to the improvement of the competitiveness of the economy. At the same time, acquired knowledge and skills during university studies, especially so-called soft skills and practical knowledge, are not fully adjusted to labour market needs. With the aim of overcoming this situation, vocational curricula, study programmes and the admissions policy should be continuously harmonized with market demand, and cooperation between higher education institutions and employers should be strengthened.

Report on the implementation of policy guidelines from May 2016: The development of qualifications in accordance with the labour market needs represents a response to Recommendation No. 6 from the ministerial meeting in Brussels in May 2016 as well as a continuation of vocational education reform. The new structure of the study programmes of the University of Montenegro, based on a 3+2+3 model has been prepared, instead of the previously dominant 3+1+1+3 model. The new Strategy for the Development of Higher Education in Montenegro 2016–2020 was adopted. All activities on realisation of the fifth cycle of the Programme of Professional Training for University Graduates, as well as the Tracer Study for university graduate cohorts from 2009 and 2013 are carried out . Learning outcomes for all study programmes at the universities in Montenegro have been defined.

Priority reform plans: The OECD suggests that preschool education impacts learning achievements later on in the life and that investment in the early-childhood education has a significantly greater impact than any other investments later in life. Montenegro is implementing set of reform measures addressing preschool education with the aim of increasing of the coverage. In the previous period Interactive services as well asthe three-hour programme have been introduced, the campaign “Preschool for All” was implemented with the purpose of , influencing the level of parents’ awareness on the importance of preschool education. In order to provide necessary accommodation premises, a loan from the Council of Europe Development Bank was provided for the construction of seven new preschool units. This is a reform measure described in the 2016 ERP, and its implementation is under way, so it is not repeated again in this document. Apart from this ongoing measure, this year we are proposing - two more measures concerning vocational education and higher education.

Continuous improvement of the quality and efficiency of the vocational education, its relevance for the labour market and further development of lifelong learning and mobility represents one of the priorities. The modernization of curricula for all vocational education levels will enable linkage between education and the labour market through the development of qualifications based on learning outcomes.. Bearing in mind, that 67% of all secondary school pupils attend vocational curricula, it is necessary that curricula is aligned with the labour market needs.

Following the sectoral analysis and in line with the qualifications and curricula which need to be revised or developedin cooperation with employers, 23 occupational standards were developed in the areas of engineering (electrical and mechatronics), civil engineering, hospitality, economics and services. These standards are basis for development of curricula. Qualification standards and credit-based modularized curricula are being developed,and are going to be applied as of the 2017/2018 school year.

Montenegrin higher education system aims at greater recognition and relevance in the European Higher Education Area, by delivering high quality standards and scientific research work.. The Government of Montenegro is implementing a set of reforms aimed at aligning higher education with labour market needs in order to bridge the gap between supply and demand and increase of youth employment. Very important segment for the overall functioning of the higher education system is financing. In relation to this, the Government has opted for a so-called contract-based funding model in higher education, respectively funding based on the performance.

The 2017 Programme of Professional Training for University Graduates has started with implementation on 15th January and involves 3,274 graduates registered at the Employment Office..

As of the 2017/2018 academic year, the reformed 3+2+3 model of studies will be implemented at the University of Montenegro as the predominant European Higher Education Area model , and analysis of the Tracer Study will be carried out. The new studies model provides a continuity of studies and full alignment with international quality standards. This will create more conducive enviroment for educating competitive labour force with the knowledge and skills demanded by the modern labour market. A contract-based funding model between the University of Montenegro and the Government will start to be applied in 2018. The impact of the new funding model on the quality of work of institutions will be analysed in 2019. Moreover, the contents and structure of the study programmes leading to acquiring qualifications for the regulated professions were aligned with Directive 2005/36/EC and the amendments introduced by Directive 2013/55/EU governing this field.

Priority reform measure No. 17: Development of qualifications in line with labour market needs

Brief description of the measure: In accordance with the Vocational Education Development Strategy 2015–2020, this measure involves the modernization of curricula at all levels of vocational education. In order to achieve this, decisions on the demand for certain qualifications should be based on relevant labour market information. Qualifications should be based on learning outcomes, with an increasing volume of work-and-learn models and improving of quality of practical training. This measure is relevant for the implementation of Development Directions for Montenegro 2015–2018 as well as SEE 2020. Strategy.

Timetable by year:

- 2017 – Ten curricula developed, at least 150 teachers trained to deliver teaching based on learning outcomes, and eight schools equipped to deliver the modernized curricula
- 2018 – Fifteen curricula developed and at least 250 teachers trained to deliver teaching based on learning outcomes
- 2019 – Twenty curricula developed and at least 350 teachers trained to deliver teaching based on learning outcomes

Fiscal impact:

2017 – EUR 184,560 from the budget and EUR 706,906.83 from IPA

2018 – EUR 246,080 from the budget

2019 – EUR 270,000 from the budget and EUR 650,000 from IPA (for 2018 and 2019)

Expected impact on competitiveness: A competitive labour force with professional and key competences, is equipped for lifelong learning and mobility, it adapts better to labour market changes, which influences the quality of life of every individual and is the basis for economic growth.

Expected social outcome of the measure: A labour force with qualifications that the labour market needs and with skills developed through work, on the work place, with the active involvement of employers in the assessment of students' achievements, developed in cooperation with partners, guarantees better employability.

Potential risks in implementation of the measure: No risks are identified at this stage in implementation of the measure.

Priority reform measure No. 18: Alignment of higher education with labour market needs

Short description of the measure: Harmonization of the supply and demand of people with higher education in the labour market is a challenge and primary task which has been set before the relevant ministries, higher education institutions and all relevant institutions. Results of implementation of measures and planned activities in the field of education are aimed at bridging the gap between supply and demand as well as increasing youth employment. In this regard, the Higher Education Development Strategy 2016–2020 envisages, among other things, the following priority areas for the development of higher education: reform of the study model of and the development and optimization of study programmes, improvement of the quality of teaching process as well as teaching staff, introduction of a proper financing model for higher education and establishment of mechanisms to assess student advancement.

This measure is relevant for the implementation of Development Directions for Montenegro 2015–2018 as well as the SEE 2020 Strategy.

In future, efforts should be made for further strengthening of the cooperation between higher education institutions and employers and for providing practical training of students. The funding is vital for a proper functioning of higher education system; hence, the Government has opted for contract-based funding model.

Timetable by year:

- 2017 – Implementation of the Programme of Professional Training for University Graduates; implementation of the reformed 3+2+3 model of studies at the University of Montenegro; Analysis of Tracer Study.
- 2018 – Implementation of a new model for higher education financing (contract-based funding model between the University of Montenegro and the Government of Montenegro).
- 2019 – Assessing the impact of the new financing model on the quality of work of higher education institutions as regards the quality of teaching and research, and the reformed 3+2+3 model of studies at the University of Montenegro.

Fiscal impact:

- 2017 – EUR 8 million from the budget
- 2018 – EUR 5 million from the budget
- 2019 – EUR 5 million from the budget

Expected impact on competitiveness: Implementation of this measure will result in better offer of study programmes based on learning outcomes and adequate enrolment policy. Increasing youth employment will influence an overall GDP increase and reduced budget allocations for the unemployed, which will, in turn, result in overall economic growth. This is also in a function for the implementation of Recommendation No. 6 from the ministerial meeting in Brussels in May 2016.

The expected social outcome of the measure: Implementation of these measures will result in the production of high-quality l employees and occupations that are in demand on the labour market, which will impact reduction of unemployment.

Potential risks in implementing the measure: Potential risks may be caused by: inconsistencies in conducting of enrolment policy; a lack of cooperation between higher education institutions and employers; failing to follow the trend of supply and demand in the labour market; and ignoring the results of the Tracer Study and reports on the results of the Programme of Professional Training for University Graduates.

4.3.8 Employment and labour market

Diagnosis: The current situation in the labour market indicates that challenges related to low employment and high inactivity of the labour force, long-term unemployment, a structural mismatch between supply and demand, a high rate of unemployment, especially among young people and women still persist, indicating a lack of labour market flexibility.

The lack of labour market flexibility, as a precondition for higher employment, stems from certain provisions of the Labour Law, specifically, the limited duration of part-time employment contracts (up to 24 months), lengthy disciplinary proceedings and restrictions applicable to cancelling employment contracts. Although the 2011 amendments to the Labour Law introduced additional flexibility in terms of the duration of part-time employment contracts up to 24 months, data shows that this provision is in need of further improvement. According to the data from the 2011 Labour Force Survey, the share of part-time employment contracts was 18.1% compared to 30.2% in 2015.

On the other hand, the new social policy provision, which has allowed an early exit from the labour market for certain categories of women, poses an additional challenge. The Law amending the Law on Social and Child Protection made in 2015, stipulates that certain categories of women with three or more children are entitled to a lifetime benefit, which goes against the objective of greater activation and employment in the labour market, particularly for women. This leads to the inactivation of the population that is able to work, which has direct implications on the labour market and the social protection system. It encourages fictitious unemployment on one hand, and working in the grey economy on the other.

At the same time, the Montenegrin pension system is in transition, because its reform carried out in 2011 enabled a long transition period for the gradual equalization of women and men in terms of pension entitlements, gradually increasing the age limit for old-age pensions to 67 years by 2025 for men and by 2042 for women (see Section 4.3.9).

These challenges must be addressed through concerted action in the systems that regulate labour market supply and demand, and entry and exit from the labour market, particularly in the provisions regulating the labour market and social protection. In parallel, it is necessary to strengthen active labour market measures, as short-term measures for striking a balance between supply and demand. This should enable better labour market efficiency towards greater activation, higher employment rates, especially for women, the reduction of undeclared work, the strengthening of social dialogue and the protection of labour rights, together with fostering inclusiveness and equal opportunities.

Report on the implementation of policy guidelines from May 2016, if relevant to the given area: In order to improve labour market participation of the long-term unemployed, of women and of young people, in accordance with the recommendation of the ministerial meeting in Brussels in May 2016, active labour market measures are implemented in continuity through various programmes aimed at special target groups of the unemployed (public works, education and training programmes, and stimulation of entrepreneurship). The limited availability of funding for active labour market measures implemented through the Employment Agency, which annually covers around 3,250 unemployed people, or about 8.8% of the total number (2015 data), should be noted.

The Internship Programme for University Graduates engages on average 3,500 registered unemployed graduates in nine-month-long professional training. Approximately 900 people with disabilities, i.e. 40.64% of the total number of registered unemployed people with disabilities, are included on average in professional rehabilitation and employment activities each year. Hence, 18% of the unemployed are covered by some form of activation measures.

The work of the inspection services, primarily the Labour Inspection, contributes to higher employment and a reduction in fictitious unemployment. Their primary task is to curb informality in the labour market, and unregistered labour as one of its forms, and to ensure occupational health and safety. Between January and September 2016, a total of 34 labour inspectors carried out 8,268 checks, of which 5,353 were regular checks, 1,635 follow-ups, and 1,280 based on reports. The most commonly reported irregularities relate to: unregistered employment (no employment contract or no payment of mandatory social insurance, foreigners without residence and work permits or a work registration certificate); delayed payment of salaries and related contributions; non-issuance of pay cheques; denial of the right to weekly rest and annual leave; failure to record and pay extra for working during public and other holidays; unpaid overtime; non-compliance with occupational health and safety requirements. The following data is illustrative of the results achieved by labour inspectors: out of 1,771 unregistered workers found during checks, 686 (of which 439 were Montenegrin citizens and 247 were foreigners) obtained regular employment under the Labour Law and the Law on Foreigners. As for occupational health and safety, the work of the Labour Inspectorate helped improve work conditions to prevent injuries, occupational hazards and work-related diseases, providing for the full physical and psychological protection of workers.

Priority reform plans: In accordance with the above, with the aim of better regulation of labour market supply and demand and greater market flexibility, one of the planned measures is the adoption of the new Labour Law, whose draft version has been prepared and which provides a basis for further negotiation with social partners. The issues noted in the diagnosis section will also be put up for discussion. At the same time, a new Law on Employment and Unemployment Insurance Entitlements is being drafted, which will revise the system of unemployment benefits and active labour market measures. In this area, special attention will be focused on unemployment benefits in terms of reviewing the criteria for entitlement to unemployment benefit, its amount and duration. As for active labour market measures, priority will be given to, among other things, the activation of welfare beneficiaries.

In addition, the focus will be on grant schemes, as a priority reform measure from the previous year, which will aim at supporting education and training programmes to increase the employability of the unemployed, particularly the long-term unemployed, young people and women, and for the professional rehabilitation and employment of people with disabilities.

In line with the above, the 2017 ERP identifies one priority reform measure in the area of employment and labour market, which at the same time addresses the recommendations from the ministerial meeting held in Brussels in May 2016. The measure is shown below.

Priority reform measure No. 19: Amendments to statutory provisions related to the labour market

Short description of the measure: This is an administrative measure which, in reference to the obstacles identified in the situation analysis, involves the drafting of new labour market regulation. This involves the adoption of laws to increase labour market flexibility, introduce more stringent sanctions for unregistered work, better targeting of active labour market measures for both workers in risk of losing their jobs and jobseekers, and furthermore to increase market participation for different groups of jobseekers (the elderly, women, young people and welfare beneficiaries). In this regard, there is a need to draft a new Labour Law and the Law on Employment and Exercising Rights with respect to Unemployment Insurance. The measure is in support of: the National Employment and Human Resources Development Strategy 2016–2020; Development Directions for Montenegro 2015–2018; the Regional Development Strategy 2014–2020; and the SEE 2020 Strategy.

Timetable by year: The Labour Law drafting group, in cooperation with the social partners, commenced its work in 2016. They drafted the working text as the basis for further improvement and agreement on different provisions regarding part-time and open-ended contracts and removing barriers to greater labour market fluctuations. The Action Plan for Chapter 19 on Social Policy and Employment and Montenegro's 2014–2018 Programme of Accession to the EU envisage the approval of the Labour Law by the Government in Q4 2017.

On the other hand, when drafting the new Law on Employment and Exercising Rights with respect to Unemployment Insurance, apart from the renaming, new active labour market measures need to be defined, further detailed through implementing legislation, to enable the faster response of such measures to labour market needs. At the same time, the amount and duration of entitlement of unemployment benefit and the eligibility of beneficiaries need to be redefined. Montenegro's 2014–2018 EU Accession Programme schedules approval of this law by the Government in Q4 2017.

Fiscal impact: The estimated net annual impact for implementing this measure will be in excess of EUR 5.8 million from 2018, through a combination of reducing expenditures and increasing revenues stemming from new employment.

Expected impact of the measure on competitiveness increase: The impact of the measure on economic development and competitiveness may be seen from the point of view of greater flexibility and adaptability to the labour market, which is a precondition for generating new jobs as a contribution to making the business environment more conducive to both domestic and foreign business.

The expected social outcome of the measure: This will create more favourable conditions in the labour market, thus contributing to employment or reducing unemployment, which will in turn have positive ramifications on the welfare system. On the other hand, measures should be conducive to decent jobs by curbing unregistered labour and reinforcing formal employment, thus leading to better social inclusion.

Potential risks in the implementation of the measure: There are no risks for implementation of the measure. Risks exist while drafting the above legislation if there is a failure to reach an agreement between social partners in reference to specific provisions.

4.3.9 Social inclusion, poverty reduction and equal opportunities

Diagnosis: The project "Reform of the System of Social and Child Protection: Promotion of Social Inclusion" deals with upgrading the social and child protection system. During the project timeframe, the new Law on Social and Child Protection was adopted in 2013, as well as the necessary strategic documents. The Law introduced the Institute for Social and Child Protection, social inspection was organized, social welfare centres were restructured, licensing of professionals and service providers was introduced, etc.

One of the obstacles in the field of social and child protection is complicated access to services, particularly for children, people with disabilities and the elderly, as the most vulnerable groups at risk of poverty. The difficulties arise from services being underdeveloped, in spite of the relevant legislation being in place. Therefore, some measures are needed to increase the number of service providers and to make more funding available for that purpose.

As regards social and child protection, a number of strategic documents were adopted relating to the protection of children, adults with disabilities and the elderly, foster care and protection against domestic violence. In order to improve the rights of people with disabilities, the new 2016–2020 Strategy for Integration of People with Disabilities was adopted, laying down the activities to ensure their full and active participation in all spheres of social life. The Strategy for the Development of Social Protection for the Elderly covers the period 2013–2017 and upon its expiry, a new strategic document will be adopted. When it comes to the 2011–2015 Strategy for the Lasting Solution of Issues regarding Refugees and Internally Displaced Persons, with special emphasis on the Konik Camp, its continuation was not envisaged given the statutory deadline for refugees and internally displaced persons to regulate their status in Montenegro. Intensive efforts have been made to implement the strategy, with activities ongoing on solving their housing issues within an IPA project and the Regional Housing Project. The Roma and Egyptian (RE) population is particularly exposed to poverty. When it comes to their protection under the Law on Social and Child Protection and strategic documents, they exercise the same rights as all other citizens, and there are no desegregated statistics to capture their specific situation. Social inclusion of Roma and Egyptians is addressed separately in the field of minority and human rights and the separate 2016–2020 Strategy on Social Inclusion of Roma and Egyptians in Montenegro.

In addition, the current situation in the field of social and child protection points to the possibility of abuse in the process of the realization and exercise of rights through informal work, use of facilities that have not been legalized, as well as due to the failure to conduct probate proceedings or their long duration. Overcoming these challenges, which are partly within the competence of the other systems, will contribute to the improvement of social and child protection.

Data indicates that the positive trend of reducing the number of beneficiaries of cash allowances has continued, and there were 8,077 beneficiary families in September 2016, for which purpose EUR 751,915.62 was allocated, a reduction of 45.19% of families and of 43.84% of monthly allocation compared to July 2013 when the Law on Social and Child Protection entered into force and when there were 14,737 families with a monthly allocation of EUR 1,338,798.01.

The positive effects in applying the law so far were partly annulled by introducing new entitlements in the field of social and child protection.

Namely, the Law amending the Law on Social and Child Protection was adopted in 2015 ("Official Gazette of Montenegro" No. 42/15), which stipulates the right to compensation for a parent or guardian or a caregiver of a person, who is a beneficiary of personal disability benefits, and the right to compensation on the basis of giving birth to three or more children, despite the negative opinion of the Government of Montenegro. The proposer of the Law did not carry out a proper fiscal impact assessment, only provisionally citing figures of about 5,000–6,000 possible beneficiaries. From 1 January 2016, when the benefit for mothers of three or more children began to be applied, until the end of December 2016, this entitlement was recognized for 21,597 women, with approximately EUR 5.5 million being allocated for this purpose in December 2016. The annual allocation on these grounds exceeds the total amount of funds allocated altogether for social and child protection.

Amendments made to the Law in 2015 stipulate an unrealistic amount of compensation in relation to the average pension and minimum wage without establishing social protection criteria (disability, inability to work and earn, a property census and other specific characteristics of social vulnerability). Provisions are not in accordance with the provisions of the Family Law which refer to supporting a spouse and the obligation of children to support parents. The system of pension and disability insurance has been infringed, whereby a number of female beneficiaries of pensions have transferred to the usage of such benefits. The area of employment has also been infringed, because the established benefit discourages a number of women engaged in work, who have left the labour market in order to exercise the right to receive benefits, and there is also the phenomenon of a number of women in the labour market returning to the field of informal work. The provisions of the Law involve discriminatory elements, bearing in mind that women who have given birth to fewer children than prescribed by law are not included, nor are fathers in cases where they themselves raise the children. It is necessary to bear in mind that the number of users will increase continuously when meeting the requirements for exercising the rights. The possible elimination of these allowances involves the prior examination of the possible problems related to the procedure (the opinion about whether the mentioned right is a vested right in the context of other financial benefits related to social and child care), as well as problems related to the possibility of women of working age returning to the labour market.

In addition, the Law amending the Law on Social and Child Protection was adopted in August 2016 ("Official Gazette of Montenegro" No. 66/16), at the proposal of a group of MPs, without any regulatory fiscal impact assessment being carried out. The mentioned law provides that elementary or secondary school children are entitled to a child allowance, provided their parents do not receive benefits on any grounds and are registered as unemployed with the Employment Agency (Art. 42(1)(6) of the Law). The beginning of application of this law is envisaged as of 1 January 2017. No eligibility criteria are set for this entitlement, and the unemployment of parents is not *per se* a measure of the financial means of a family; rather, means testing needs to be done to see whether the given family has any other income, earnings or assets (movable or immovable) which may provide their livelihood. This child allowance was set at EUR 31.80 and cannot significantly improve the financial standing of a family.

The existing pension system also hinders competitiveness. The main objective of the pension system is the provision of the adequacy and sustainability of pension benefits. The Montenegrin pension system is in transition because its reform carried out in 2011 enabled a long transition period for the gradual equalization of women and men in terms of the conditions for entitlement to a pension and the gradual raising of the age limit for old-age pensions to 67 years (by 2025 for men and by 2042 for women).

The report on the implementation of the policy guidelines as of May 2016, if relevant for the area: The Law on Social and Child Protection, as well as the measures and activities identified in strategic documents have been continuously implemented in order to improve the system of social and child protection. In accordance with Recommendation No. 6 of the ministerial meeting in Brussels, the Government proposed amendments to the Law on Social and Child Protection in late 2016, in order to ensure more equitable distribution of social funds, and the mentioned amendments were enacted by the Parliament.

Priority reform plans: In the coming period, apart from the amendments to the Law on Social and Child Protection, the focus will be also on pension reform, focusing on the review of legal requirements that allow for an early retirement and greater equity. Future reforms in this area will be focused on preventing an early departure from the labour market and early retirement. The amendments to the Law on Social and Child Protection reduce the amount of benefits for mothers of three or more children, and postpone child allowance for primary and secondary school children whose parents do not receive benefits on any grounds and are registered as unemployed with the Employment Agency. These amendments are to be applied in 2017, and as such are seen as a priority reform measure and are presented below.

Priority Reform measure No. 20: Amendments to the Law on Social and Child Protection

Brief description of the measure: The measure is in support of: the National Employment and Human Resources Development Strategy 2016–2020; Development Directions for Montenegro 2015–2018; the Industrial Policy of Montenegro 2020; and the SEE 2020 Strategy. Social and child protection plays a vital role in terms of providing protection for the most vulnerable (especially children, people with disabilities and the elderly) by creating the legal conditions for exercising these rights. The new entitlement for mothers of three or more children has not produced positive effects. Due to the high benefit amounts, this entitlement has resulted in a number of employed women exiting the labour market, together with a number of women who were registered jobseekers. In addition, a number of women renounced their pension or welfare benefits and opted for the benefit for mothers, given that it is of a higher amount compared to other benefits.

This reform measure, which is of an administrative nature, envisages the reduction of the benefit for mothers of three or more children by 21% and 25% in nominal terms, and the postponement of application of entitlement to the allowance for children attending primary or secondary school, whose parents do not receive any benefits and are registered jobseekers, until 1 July 2017, which will result in a more rational use of funds and better targeting of beneficiaries. This is the essence of the amendments to the Law on Social and Child Protection enacted by the Parliament in late 2016 at the proposal of the Government. The measure is part of the adopted Budget Deficit and Public Debt Consolidation Plan to 2021.

Timetable by year: The provisions of the amended Law on Social and Child Protection concerning the benefit for mothers of three or more children apply from 1 January 2017, while the application of the provision on the allowance for primary and secondary school children whose parents do not receive any benefits and are registered jobseekers is postponed until 1 July 2017.

Fiscal impact: Based on December 2016 data, there were 21,597 beneficiaries of the benefit for mothers, of whom 12,767 receive EUR 193.00 as registered unemployed, and 8,830 receive EUR 336.00 on the basis of the length of their working service. The funds paid in 2016 for benefits on the grounds of giving birth to three or more children totalled EUR 54,021,220.17. Based on the processed data as of September 2016 (first three quarters) the right to benefits for mothers accounted for 1.54% of total GDP. In 2016, EUR 52,825,244.53 was paid for other rights to social and child protection. Consequently, total expenditure on social and child protection amounted to EUR 106,846,464.70, or 2.8% of estimated GDP.

Bearing in mind disadvantages of this Law presented in the diagnosis and it's pressure on country's public finance, the Government proposed measure of new amending of this Law at the end of December. By the proposed measure, the benefit equal to 70% of the average net wage (EUR 336.00) is reduced to the amount of EUR 264.00, and the benefit equal to 40% of the average net wage (EUR 192.00) is reduced to the amount of EUR 144.00. For the category which has been reduced from EUR 336 to EUR 264 (by 21% nominally), an annual savings will amount to EUR 7.63 million in 2017 (i.e. reducing expenditure from EUR 35.60 million to EUR 27.97 million), while for the latter (reduced from EUR 193.000 to EUR 144.00 or 25% nominally), the annual savings would amount to EUR 7.35 million (reducing expenditure from EUR 29.41 million to EUR 22.06 million in 2017). The estimate in the Consolidation Plan is that budget expenditure, based on above mentioned, will decrease by EUR 14.90 million.

The fiscal impact of postponing the application of the provisions on the allowance for children whose parents are registered unemployed until 1 July 2017 is in the region of EUR 900,000.

Hence, the total impact of this measure will be to cut budget expenditure by EUR 15.80 million in 2017.

Expected impact on competitiveness: This measure will have a positive impact on the labour market in terms of reducing the interest of women, who are able to work, in reduced maternal benefits, with some of the current beneficiaries returning to the labour market. In addition, it will contribute to a reduction in the informal economy and the strengthening of fiscal stability as well as the enhancement of competiveness in general.

The expected social outcome of the measure: It will have a positive impact on the labour market, resulting in increased employment and more equitable distribution of social assistance funds.

Potential risks in implementing the measure: A lack of job creation, which would enable the beneficiaries who are able to work to get employment; insufficient and inadequate incentives for formalizing informal work.

5 BUDGET IMPLICATIONS OF STRUCTURAL REFORMS

In line with the EC Guidance on the ERP, this chapter shows the total direct impacts of priority structural reforms on budgetary revenues and expenditures in 2017, and their estimated impacts in 2018 and 2019. The direct fiscal impact of the 20 priority reform measures is given in Table 10 of the Annex. Any priority reform measure that increases budgetary expenditures is marked with a minus (−) sign, and if it increases revenues or has a positive net impact, it is marked with a plus (+) sign. Based on Table 10 with the direct fiscal impacts of each of the 20 priority structural reforms, the budget implications of the priority reform measures envisaged for 2017 are given below.

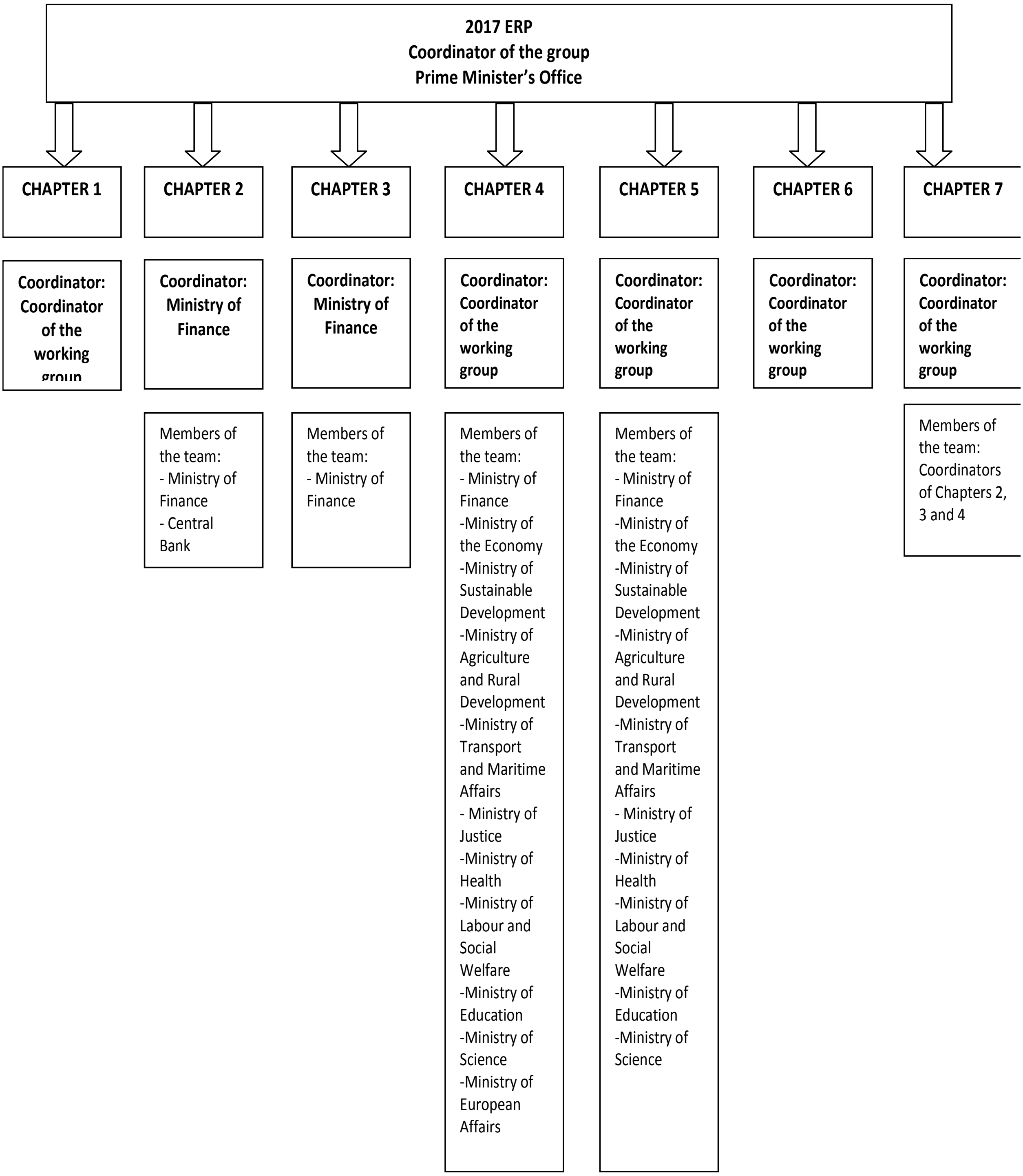
In line with the above, by far the largest increase in budgetary expenditures will be accounted for by the construction of the Smokovac–Mateševo priority section of the highway. On the other hand, in 2017 the largest impact on budget expenditures will stem from implementation of the amended Law on Social and Child Protection, leading to savings of EUR 15.8 million.

Structural reforms will also have an impact on budget revenues, most often by increasing revenues, for instance the introduction of electronic fiscal invoices to curb the informal economy. The increase in budget revenues due to this structural reform/measure is shown by the presence of a plus (+) sign, although its impact will only be felt in 2018.

Based on the above, the net direct impact of the 20 priority reform measures referred to in Chapter 4 of the 2017 ERP will be EUR 352.9 million (including direct budget expenditure, loans, IPA funds and others) which means that this amount is equal to the increase in total expenditure of implementation of the measures. In 2018 and 2019, bearing in mind the pace of construction of large infrastructural projects, the net direct impact on expenditure will be EUR 637.4 million in 2018 and EUR 365.0 million in 2019.

6 INSTITUTIONAL MATTERS AND INVOLVEMENT OF INTERESTED PARTIES

The process of preparing the Economic Reform Programme in Montenegro begins with the adoption of the Government's Decision to establish a team to prepare the Economic Reform Programme for the current year. In this way, on 1 September 2016 the Government adopted the Decision for establishing a working team to prepare the 2017 ERP. National coordination of the ERP, coordination of the chapters and institutions whose representatives participated in the preparation of the 2017 ERP are shown in the following chart:



The need for public debate has stemmed not only from the obligations that the European Commission required through the Guidelines, but also because of the consensus of government bodies that the quality of documents depends largely on the contributions of all stakeholders to the final text. The draft document was therefore the subject of a consultation process with interested parties in the period from 13–23 January 2017, and during the reporting period the draft was available to the media and the general public on the website of the Government. The draft document (http://www.gov.me/vijesti/168403/Objavljen-Nacrt-programa-ekonomskih-reformi-2017-2019.html) was made available, on the basis of a notification from the Government to all media at the beginning of a public debate on the draft text of the 2017–2019 ERP, in several print media and television companies.

The document was the subject of consideration at a meeting of the Parliamentary Committee for the Economy, Finance and Budget, held on 18 January 2017, when Members of Parliament had very constructive comments and suggestions to improve the content of the document (see Annex 2 of the document). A significant number of the comments of MPs have been recognized and included in the document for the purpose of its finalization.

Subsequently, on 20 January 2017, a roundtable discussion was held within the framework of the consultative process with stakeholders and was attended by representatives of employers' associations, the Chamber of Commerce of Montenegro, labour unions, representatives of non-government organizations, the Central Bank, the University of Montenegro, Mediterranean University, the Union of Municipalities of Montenegro and relevant departments in the Government. Details on the discussions at the public hearing are included in Annex 2. A significant number of the comments from the public discussion have been recognized with the aim of improving the document.

Upon the receipt of all the contributions and overall suggestions during the consultation process, and improvements to the text of the 2017 ERP, the document was finalized and submitted for further consideration and adoption by the Government of Montenegro.

7 SUMMARY DATA

ANNEX 1: TABLES TO BE CONTAINED IN THE ECONOMIC REFORM PROGRAMMES AND THEIR UPDATES

Table 1a: Macroeconomic prospects

Percentages unless otherwise indicated	ESA Code	Year 2015	Year 2015	Year 2016	Year 2017	Year 2018	Year 2019
		Level (mill EUR)	**Rate of change**				
1. Real GDP at market prices	B1*g	3,420.385	3.3	2.4	3.2	4.3	2.6
2. Current GDP at market prices	B1*g	3,457.922	4.9	2.9	5.3	6.3	4.3
Components of real GDP							
3. Private consumption expenditure	P3	2,801.576	2.2	3.7	-1.3	1.0	1.4
4. Government consumption expenditure	P3	663.923	1.9	1.2	-1.7	-1.5	-0.6
5. Gross fixed capital formation	P51	660.887	11.9	28.1	19.6	9.8	0.3
6. Changes in inventories and net acquisition of valuables (% of GDP)	P52+P53	13.769	-57.9	-100.0	:	:	:
7. Exports of goods and services	P6	1,380.185	5.7	8.0	2.4	1.8	2.0
8. Imports of goods and services	P7	2,099.955	4.5	16.7	2.2	-0.4	-1.2
Contribution to real GDP growth							
9. Final domestic demand		4,126.4	4.4	8.9	3.6	3.3	1.0
10. Change in inventories and net acquisition of valuables	P52+P53	13.8	-0.7	:	:	:	:
11. External balance of goods/services	B11	-719.8	-0.4	-6.8	-0.4	1.0	1.6

Table 1b: Price developments

Percentage changes. annual averages	ESA Code	Year 2015	Year 2016	Year 2017	Year 2018	Year 2019
1. GDP deflator		1.5	0.5	2.1	1.9	1.7
2. Private consumption deflator		1.2	-0.4	2.2	2.0	1.7
3. HICP		1.9	:	:	:	:
4. National CPI change		2.2	-1.9	2.6	-0.2	-0.3
5. Public consumption deflator		2.8	5.7	1.5	1.5	1.5
6. Investment deflator		0.1	-0.5	1.5	1.5	1.5
7. Export price deflator (goods & services)		4.9	-3.9	1.5	1.5	1.5
8. Import price deflator (goods & services)		2.1	-2.3	1.4	1.4	1.4

Table 1c: Labour markets developments

	ESA Code	Year 2015	Year 2015	Year 2016	Year 2017	Year 2018	Year 2019
		Level	Level/Rate of change				
1. Population (thousands)			622.2	623.1	623.9	624.8	625.6
2. Population (growth rate in %)			0.1	0.2	0.1	0.1	0.1
3. Working-age population (persons)[34]			268.9	:	:	:	:
4. Participation rate			53.7	:	:	:	:
5. Employment. persons [35]			221.7	223.9	228.4	230.7	231.8
6. Employment. hours worked[36]			:	:	:	:	:
7. Employment (growth rate in %)			2.5	1.0	2.0	1.0	0.5
8. Public sector employment (persons)			:	:	:	:	:
9. Public sector employment (growth in %)			:	:	:	:	:
10. Unemployment rate [37]			55.7	:	:	:	:
11. Labour productivity. persons[38]		16116.1	0.8	1.3	1.1	3.3	2.1
12. Labour productivity. hours worked[39]			:	:	:	:	:
13. Compensation of employees	D1	2.1	2.8	5.0	2.5	3.0	2.5

Table 1d: Sectoral balances

Percentages of GDP	ESA code	Year 2015	Year 2016	Year 2017	Year 2018	Year 2019
1. Net lending/borrowing vis-à-vis the rest of the world	B.9	-15.2	-13.3	-21.0	-20.8	-18.8
of which:						
- Balance of goods and services		-19.8	-18.6	-24.8	-24.3	-22.1
- Balance of primary incomes and transfers		4.6	5.3	3.9	3.5	3.4
- Capital account		0.0	0.0	0.0	0.0	0.0
2. Net lending/borrowing of the private sector	B.9/ EDP B.9	-6.9	-9.5	-14.9	-15.2	-15.0
3. Net lending/borrowing of general government		-8.3	-3.8	-6.1	-5.5	-3.8
4. Statistical discrepancy		0.0	0.0	0.0	0.0	0.0

Table 1e: GDP. investments and gross value added

	ESA Code	Year 2015	Year 2016	Year 2017	Year 2018	Year 2019
GDP and investment						
GDP *level* at *current* market prices (in domestic currency)	B1g	3625.6	3729.5	3928.5	4176.9	4357.8
Investment ratio (% of GDP)		20.3	25.2	29.0	30.4	29.7
Growth of Gross Value Added. percentage changes at constant prices						
1. Agriculture		2.1	2.0	4.0	4.0	4.0
2. Industry (excluding construction)		0.7	-4.6	4.3	5.3	3.2
3. Construction		4.7	30.0	25.0	6.0	5.9
4. Services		4.6	2.0	3.3	3.3	2.3

[34] Age group of 16-64 years

[35] Occupied population, domestic concept national accounts definition

[36] National accounts definition

[37] Harmonised definition, Eurostat; levels

[38] Real GDP per person employed

[39] Real GDP per hour worked

Table 1f: External sector developments

Billion Euro unless otherwise indicated		Year 2015	Year 2016	Year 2017	Year 2018	Year 2019
1. Current account balance (% of GDP)	% of GDP	-13.3	-21.0	-20.8	-18.8	-16.9
2. Export of goods	Mill.€	325.2	346.7	360.6	367.8	378.8
3. Import of goods	Mill.€	1.787.9	2.002.4	2.082.5	2.103.4	2.103.4
4. Trade balance	Mill.€	-1.462.7	-1.655.8	-1.722.0	-1.735.6	-1.724.6
5. Export of services	Mill.€	1.213.9	1.250.1	1.299.8	1.347.3	1.396.8
6. Import of services	Mill.€	424.7	520.9	531.3	536.7	542.0
7. Service balance	Mill.€	789.2	729.2	768.4	810.7	854.8
8. Net interest payments from abroad	Mill.€	92.8	35.6	29.9	30.5	24.0
9. Other net factor income from abroad	Mill.€	0.0	0.0	0.0	0.0	0.0
10. Current transfers	Mill.€	98.8	109.0	108.4	109.8	110.1
11. Of which from EU	Mill.€	:	:	:	:	:
12. Current account balance	Mill.€	-481.9	-781.9	-815.2	-784.6	-735.7
13. Capital and financial account	Mill.€	160.2	:	:	:	:
14. Foreign direct investment	Mill.€	619.3	:	:	:	:
15. Foreign reserves	Mill.€	-125.7	:	:	:	:
16. Foreign debt	Mill.€	:	:	:	:	:
17. Of which: public	Mill.€	:	:	:	:	:
18. O/w: foreign currency denominated	Mill.€	:	:	:	:	:
19.O/w: repayments due	Mill.€	:	:	:	:	:
20. Exchange rate vis-à-vis EUR (end-year)	NCU/EUR	1.0	1.0	1.0	1.0	1.0
21. Exchange rate vis-à-vis EUR (annual average)	NCU/EUR	1.0	1.0	1.0	1.0	1.0
22. Net foreign saving	% of GDP	:	:	:	:	:
23. Domestic private saving	% of GDP	:	:	:	:	:
24. Domestic private investment	% of GDP	:	:	:	:	:
25. Domestic public saving	% of GDP	:	:	:	:	:
26. Domestic public investment	% of GDP	:	:	:	:	:

Table 1g: Sustainability indicators

	Dimension	Year 2012	Year 2013	Year 2014	Year 2015	Year 2016
1. Current Account Balance	% of GDP	-18.5	-14.5	-15.2	-13.3	-21.0
2. Net International Investment Position	% of GDP	:	:	:	:	:
3. Export market shares	%. yoy	:	:	:	:	:
4. Real Effective Exchange Rate[40]	%. yoy	:	:	:	:	:
5. Nominal Unit Labour Costs	%. yoy	10.7	-8.0	9.8	-8.1	5.4
6. Private sector credit flow	% of GDP	:	:	:	:	:
7. Private sector debt	% of GDP	:	:	:	:	:
8. General Government Debt	% of GDP	:	:	51.8	57.0	57.0

[40] Please explain the methodology used (deflators, trade weighing, etc)

Table 2a: General government budgetary prospects

	ESA code	Year 2015	Year 2015	Year 2016	Year 2017	Year 2018	Year 2019
		€ Mill.	% of GDP				
Net lending (B9) by sub-sectors							
1. General government	S13	-302.7	-8.3	-3.8	-6.1	-5.5	-3.8
2. Central government	S1311	-276.1	-7.6	-3.5	-6.0	-5.5	-3.9
3. State government	S1312	:	:	:	:	:	:
4. Local government	S1313	11.0	0.3	-0.4	-0.1	-0.1	0.1
5. Social security funds	S1314	:	:	:	:	:	:
General government (S13)							
6. Total revenue	TR	1,525.8	42.1	45.1	44.8	43.9	42.9
7. Total expenditure[41]	TE	1,828.6	50.4	49.0	50.8	49.4	46.7
8. Net borrowing/lending	EDP.B9	-302.7	-8.3	-3.8	-6.1	-5.5	-3.8
9. Interest expenditure	EDP.D41 incl. FISIM	86.2	2.4	2.2	2.6	2.3	2.4
10. Primary balance[42]		-216.5	-6.0	-1.7	-3.5	-3.3	-1.4
11. One-off and other temporary measures[43]		:	:	:	:	:	:
Components of revenues							
12. Total taxes (12 = 12a+12b+12c)		842.5	23.2	24.5	25.0	24.6	24.2
12a. Taxes on production and imports	D2	650.0	17.9	18.8	19.3	19.1	18.8
12b. Current taxes on income and wealth	D5	177.9	4.9	5.3	5.3	5.1	5.0
12c. Capital taxes	D91	14.6	0.4	0.4	0.4	0.4	0.4
13. Social contributions	D61	437.3	12.1	12.5	12.5	12.1	11.8
14. Property income	D4	76.0	2.1	2.1	2.0	1.9	1.9
15. Other (15 = 16-(12+13+14))[44]		170.1	4.7	6.1	5.2	5.4	5.0
16 = 6. Total revenue	TR	1,525.8	42.1	45.1	44.8	43.9	42.9
p.m.: Tax burden (D2+D5+D61+D91-D995)[45]		1,279.7	35.3	37.0	37.5	36.6	36.0
Selected components of expenditures							
16. Collective consumption	P32	:	:	:	:	:	:
17. Total social transfers	D62 + D63	487.9	13.5	15.5	14.6	13.9	13.6
17a. Social transfers in kind	P31 = D63	:	:	:	:	:	:
17b. Social transfers other than in kind	D62	487.9	13.5	15.5	14.6	13.9	13.6
18 = 9. Interest expenditure (incl. FISIM)	EDP.D41 + FISIM	86.2	2.4	2.2	2.6	2.3	2.4
19. Subsidies	D3	20.3	0.6	0.7	0.7	0.6	0.6
20. Gross fixed capital formation	P51	296.6	8.2	5.0	9.0	10.0	8.4
21. Other (21 = 22-(16+17+18+19+20)[46]		937.5	25.9	25.6	23.9	22.6	21.6
22. Total expenditures	TE [1]	1,828.6	50.4	49.0	50.8	49.4	46.7
p.m. compensation of employees	D1	:	:	:	:	:	:

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

[42] The primary balance is calculated as (EDP B.9, item 8) plus (EDP D.41, item

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

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

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

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

Table 2b: General government budgetary prospects

	ESA code	Year 2015	Year 2016	Year 2017	Year 2018	Year 2019
		Mill.€				
Net lending (B9) by sub-sectors						
1. General government	S13	-302.7	-143.2	-238.2	-231.5	-164.6
2. Central government	S1311	-276.1	-129.6	-233.8	-229.1	-170.1
3. State government	S1312	:	:	:	:	:
4. Local government	S1313	11.0	-13.6	-4.4	-2.4	5.6
5. Social security funds	S1314	:	:	:	:	:
General government (S13)						
6. Total revenue	TR	1525.8	1.683.7	1.758.0	1.833.0	1.868.6
7. Total expenditure[47]	TE	1.828.6	1.826.8	1.996.2	2.064.5	2.033.2
8. Net borrowing/lending	EDP.B9	-302.7	-143.2	-238.2	-231.5	-164.6
9. Interest expenditure	EDP.D41 incl. FISIM	86.2	81.4	101.4	95.4	104.2
10. Primary balance[48]		-216.5	-61.8	-136.8	-136.1	-60.4
11. One-off and other temporary measures[49]		:	:	:	:	:
Components of revenues						
12. Total taxes (12 = 12a+12b+12c)		842.5	913.9	982.4	1025.4	1052.8
12a. Taxes on production and imports	D2	650.0	701.0	759.7	796.6	818.0
12b. Current taxes on income and wealth	D5	177.9	199.4	208.1	213.8	219.4
12c. Capital taxes	D91	14.6	13.5	14.7	15.0	15.3
13. Social contributions	D61	437.3	464.3	492.2	504.6	515.6
14. Property income	D4	76.0	76.5	77.7	79.2	80.8
15. Other (15 = 16-(12+13+14))[50]		170.1	228.9	205.8	223.7	219.4
16 = 6. Total revenue	TR	1525.8	1683.7	1758.0	1833.0	1868.6
p.m.: Tax burden (D2+D5+D61+D91-D995)[51]		1279.7	1378.2	1474.6	1530.0	1568.4
Selected components of expenditures						
16. Collective consumption	P32	:	:	:	:	:
17. Total social transfers	D62 + D63	487.9	578.6	574.2	581.1	590.9
17a. Social transfers in kind	P31 = D63	:	:	:	:	:
17b. Social transfers other than in kind	D62	487.9	578.6	574.2	581.1	590.9
18 = 9. Interest expenditure (incl. FISIM)	EDP.D41 + FISIM	86.2	81.4	101.4	95.4	104.2
19. Subsidies	D3	20.3	27.7	25.9	26.5	27.5
20. Gross fixed capital formation	P51	296.6	185.5	354.2	418.8	367.9
21. Other (21 = 22-(16+17+18+19+20)[52]		937.5	953.5	940.6	942.7	942.7
22. Total expenditures	TE [1]	1828.6	1826.8	1996.2	2064.5	2033.2
p.m. compensation of employees	D1	:	:	:	:	:

47 Adjusted for the next flow of swap-related flows, so the TR-TE = EDP.B9.

48 The primary balance is calculated as (EDP B.9, item 8) plus (EDP D.41, item 8

49 A plus sign means deficit-reducing one-off measures

50 P.11+P.12+P.131+D.39+D.7+D.9 (other than D.91).

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

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

Table 3: General government expenditure by function

% of GDP	COFOG Code	Year 2015	Year 2016	Year 2017	Year 2018	Year 2019
1. General public services	1	27.6	23.4	17.9	16.4	24.1
2. Defence	2	1.1	1.1	1.1	1.3	1.2
3. Public order and safety	3	3.6	3.8	3.6	3.4	3.3
4. Economic affairs	4	8.7	5.0	9.3	9.7	8.2
5. Environmental protection	5	0.1	0.1	0.1	0.1	0.1
6. Housing and community amenities	6	0.2	0.1	0.1	0.1	0.1
7. Health	7	5.9	6.2	5.1	4.8	4.6
8. Recreation. culture and religion	8	1.1	1.2	1.1	1.0	1.0
9. Education	9	4.5	4.8	4.4	4.2	4.0
10. Social protection	10	13.4	15.1	14.5	13.8	13.5
11. Total expenditure (item 7 = 23 in Table 2)	TE	50.4	49.0	50.8	49.4	46.7

Table 4: General government debt developments

% of GDP	ESA code	Year 2015	Year 2016	Year 2017	Year 2018	Year 2019
1. Gross debt[53]		65.7	66.6	71.6	74.9	77.5
2. Change in gross debt ratio		6.8	0.9	5.0	3.3	2.6
Contributions to change in gross debt						
3. Primary balance[54]		5.97	1.7	3.5	3.3	1.4
4. Interest expenditure[55]	EDP D.41	2.38	2.2	2.6	2.3	2.4
5. Stock-flow adjustment		-1.5	-2.9	-1.1	-2.2	-1.2
of which:						
- Differences between cash and accruals[56]		:	:	:	:	:
- Net accumulation of financial assets[57]		:	:	:	:	:
of which:						
- Privatisation proceeds		:	:	:	:	:
- Valuation effects and other [58]		:	:	:	:	:
p.m. implicit interest rate on debt[59]		4.2	3.4	4.1	3.4	3.3
Other relevant variables						
6. Liquid financial assets[60]		:	:	:	:	:
7. Net financial debt (7 = 1 - 6)		:	:	:	:	:

53 As defined in Regulation 3605/93 (not an ESA concept).

54 Cf. item 10 in Table 2.

55 Cf. item 9 in Table 2.

56 The differences concerning interest expenditure, other expenditure and revenue could be distinguished when relevant.

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

58 Changes du to exchange rage movement, and operation in secondary market could be distinguished when relevant.

59 Proxied by interest expenditure (incl. FISIM recorded as consumption) divided by the debt level of the previous year.

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

Table 5: Cyclical developments

% of GDP	ESA Code	Year 2015	Year 2016	Year 2017	Year 2018	Year 2019
1. Real GDP growth (%. yoy)	B1g	3.3	2.4	3.2	4.3	2.6
2. Net lending of general government	EDP.B.9	-8.3	-3.8	-6.1	-5.5	-3.8
3. Interest expenditure	EDP.D.41	2.4	2.2	2.6	2.3	2.4
4. One-off and other temporary measures[61]		:	:	:	:	:
5. Potential GDP growth (%. yoy)		:	2.7	2.7	2.7	2.6
Contributions:						
- labour		:	:	:	:	:
- capital		:	:	:	:	:
- total factor productivity		:	:	:	:	:
6. Output gap		:	:	:	:	:
7. Cyclical budgetary component		:	-7.3	-0.4	-4.1	-4.8
8. Cyclically-adjusted balance (2-7)		:	3.5	-5.6	-1.4	1.0
9. Cyclically-adjusted primary balance (8+3)		:	5.7	-3.0	0.9	3.4
10. Structural balance (8-4)		:	:	:	:	:

Table 6: Divergence from previous programme

	Year 2015	Year 2016	Year 2017	Year 2018	Year 2019
1. GDP growth (%. yoy)					
Previous programme	4.3	4.1	4.0	3.0	:
Latest update	3.3	2.4	3.2	4.3	2.6
Difference (percentage points)	-1.0	-1.7	-0.8	1.3	:
2. General government net lending (% of GDP)					
Previous programme	-6.5	-6.1	-6.1	-5.3	:
Latest update	-8.3	-3.8	-6.1	-5.5	-3.8
Difference	-1.8	2.3	0.0	-0.2	:
3. General government gross debt (% of GDP)					
Previous programme	64.0	68.42	71.48	73.42	:
Latest update	65.7	66.6	71.6	74.9	77.5
Difference	1.7	-1.8	0.1	1.5	:

61 A plus sign means deficit-reducing one-off measures.

Table 7a: General government guarantees

% of GDP	Year 2016	Year 2017
Public guarantees	10.0	:
Of which: linked to the financial sector	1.3	:

Table 8: Basic assumption on the external economic environment[62]

	Dimension	Year 2015	Year 2016	Year 2017	Year 2018	Year 2019
Short-term interest rate	Annual average	:	-0.3	-0.3	-0.3	:
Long-term interest rate	Annual average	:	0.1	0.2	0.3	:
USD/EUR exchange rate	Annual average	:	1.1	1.1	1.1	:
Nominal effective exchange rate	Annual average	:	:	:	:	:
Exchange rate vis-à-vis the EUR	Annual average	:	:	:	:	:
Global GDP growth. excluding EU	Annual average	3.1	2.9	3.4	3.4	:
EU GDP growth	Annual average	2.2	1.8	1.7	1.8	:
Growth of relevant foreign markets	Annual average	1.8	:	1.6	3.0	3.3
World import volumes. excluding EU	Annual average	1.4	1.3	3.2	3.3	:
Oil prices (Brent. USD/barrel)	Annual average	:	45.2	54.7	56.8	:

62 If necessary, purely technical assumption.

Tabela 9: Odabrani socijalni i pokazatelji zapošljavanja[63]

	Izvor podataka[64]	2013	2014	2015	2016	2017
Labour market participation rate (%) total (pls indicate age bracket)	e	50.1	52.7	53.7		
- male	e	56.8	59.5	60.1		
- female	e	43.6	46.2	47.6		
2.Employment rate (%) total (please indicate age bracket)	e	40.3	43.2	44.3		
-male	e	45.4	48.9	49.4		
- female	e	35.4	37.8	39.4		
3. Unemployment rate (%) total (please indicate age bracket)	e	19.5	18.0	17.6		
-male	e	20.0	17.8	17.7		
- female	e	18.8	18.2	17.3		
4. Long-term unemployment rate (%) total	e	16.0	14.0	13.6		
-male	e	16.8	13.8	13.6		
- female	e	15.1	14.1	13.3		
5. Youth unemployment (15-24 yrs) rate (%) total	e	41.6	35.8	37.6		
-male	e	(43.8)	(36.0)	(39.9)		
- female	e	38.5	35.4	34.5		

[63] Imajući u vidu različitu dostupnost podataka i brojne definicije koje se koriste za pokazatelje, zemlje treba da koriste podatke Eurostata kada su oni dostupni. U slučaju da su podaci iz nacionalnih ili međunarodnih izvora, treba dodati fusnotu za svaki pokazatelj koja označava na koji način se on definiše. U slučaju da za neki od pokazatelja ne postoje podaci, molimo provjerite da li su bilo koji podaci dostupni za sličan pokazatelj i obrazložite. Preporučuje se da godina X=2015. U slučaju da ne postoje podaci za 2015., podaci dostupni za prethodne godine (2014., 2013.) unose se u odgovarajuće kolone. Za sve pokazatelje vrjednosti se unose u tabelu, ne godišnja promjena vrijednosti kao kod nekih drugih tabela.

[64] Za pokazatelje označene „e“, pokazatelji Eurostata bi trebalo da budu dostupni za sve zemlje kandidate.

6. Young people (please indicate the age bracket of the available figures) not in employment. education or training (NEET). in %		17.8 za (15-24) i 23.2 za (15-29)	17.7 za (15-24) i 22.6 za (15-	19.1 za (15-24) i 23.4 za (15-29)		
7. Early school leavers. in % (Eurostat definition)	e	5.1	5.1	5.7		
8. Participation rate in early childhood Education and care						
9. GINI coefficient		26.2				
10. Inequality of income distribution S80/S20	e	4.3				
11. Social protection expenditure in % of GDP	e					
12. Health expenditure in % of GDP	e					
13. At-risk-of-poverty before social transfers. % of the population	e					
14. Poverty rate (Please indicate which data are available for your country)		8.6				
15. Poverty gap (Please indicate which data are available for your country)		2.4				

Table 10: Matrix of policy commitments65

	2016	2017	2018	2019
	Priority reform measure No. 1: Introduction of the e-procurement system			
A. Duration of the reform*	x	x	x	x
B. Net direct budgetary impact (if any) (in €)	-60,000	-700,000	-70,000	-10,000
B.1 Direct impact on budgetary revenue (in €)				
B.2 Direct impact on budgetary expenditure (in €)	-60,000	-70,000	-70,000	-10,000
B.3 Possible non-budgetary financing (in €)		-909,000	-591,000	
- B.3.1 Of which committed IPA funding including WBIF funding (in €)		-909,000	-591,000	
	Priority reform measure No. 2: Strengthening of managerial responsibility in the public sector			
A. Duration of the reform*	x	x	x	x
B. Net direct budgetary impact (if any) (in €)		-2,500	-1,000	-1,000
B.1 Direct impact on budgetary revenue (in €)				
B.2 Direct impact on budgetary expenditure (in €)		-2,500	-1,000	-1,000
B.3 Possible non-budgetary financing (in €)		22,500	9,000	9,000
- B.3.1 Of which committed IPA funding including WBIF funding (in €)				
	Priority reform measure 3: Construction of the undersea cable between Montenegro and Italy with transmission infrastructure in the country and interconnection with Serbia			
A. Duration of the reform*	x	x	x	x
B. Net direct budgetary impact (if any) (in €)	-85,000,000			
B.1 Direct impact on budgetary revenue (in €)				
B.2 Direct impact on budgetary expenditure (in €)	-85,000,000			
B.3 Possible non-budgetary financing (in €)	30,000,000	29,000,000	18,000,000	4,700,000
- B.3.1 Of which committed IPA funding including WBIF funding (in €)	25,000,000			
	Priority reform measure No. 4: Construction of Block 2 of the Thermal Power Plant in Pljevlja			
A. Duration of the reform*	x	x	x	x

65 Please use table 1 to fill in the direct budgetary impact of each measure contained in part II of the ERP in EUR.

B. Net direct budgetary impact (if any) (in €)				
B.1 Direct impact on budgetary revenue (in €)				
B.2 Direct impact on budgetary expenditure (in €)				
B.3 Possible non-budgetary financing (in €)	600,000	58,000,000	143,000,000	98,280,000
	Priority reform measure No. 5 : Construction of the Smokovac–Mateševo priority section of the Bar-Boljare highway			
A. Duration of the reform*	X	X	X	X
B. Net direct budgetary impact (if any) (in €)				
B.1 Direct impact on budgetary revenue (in €)				
B.2 Direct impact on budgetary expenditure (in €)[66]		-40,560	- 67,708,231.03	- 31,901,290.15
B.3 Possible non-budgetary financing (in €)[67]		- 153,700,000[68]	- 238,006,975.83	- 63,434,310.86
- B.3.1 Of which committed IPA funding including WBIF funding (in €)				
	Priority reform measure No. 6: Modernization of the Bar–Belgrade railway (Vrbnica–Bar section in Montenegro)			
A. Duration of the reform*	X	X	X	
B. Net direct budgetary impact (if any) (in €)				
B.1 Direct impact on budgetary revenue (in €)				
B.2 Direct impact on budgetary expenditure (in €)				
B.3 Possible non-budgetary financing (in €)		24,400,000	5,150,000	
- B.3.1 Of which committed IPA funding including WBIF funding (in €)				
	Priority reform measure No. 7: Boosting of investments in the industrial sector focusing on processing industries			
A. Duration of the reform*				
B. Net direct budgetary impact (if any) (in €)	X	X	X	X
B.1 Direct impact on budgetary revenue (in €)	-681,333	-1,300,000	-1,000,000	-
B.2 Direct impact on budgetary expenditure (in €)				

[66] This amount includes 15% from the Budget for the project design and construction plus the accompanying costs associated with the project implementation (supervision over the design and execution of works, subsequent expropriation, technical documentation review, etc.).

[66] SEETO road route 4: Vršac (Romanian border) - Beograd (Serbia) - Podgorica (Montenegro) - Bar (Montenegro).

[67] This amount includes 85% from the EXIM bank for the design and construction. The change in the planned disbursements (withdrawals from the Chinese EXIM bank) compared to the 2015 Report happened due to Contractor's revised Work Schedule, resulting in changes to the Disbursement Schedule.

[68] The total appropriation by the 2017 Budget Law for the project implementation is EUR 194,300,000.00; however, under Budget Law Art 11, the funds for the Contract implementation will be provided up to the amount of realisation, which is estimated to be up to EUR 268,707,000.00, out of which EUR 58,092,047.21 would be provided from the Budget, and the remaining EUR 210,614,952.79 from the Chinese EXIM bank.

B.3 Possible non-budgetary financing (in €)	-681,333	-1,300,000	-1,000,000	-
- B.3.1 Of which committed IPA funding including WBIF funding (in €)				
	Priority reform measure No. 8: Support for the development and modernization of the industrial sector			
A. Duration of the reform*	X	X		
B. Net direct budgetary impact (if any) (in €)	-9,500	-100,000	-100,000	
B.1 Direct impact on budgetary revenue (in €)				
B.2 Direct impact on budgetary expenditure (in €)	-9,500	-100,000	-100,000	
B.3 Possible non-budgetary financing (in €)	50,000	700,000	700,000	
- B.3.1 Of which committed IPA funding including WBIF funding (in €)				
	Priority reform measure No. 9 : Support for investments in the food production sector in view of achieving EU standards			
A. Duration of the reform*				
B. Net direct budgetary impact (if any) (in €)				
B.1 Direct impact on budgetary revenue (in €)				
B.2 Direct impact on budgetary expenditure (in €)		-1,000,000	-11,000,000	-15,000,000
B.3 Possible non-budgetary financing (in €)		14,000,000	13,600,000	15,000,000
- B.3.1 Of which committed IPA funding including WBIF funding (in €)		14,000,000	13,600,000	15,000,000
	Priority reform measure No. 10: Improvement of the tourist product in the north of Montenegro through construction of the required infrastructure at ski resorts			
A. Duration of the reform*	x	x	x	x
B. Net direct budgetary impact (if any) (in €)	-12,225,000	-10,040,000	25,220,000	-7,000,000
B.1 Direct impact on budgetary revenue (in €)				
B.2 Direct impact on budgetary expenditure (in €)	-12,225,000	-10,040,000	25,220,000	-7,000,000
B.3 Possible non-budgetary financing (in €)				
- B.3.1 Of which committed IPA funding including WBIF funding (in €)				
	Priority reform measure No. 11: Introduction of e-services in the land registration system			
A. Duration of the reform*	X	X	X	X
B. Net direct budgetary impact (if any) (in €)				
B.1 Direct impact on budgetary revenue (in €)				

B.2 Direct impact on budgetary expenditure (in €)				
B.3 Possible non-budgetary financing (in €)		50,000		
- B.3.1 Of which committed IPA funding including WBIF funding (in €)				
	Priority reform measure No. 12: Introduction of electronic fiscal invoices to reduce the informal economy			
A. Duration of the reform*				
B. Net direct budgetary impact (if any) (in €)				
B.1 Direct impact on budgetary revenue (in €)			+10,000,000	
B.2 Direct impact on budgetary expenditure (in €)		-500,000		
B.3 Possible non-budgetary financing (in €)				
- B.3.1 Of which committed IPA funding including WBIF funding (in €)				
	Priority reform measure No. 13 : Improvement of financial support for SMEs			
A. Duration of the reform*	X	x	x	x
B. Net direct budgetary impact (if any) (in €)		-100,000		
B.1 Direct impact on budgetary revenue (in €)				
B.2 Direct impact on budgetary expenditure (in €)		-100,000		
B.3 Possible non-budgetary financing (in €)		120,000,000	120,000,000	120,000,000
- B.3.1 Of which committed IPA funding including WBIF funding (in €)				
	Priority reform measure No. 14: : Improvement of non-financial support for SMEs			
A. Duration of the reform*	x	x	x	x
B. Net direct budgetary impact (if any) (in €)		-132,457	-132,457	123,214
B.1 Direct impact on budgetary revenue (in €)				
B.2 Direct impact on budgetary expenditure (in €)		-132,457	-132,457	123,214
B.3 Possible non-budgetary financing (in €)		40,756	40,756	39,312
- B.3.1 Of which committed IPA funding including WBIF funding (in €)				
	Priority reform measure No. 15: Establishment of the Science and Technology Park (STP) in Podgorica			
A. Duration of the reform*	x	x	x	x
B. Net direct budgetary impact (if any) (in €)				
B.1 Direct impact on budgetary revenue (in €)				

B.2 Direct impact on budgetary expenditure (in €)				
B.3 Possible non-budgetary financing (in €)		60.000	4.000.000	4.200.000
- B.3.1 Of which committed IPA funding including WBIF funding (in €)			800.000	
	Priority reform measure No. 16: Development of business zones with the aim of encouraging direct investment and increasing employment			
A. Duration of the reform*				
B. Net direct budgetary impact (if any) (in €)	-30,000	-101,000		
B.1 Direct impact on budgetary revenue (in €)				
B.2 Direct impact on budgetary expenditure (in €)	-30,000	-101,000		
B.3 Possible non-budgetary financing (in €)	50,000 (UNDP. GLOC) 65,000 Local self-government units	50,000 (UNDP. GLOC)		
- B.3.1 Of which committed IPA funding including WBIF funding (in €)				
	Priority reform measure No. 17: Development of qualifications in line with labour market needs			
A. Duration of the reform*	X	X	X	X
B. Net direct budgetary impact (if any) (in €)	- 120,600	- 184,560	- 246,080	- 270,000
B.1 Direct impact on budgetary revenue (in €)	-	-	-	-
B.2 Direct impact on budgetary expenditure (in €)	-120,600	-184,560	-246,080	-270,000
B.3 Possible non-budgetary financing (in €)	-	-	-	-
- B.3.1 Of which committed IPA funding including WBIF funding (in €)	441,535.17	706,906.83	650,000	
	Priority reform measure No. 18: Alignment of higher education in line with labour market needs			
A. Duration of the reform*	x	x	x	x
B. Net direct budgetary impact (if any) (in €)	- 8,039,000	- 8,000,000	-5,000,000	-5,000,000
B.1 Direct impact on budgetary revenue (in €)	-	-	-	-
B.2 Direct impact on budgetary expenditure (in €)	- 8,039,000	- 8,000,000	-5,000,000	-5,000,000
B.3 Possible non-budgetary financing (in €)				
- B.3.1 Of which committed IPA funding including WBIF funding (in €)				
	Priority reform measure No. 19: Amendments to statutory provisions related to the labour market			
A. Duration of the reform*	X	X	X	
B. Net direct budgetary impact (if any) (in €)			+5,800,000	

B.1 Direct impact on budgetary revenue (in €)				
B.2 Direct impact on budgetary expenditure (in €)				
B.3 Possible non-budgetary financing (in €)				
- B.3.1 Of which committed IPA funding including WBIF funding (in €)				
	Priority reform measure No. 20: Amendments to the Law on Social and Child Protection			
A. Duration of the reform*				
B. Net direct budgetary impact (if any) (in €)		+15,800,000		
B.1 Direct impact on budgetary revenue (in €)				
B.2 Direct impact on budgetary expenditure (in €)[69]				
B.3 Possible non-budgetary financing (in €)				
- B.3.1 Of which committed IPA funding including WBIF funding (in €)				
Total net budgetary impact 352,898,679 637,425,499 364,968,126				
Total impact on budgetary revenue			15,800,000	
Total impact on budgetary expenditure		*352,898,679*	*637,425,499*	*364,968,126*

[69] With this measure budget expenditures will be reduced by some 16 million euro in 2017.

Table 11: Summary of Structural Reform Measures

Priority reform measure No. 1: Introduction of the e-procurement system

Short description	The main strategic goal of introducing e-procurement in Montenegro is, first and foremost, to increase the transparency and efficiency of public procurement, to help fight corruption and other irregularities occurring in procurements, and to set up a single procurement system by unifying and standardizing the procedures. The project should result in having e-procurement in place and will be the main contribution to achieving this goal in the coming period. This will considerably improve the existing functionalities and introduce new ones to the Montenegrin public procurement portal, a successful platform for posting contract notices, tender dossiers and other procurement-related documents. The introduction of the e-procurement system is envisaged by the 2016–2020 Strategy for the Development of the Public Procurement System with the accompanying AP and the 2016–2020 Public Finance Management Reform Programme.
Timetable by year	In 2017, the tendering procedure for the selection of the most advantageous tenderer for the e-procurement project will be completed and the system will start to be developed.
	In 2018, the trial version will be completed, the Public Procurement Administration staff will be trained and possible system problems removed. In parallel, the Training Plan and the training material will be developed for system users (contracting authorities and tenderers). The system is expected to be put into use, together with user training, in late 2018.
	In 2019 – system in full use, ongoing training provided.
Cost of implementation and impact on the annual budget	This project is worth EUR 1,650,000. It will be funded through the IPA 2014, with the amount of EUR 1,500,000, and the remainder will be from the budget (EUR 165,000 co-financing). Of the budget amount, in 2017 a total of EUR 70,000 will be provided. Once this system is up and running, the direct impact of the measure on the decrease of budget expenditures will be substantial.
Expected impact on competitiveness	Having the e-procurement system in place will increase efficiency, transparency, reduce irregularities, improve monitoring, which will, in turn, increase competitiveness, shorten procedures and cut the costs of the procurement procedures. Given that the state enters the market through public procurement procedures, its conduct has a great bearing on the overall social and economic activity. Improving public governance and public procurement system is key to achieving macroeconomic stability, having better competitiveness and economic growth and development.
Expected social outcomes including on employment and on social groups, in particular on gender	Using procurement as a tool to promote sustainable development with respect for high social and environmental criteria, increases the accessibility of the procurement process, particularly for SMEs. This stimulates entrepreneurial development, as a model for increasing employment and social inclusion and respect for the principle of gender equality.

Priority reform measure No. 2: Strengthening of managerial accountability in the public sector

Short description	In order to overcome/address the noted issue of lack of managerial accountability in the civil service, it needs to be strengthened based on the principles of delegating tasks and authorities. The key challenges in pursuing this reform measure will refer to rectifying irregularities regarding formal delegation of responsibilities for achieving the goals of state authorities. In the practice to date, decision making related to financial management is not delegated lower than the level of ministry secretaries. At the same time, it is noteworthy that managers largely failed to attend or else sent lower-ranking staff to training events intended for those responsible for financial management and control.
Timetable by year	2017: Q3 & Q4
	2018: Continuously
	2019: Continuously
Cost of implementation and impact on the annual budget	The funds needed in 2017 for developing the methodology for delegation of responsibilities and authorities amount to EUR 15,000, and will be provided from the IPA 2014 and the budget. In 2018 and 2019 PIFC-related training will continue, with a focus on managers, and the funds needed will amount to EUR 10,000 for each year.
Expected impact on competitiveness	Prudent public finance management and purposeful spending will affect the achievement of goals pursued by public entities, and consequently on the achievement of the Government's strategic development goals. In addition to increasing confidence in the institutions, it will also help increase the credibility of the state, as the main precondition for attracting investors, particularly foreign ones.
Expected social outcomes including on employment and on social groups, in particular on gender	Improving efficiency, effectiveness and economy in public finance management (PFM) will ensure better service to the public with minimum costs to public-sector operation.

Priority reform measure No. 3: Construction of the undersea cable between Montenegro and Italy with transmission

Short description	This priority reform measure involves investment in the construction of the transmission grid in the country: (the 400/110/35 kV Lastva substation and the 400 kV Lastva–Pljevlja transmission line) and the construction of the 400 kV interconnection with Serbia. It is compatible with the undersea interconnection between Montenegro and Italy, with the Italian transmission system operator (TERNA) being in charge of the project.
Timetable by year	2017: Construction of the Lastva substation and the 400 kV Lastva–Pljevlja transmission line
	2018: Construction of the 400 kV Lastva–Pljevlja transmission line
	2019: Construction of the 400kV Pljevlja–Bajina Bašta transmission line (up to the Serbian border)
Cost of implementation and impact on the annual budget	
Expected impact on competitiveness	Construction of the transmission infrastructure in the country and the interconnection with Serbia enables full capitalization on the interconnection with Italy and it achieves better connection with the region and the EU energy market, thus contributing to competitiveness.

Expected social outcomes including on employment and on social groups, in particular on gender	It is expected to have an impact on the utilization of construction and transport companies and other service SMEs.

Priority reform measure No. 4: Construction of Block 2 of the Thermal Power Plant in Pljevlja

Short description	This priority measure involves investment in the construction of Block 2 of TPP Pljevlja, of the planned capacity of 254 MW and the annual output of 1,600 GWh. The project also envisages the construction of a thermoelectric power station for district heating in Pljevlja. The project is envisaged by Montenegro's Strategy for Energy Development by 2030 and the accompanying 2016–2020 Action Plan.
Timetable by year	2017: Secure funding, make the contract effective, prepare the main design, purchase and deliver equipment, start construction works. In years after, preparation of the main design should be continued, purchase and deliver equipment (continued), construction works (continued) and commence with equipment assembly, trial runs, initial commissioning and trial operation.
Cost of implementation and impact on the annual budget	
Expected impact on competitiveness	The construction and putting into operation of the Block 2 of the TPP will increase the total annual power output in Montenegro by some 50%. This will improve the structure generated from its own sources, which will greatly impact Montenegro's competitiveness in the power market, particularly given the Montenegro–Italy undersea interconnection.
Expected social outcomes including on employment and on social groups, in particular on gender	The project will ensure the continuation of the functioning of Pljevlja Coal Mine and TPP Pljevlja, thus ensuring an optimum number of jobs in these two entities in the energy sector. In addition, the project envisages district heating for Pljevlja from the thermoelectric power plant, generating additional new jobs (maintenance, district heating system management, etc.). Having a centralized district heating in place will improve air quality in the Pljevlja region and have knock-on positive social impacts. In the implementation stage, the project is estimated to generate between 70–100 new jobs, and once completed it would generate 50 new jobs in the thermoelectric power plant and some 40 jobs in the district heating system and other supporting activities.

Priority reform measure No. 5: Construction of the Smokovac–Mateševo priority section of the Bar–Boljare highway

Short description	The Bar–Boljare highway was included in the South-East Europe Transport Observatory (SEETO) Comprehensive Network as SEETO Road Route 4[70], through *Annex III VOL 30/33 and 31/33)* in October 2011 and is the Government's priority and one of the elements on the country's EU accession agenda, that will provide for better and safer movement of people, goods and services. Montenegro's Transport Development Strategy envisages integration into Trans-European Transport Network *(TEN-T)* to be achieved, among other things, via the Bar–Boljare highway. It cuts transversally through the whole Montenegrin territory as an integrational connection within the country, and will enable the tapping into development resources in the north of Montenegro. Finally, it will be the fastest connection from Montenegro to Serbia and Central Europe. Since last year the Bar–Boljare–Belgrade transport corridor has been an integral part of the main Western Balkans Transport Network. It constitutes an extension of the TEN-T Middle East – East Med Corridor. Montenegro's 2014–2020 Regional Development Strategy envisages the implementation of some key capital projects, one of the most significant being the Bar-Boljare highway, as one of the tools to reduce regional disparities in Montenegro and to achieve a more balanced social and economic development of its regions, based on competitiveness, innovation and employment. The importance of the Bar–Boljare highway for transport and economic connections and the intensive economic development of Montenegro and the region is also identified in Montenegro's Strategy for the Development and Maintenance of State Roads. As one of relevant arguments in favour of building the Bar–Boljare highway, this Strategy mentions the need to increase road safety and reduce the number of accidents, given that the current Platije road cannot feasibly be upgraded to the level of a high-speed highway, since the funding needed would approximate that of a completely new highway, without fully resolving the issues. The Bar–Boljare highway is on the Unified List of Priority Infrastructure Projects that was approved by the Government in December *2015.* Having put in place the statutory and contractual requirements, 11 May 2015 was set as the Commencement Date for the works on the Smokovac–Uvač–Mateševo priority section of the Bar–Boljare highway, when the contractual term of	
Timetable by year	2017: 1. Preparatory works 2. Design 3. Part of permanent works	
	2018: 1. Preparatory works 2. Design 3. Part of permanent works	
	2019: 1. Works 2. Some designs	
Cost of implementation and impact on the annual budget	The total of EUR 194.3 million is provided in the 2017 Capital Budget for this project, of which EUR 153.7 million refers to a loan provided by Exim Bank.	
Expected impact on competitiveness	The real impact on competitiveness can be assessed only once the construction is completed and utilization starts, when it is expected to see the following: better connection to the network of pan-European corridors and attracting commodities and traffic flows in the region, shortening travel time and saving costs due to increased vehicle operational speeds, changed market conditions and better competitiveness of companies due to easier access to the (regional) market and reducing the associated purchase costs, better tapping into the agricultural, forestry and water resources, tourism development, better use of the prospects offered by the Port of Bar and the Container Terminal and their better connection with the zone gravitating towards them, direct use of domestic construction firms, equipment, materials and labour during the construction stage which will have knock-on effects on overall economic growth.	
Expected social outcomes including on employment and on social groups, in particular on gender	The real social outcomes can be assessed only once the construction is completed and when utilization starts, when it is expected to see the following: more balanced development of the north and the south, a considerable reduction in the number of road accidents and savings in vehicle utilization costs, cost savings due to fewer accidents and less pollution, increased accessibility to remote areas, better mobility, significant demographic changes, increased employment and changed employment structure.	

Priority reform measure No. 6: Modernization of the Belgrade–Bar railway (Vrbnica–Bar, the section passing through Montenegro)

Short description	The Vrbnica–Bar railway is part of the international Belgrade–Bar railway, connecting the Port of Bar and Montenegro with the Western Balkans and Central Europe. The SEETO Comprehensive Network recognizes it as Rail Route 4. The approved IFI loans granted by the EBRD and the EIB, and the IPA and the WBIF funds are intended for the reconstruction and upgrade of the above railway to improve rail transport security and safety, and fully meet interoperability requirements in the rehabilitated sections, increasing the speed and reducing freight and passenger travel times, increasing the competitiveness of the railway compared to other competing rail routes and other modes of transport, as well as putting to better use the Port of Bar facilities. Implementing the reform in this area will benefit the 1.2 million passengers using local and international transport, and the roughly 1 million tonnes of freight transported annually, and have an indirect impact on the wider economy.
Timetable by year	<u>2017:</u> - Repair of the Kolašin–Kos section – EUR 5,898,315.30 (EIB) - Dismantling of the existing and the purchase and assembly of a new traction substation in Trebješica – EUR 3,140,000.00 (IPA III) - 106 tunnels and the main design for the priority rehabilitation – EUR 2,500,000.00 (WBIF) - Rehabilitation of the Morača Bridge – EUR 886,713.47 (EIB) - Repair of the Virpazar–Sutomore section in Sozina Tunnel – EUR 4,500,000.00 (IPA III) - Rehabilitation of six gradients – EUR 4,500,000.00 (EIB and WBIF (new 20+20 loan)) - Railway station signalling system in Podgorica – EUR 6,000,000.00 (EIB and WBIF (new 20+20 loan)) - Urgent rehabilitation of five concrete bridges – EUR 500.000,00 (EIB and WBIF (new 20+20 loan))
	<u>2018:</u> - Track repairs on the Kos–Trebješica section – EUR 4,140,000.00 (IPA 2014) - Urban planning and engineering development of the border station at Bijelo Polje – EUR 1,375,000.00 (IPA 2016 (programmed))
	<u>2019:</u> - Rehabilitation of priority bridges and tunnels, where main designs are planned for drafting in 2017 and early 2018
Cost of implementation and impact on the annual budget	The above measure will be implemented between 2016 and 2018 through the execution of works within the framework of projects where contracts have already been signed and though programmed funding, that will ensue after signing of the agreement between the EIB, the WBIF, Montenegro's railway infrastructure manager, and with state guarantees (the new 20+20 loan). No guarantees will be needed for projects funded through the IPA, i.e. there will be no financial implications for the Government, while for the projects funded through the new 20+20 loan (EUR 20 million from the EIB loan and EUR 20 million from the WBIF grant), to be implemented between 2016 and 2019, guarantees are needed which the Government included in the budget plan for the previous year; however, given that no agreement between the financial institutions has been signed as yet, a 2016 guarantee validity extension was requested.
Expected impact on competitiveness	Increased railway transport service quality, where currently much reduced speeds will move up to the level of design speeds, which will have a direct impact on reducing the passenger and freight travel time. In addition, railway transport safety will improve and all interoperability requirements will be met in the repaired sections, which will boost the competitiveness of railway transport. Moreover, the railway network upgrades will certainly have a positive impact on the operation of the Port of Bar.
Expected social outcomes including on employment and on social groups, in particular on gender	– The increase in the number of passengers, particularly from the underdeveloped north (students are frequent users of this mode of transport) using the railway as a practical and economical connection with Podgorica and the coastal region. Visitors from Serbia are also frequent railway users during the summer and winter tourist seasons. - The project will directly benefit some 1.2 million passengers using this mode of transport each year and around 1 million tonnes of freight, and indirectly the wider economy by facilitating trade, regional integration and sustainable growth.

Priority reform measure No. 7: Boosting of investments in the industrial sector focusing on processing industries

Short description	Boosting domestic and foreign investment in the industrial sector, focusing on processing industries, with reference to the Decree to Foster Direct Investments. It envisages incentives for investors in projects which generate jobs and contribute to the overall economic and balanced regional development of Montenegro. Incentives for stimulation of investments are allocated according to predefined criteria that include: investors' references; the economic aspect of the investment project; effects on human resources; research and development; regional development; the effects on the environment, etc. The amount of funds for fostering investments is determined according to the criteria based on the number of new employed people to be employed on jobs related to the investment project implemented (in the range of EUR 3,000–10,000 per person employed, based on the points under each criterion).
Timetable by year	2017: It is envisaged to have at least one call for providing incentives for direct investments. Depending on the funding available and investor interest, several calls could possibly be issued. The process of allocating funds for fostering investments includes the following stages: Public call for allocation of incentives; Submission of the required documents by the published deadline; Evaluation of technically valid submitted applications; Decision on the allocation of subsidies; Signing the contract.
	2018: Continue subsidizing investment projects according to the agreed schedule, and issue a new call for incentives for direct investments.
	2019: Continue subsidizing investment projects according to the agreed schedule, and issue a new call for incentives for direct investments.
Cost of implementation and impact on the annual budget	Given the staged disbursement of approved subsidies for investment projects, in three instalments (upon signing of contract, upon receiving confirmation of more than 50% of the investment being carried out, and after reaching full employment envisaged by the project and its full implementation), 2017 budget funds will be used for the disbursements under the 2017 call, and the instalments due from previous calls. The budget in 2017 for this measure is EUR 1.3 million.
Expected impact on competitiveness	Providing subsidies to investors has a direct impact on the greater contribution of the industrial sector to generating gross added value by increasing employment, output and exports. In addition to the above, the knock-on effect of investments at the microeconomic level, i.e. the SME sector, is also noteworthy.
Expected social outcomes including on employment and on social groups, in particular on gender	The Decree to Foster Direct Investments applies to projects which, among other things, generate new jobs, which is the main aim of this decree. At the same time, the amendments to the Decree taking into account the situation of underdeveloped municipalities have an additional impact on social inclusion of the population from underdeveloped areas. The proposed measure has no gender-specific features.

Priority reform measure No. 8: Support to the industrial sector development and modernization

Short description	Financial support aimed at co-funding eligible equipment purchase costs by up to 20% for entrepreneurs, micro and small enterprises, and up to 10% for medium-sized enterprises, exclusive of VAT. The remaining funding needed, up to 70% for small, and up to 60% for medium-sized enterprises (of the total amount) is provided under state-aid rules through credit arrangements with the Investment and Development Fund of Montenegro (IDF).
Timetable by year	2017: Continue with grant programme for equipment purchase and public calls.
	2018: Grant scheme for equipment purchase continues via the issuing of public calls.
	2019: Grant scheme for equipment purchase continues via the issuing of public calls.
Cost of implementation and impact on the annual budget	In 2017 – EUR 100,000
Expected impact on competitiveness	Provision of this type of incentive has a direct impact on an increase in production outputs and exports, and on increasing the country's competitiveness. At the same time, by investing in state-of-the-art technologies, followed by upgrading skills, optimum use of resources, better company competitiveness and their integration into global value chains are achieved.
Expected social outcomes including on employment and on social groups, in particular on gender	In the longer-term perspective, investing in equipment helps businesses to grow, and thus to increase the number of their staff. This has a partial impact on social inclusion, especially in underdeveloped areas (eligible companies are in the food and wood-processing industries in the north). The proposed measure has no gender-specific features.

Priority reform measure No. 9: Support for investments in the food production sector in view of achieving EU standards

Short description	This measure supports the development of new perennial plantations, increasing livestock, the purchase of processing equipment, the construction and rebuilding of facilities for the processing of farm and fish-farm produce with a view to improving food safety standards, animal wellbeing and plant health.
Timetable by year	2017: Implementation
	2018: Implementation
	2019: Implementation
Cost of implementation and impact on the annual budget	In 2017 the total planned amount of support is EUR 24.0 million, broken down as follows: EUR 14.0 million from the IPA, and EUR 10.0 million from the national budget. In 2018, the total amount of support is envisaged at EUR 24.6 million, of which EUR 11.0 million is from IPA funding, and EUR 13.6 million is from national funding. In 2019, the total amount of support is envisaged at EUR 30.0 million, with EUR 15.0 million from IPA funding, and the remaining EUR 15.0 million from national funding.
Expected impact on competitiveness	- Reduce food imports - Increase food produce exports to the regional market and open up opportunities for exporting to the EU market - Better productivity and higher product quality
Expected social outcomes including on employment and on social groups, in particular on gender	More women and young people engaged in agriculture.

Priority reform measure No. 10: Improvement of the tourist product in the north of Montenegro through construction of the required infrastructure at ski resorts

Short description	The 2015–2018 Development Directions for Montenegro, and also other strategy papers, such as the Tourist Development Strategy by 2020, envisage a number of measures intended to diversify and enhance the tourist product, and as a result increase the competitiveness of destinations, reduce regional disparities, increase the number of SMEs involved and generate new employment. One of the measures includes the development of the necessary ski infrastructure. The proposed measure consists of several stand-alone projects aimed at putting in place the infrastructure needed for winter tourism in the north.
Timetable by year[71]	2017: Kolašin 1600 – complete the development of a reservoir with a capacity 15,000 m^3 of water for snow making, with necessary installations and devices; install a snow-making device – 2 km. Cmiljača – Snow-making device planned to be installed – 1.5 km; complete works on building a 10,000m^3 reservoir for snow making, with the accompanying installations and devices. Žarski – start the construction of a 14-km-long road, placing telecommunication infrastructure, build 4 km of ski slopes, and chairlifts of an initial capacity of 1,600 skiers per hour, design and develop chairlift facilities (pylons, stations, etc.) with the design of tracks, purchase of machines and other equipment, developing a source of drinking water, and start the construction of a number of facilities – a garage for snow-grooming machines, a workshop, ski storage, ticket office, restaurant, toilets for skiers, first-aid station and administrative building. Savin kuk – Construction of a 1.5-km road with a 300-lot parking space; the main design and construction of the water supply system planned; purchase and instalment of snow-making devices and installations; call and main design for additional base settlement facilities; commencement of work on developing approximately 4 km of ski tracks with the project documentation for the snow-making system, completion date due in 2018; purchase and instalment of a new 6-person chairlift on a design–build principle, approximately 1.8 km long, with completion due in 2018. Vučje – Development of a reservoir at Vučje, thus completing the project at this ski resort. Hajla – In 2017, stage 2 of the Rožaje–Štedin road and development of the planning documents for the given site. The schedule of subsequent activities depends on having the planning documents in place.
	2018: The schedule of all activities in the coming years will depend on the level of completion in 2017.
	2019: The schedule of all activities in the coming years will depend on the level of completion in 2018.
Cost of implementation and impact on the annual budget	Kolašin 1600 – EUR 5.30 million; Cmiljača – EUR 2.10 million from the central budget; Žarski – EUR 1.03 million; Savin kuk – EUR 1.03 million, Hajla – EUR 700,000. TOTAL: EUR 10.04 million. All funding will come from the central budget.
Expected impact on competitiveness	The set of planning documents for the area of Bjelasica and Komovi (the Kolašin 1600, Cmiljača and Žarski resorts, as well as some other sites, belong to this area) include a macroeconomic evaluation showing the long-term macroeconomic balance with the following forecasts: investments of EUR 1.216 million; revenues of EUR 926 million; added value of EUR 204 million; employment of 13,900 jobs. The macroeconomic impact study done as a part of the planning documents for the Durmitor area (where Savin kuk is located) gives the following forecasts: investments in construction and rehabilitation of tourism, hospitality, mixed and leisure facilities will amount to EUR 74,318.4 million; the number of accommodation units in hotels and mixed properties – 213,320; the number of staff – 500.
Expected social outcomes including on employment and on social groups, in particular on gender	The measure will have an impact on the employment of different societal groups, primarily from the north, taking into account gender equality. The measure should contribute to reducing regional disparities between the north and south.

[71] In addition to these, there are other defined activities for the coming period, but with no clear timing, since practice has shown that there are frequent deviations from the set timeframes for various reasons, so more precise timing schedules will be provided once it is clear that all the preconditions for their implementation are in place.

Priority reform measure No. 11: Introduction of e-services into the land registration system

Short description	Within the framework of the project *Cutting Red Tape – Public Administration Tailored to the Needs of Citizens and Businesses* implemented by the United Nations Development Programme (UNDP) in cooperation with the Ministry of Finance, with funding provided by the UK Embassy in Podgorica, a consultant was selected tasked with providing expert assistance in drafting the legislation to govern the operation of the Real Estate Administration's IT system. The aim is to enable access to the integrated IT system by banks, local self-governments and state authorities to relieve the burden and speed up the procedure of issuing various cadastral documents.
Timetable by year	2017: - Consultancy provided within the UNDP-implemented project for introducing e-services in the Real Estate Administration, until the end of March 2017 - Putting in place the legal preconditions, the action plan for involving state authorities, local self-government bodies and notaries in stage 1 of the e-services application - Cost estimates
	2018: - Introduction of e-services in the land register
	2019: - Improvement to and application of the new cadastral e-services
Cost of implementation and impact on the annual budget	EUR 50,000 provided by the UK Embassy in cooperation with the UNDP
Expected impact on competitiveness	The above measure, in addition to the ongoing activities to strengthen the staffing and IT capacities of cadastral offices, will contribute to better quality, efficiency and accessibility of cadastral services. The main aim is to reduce the workload and speed up the procedure of issuing various documents provided by the Real Estate Administration. This, in turn, will improve the business environment and ultimately boost competitiveness, particularly as regards its ranking in various global reports, such as the WB's Doing Business Report.
Expected social outcomes including on employment and on social groups, in particular on gender	Relieving individuals and businesses of administrative burdens, made possible by the new ways of obtaining cadastral documents. With this system up and running, while performing certain legal dealings before the state authorities, citizens and businesses will no longer be obliged to obtain land-register documents themselves only to make them available to another state authority. This is particularly important, for instance, in registering property, where notaries will be able to provide title deeds using e-services from their own offices, with no need to visit cadastral offices.

Priority reform measure No. 12: Introduction of electronic fiscal invoices to reduce the informal economy

Short description	Introducing of e-VAT taxation, as one of the measures for curbing the grey economy, will provide information on the sale of goods and services in real time and would make a great improvement in controlling records of sales paid in cash. The existing VAT taxation model in Montenegro is complex and obsolete in terms of its business procedures and processes.
Timetable by year	2017: Provide in parallel both legal and technical support for the project implementation
	2018: Actual implementation of the Introduction of e-VAT taxation project
	2019:
Cost of implementation and impact on the annual budget	The funding needed in 2017 for adapting the Tax Administration's IT system, which includes the purchase of software and hardware is estimated at approximately EUR 500,000. Having the e-VAT taxation in place would increase 2018 budget revenues by EUR 11 million.
Expected impact on competitiveness	This measure will boost the competitiveness of Montenegrin economy
Expected social outcomes including on employment and on social groups, in particular on gender	

Priority reform measure No. 13: Improvement of financial support for SMEs

Short description	The reform measure of improving financial support to SMEs refers to facilitated access to credit schemes and factoring arrangements, the use of cluster development grant schemes, continued implementation of the COSME programme guarantee scheme, and the development of a new equity financing tool. The planned supply of improved and new financial instruments, their terms and procedures, will generate greater demand, improved knowledge about starting a business and financial management, business and cluster growth and development, and the use of new sources of funding.
Timetable by year	2017: - Improved financial support for business start-ups and SMEs from the IDF by providing favourable terms and procedures for credit lines and factoring arrangements - Financial support for setting up new clusters and improving the operation of existing ones through a grant model - Continuation of the COSME guarantee arrangement for SMEs by CKB bank - Start applying the financial tool of equity financing through the WB EDIF–ENIF facility
	2018: - Improve the existing credit lines and open new ones, and improve the provision of factoring services (international factoring and silent factoring) - Full implementation of the CKB COSME guarantee arrangement and the signing of new ones by financial agents - Continued equity financing within the framework of the WB EDIF–ENIF facility
	2019: - Continue activities planned for 2018
Cost of implementation and impact on the annual budget	EUR 100.1 million, with an impact of EUR 100,000 on the annual budget
Expected impact on competitiveness	The measure contributes to the better availability and accessibility of financial services and access to loans, setting up new businesses, more efficient SME operation and development, their greater contribution to GDP, trade, overall investments, more balanced regional development and the country's better export competitiveness.
Expected social outcomes including on employment and on social groups, in particular on gender	The measure contributes directly to new employment and greater labour market demand, greater involvement of women and young people in business and the improvement of work conditions in the SME sector.

Priority reform measure No. 14: Improvement of non-financial support to SMEs

Short description	Non-financial support to SMEs primarily refers to support provided to SMEs in the form of training and business counselling services and preparations for access to financing, as key in setting up businesses and boosting their competitiveness. The intended support aims at improving knowledge about setting up a business and financial management and access to finance, strengthening the export performance of businesses and further development of clusters.
Timetable by year	2017: - Delivery of training in entrepreneurial skills for business start-ups focusing on women and young people (training on how to set up and run a business, business planning and financial and tax system, legislation) - Continue implementing the *Mentorship for SMEs* project - Continue providing consultancy services within the EEN - Organize business-to-business events - Deliver training in improving the export performance of companies - Technical support in drafting project proposals to apply for foreign funding; support in drafting and implementing support programmes for clusters when applying for grant funding
	2018: - Continue activities planned for 2017
	2019: - Continue activities planned for 2018
Cost of implementation and impact on the annual budget	A total of EUR 20,000 is provided by the 2017 Budget for non-financial support to SMEs
Expected impact on competitiveness	Job generation, SME development and better productivity, better export performance of companies that would increase overall exports.
Expected social outcomes including on employment and on social groups, in particular on gender	The capacities of people ready for entrepreneurial ventures and staff with entrepreneurial skills who set up their own business will be increased, expertise and competences will be improved, and thus also employability, particularly of young people and women.

Priority reform measure No. 15: Establishment of the Science and Technology Park in Podgorica

Short description	The establishment of a Science and Technology Park in Podgorica is one of the key tools for the development of science and research in Montenegro. Its establishment is envisaged in all the key science-related strategy papers adopted recently: the 2011 Feasibility Study for Establishment of a Science and Technology Park in Montenegro (2012–2018), the 2012 Strategic Plan to Establish a Science and Technology Park in Montenegro (2013–2018), the revised Science and Research Strategy (2012–2016), The Law on Innovations (Official Gazette of Montenegro No. 42/16), and the Strategy for Innovations with implementation Action Plan (2016–2020). Montenegro's Science and Technology Park (2014–2020) (STP) is designed as a networked structure with its headquarters in Podgorica, and three impulse centres in Nikšić, Bar and Pljevlja. The coordination and administration of the STP will be done from the central Podgorica-based unit, which will offer infrastructure and a wide range of services to institutions, primarily to SMEs in the given area. In addition to SMEs, STP users will also include research institutes, higher education institutions, centres of excellence, centres for technology transfer and other innovative organizations. The STP will be located within the University of Montenegro (UoM) campus, and will gather together all universities and higher-education institutions within a total area of 5,000 m^2, using some of the already existing UoM capacities, a laboratory currently used for the needs of engineering departments, the BIO–ICT Centre of Excellence, and the Central IT System (CIS). Having the STP in place will enable linkages between research and higher education institutions and businesses to create new value that would directly impact economic growth and reduce unemployment. The STP will thus provide an environment conducive to nurturing and boosting commercial use of research and support technology-oriented businesses. The STP's basic aim is to gather together entrepreneurial, innovative, scientific and economic capacities and build strong linkages with local and regional business centres, business incubators, clusters and voucher schemes. The STP will provide specialized infrastructure and services, an IT system, expertise and consultancy in different fields of the sciences: to boost multidisciplinarity; to encourage and manage knowledge and high-tech transfer; for better internationalization and commercialization of research; to create new innovative businesses; to encourage, develop and apply new technologies, procedures, products, services and market processes, or improve existing ones, based on best scientific results, to be serve the function of the economic development of the region and of the country.
Timetable by year	2017: Preparation: • Negotiation of loan agreement with the World Bank to continue the "Higher Education and Research for Innovation and Competitiveness of Montenegro" project, and fund the STP in Podgorica between 2017 and 2020 (by the end of 2017) Implementation: • Tendering procedure for selecting the most advantageous tender for reconstruction and adaptation works for the STP building (June–December 2017) • Contracting (December 2017)
	2018: • Commencement of construction works (January 2018)
	2019: • Completion of construction works and technical approval (September 2019) • Equipping of the STP building (October 2019–February 2020)
Cost of implementation and impact on the annual budget	The STP development will be funded through loans and grants. A total of EUR 60,000 of loan money is planned for this measure in 2017
Expected impact on competitiveness	Linking science and research with innovation and business through support for the STP will enable: the setting up and attracting of new SMEs, start-ups and spin-offs of innovative entities and of existing businesses; creation of strong linkages with local and regional business centres, incubators, clusters and voucher schemes; stimulation of knowledge and high-tech transfers from research institutions to businesses; better commercial use of research; encouragement for the development and application of new or improved technologies, procedures, products, services and market processes, based on best scientific knowledge, and employment in existing and new companies.

Expected social outcomes including on employment and on social groups, in particular on gender	This measure will involve the recruitment of 15 members of staff between 2017 and 2019, while through the STP's activities new SMEs will be set up that will increase the level of employment, particularly among young people, through setting up their own start-ups and spin-offs.

Priority reform measure No. 16: Development of business zones with the aim of encouraging direct investments and increase employment

Short description	The Government of Montenegro adopted the Decree on Business Zones in 2016 which defined the model for setting up business zones, incentives, management and operation of local and national business zones.
Timetable by year	2016–2017 – Declare and set up the first business zone (BZ) of strategic importance 2017 – Set up the company to manage the business zone of strategic importance 2017 – Draft the plan of actions that need to be undertaken for the smooth operation of the BZ of strategic importance 2017–2018 – Phased infrastructure provision for the first BZ of strategic importance, to suit the needs of prospective investors.
Cost of implementation and impact on the annual budget	Phase 3 (2017): EUR 151,000 (central budget + local budget + UNDP, GLOC)
Expected impact on competitiveness	- More new investors - More new SMEs - Putting to use disused industrial facilities - Putting to use green-field sites owned by the state and local self-governments - Tapping into underused resources in industries with largest prospective growth
Expected social outcomes including on employment and on social groups, in particular on gender	- More jobs generated within business zones - Increased employment - Matching skills to labour market demand

Priority reform measure No. 17: Development of qualifications in line with labour market needs

Short description	Development of qualifications based on learning outcomes in cooperation with employers and designing credit-based modular curricula for all levels of vocational education and training will provide for better linkages between education and the labour market. Relevant information on labour market needs for skills and qualifications is the basis for curriculum development. The emphasis is given to learning through work and the provision of good-quality practical training, assessment of student achievements involving employers, continuous professional development of teachers regarding teaching methods and developing key competencies and soft skills in
Timetable by year	2017: Ten curricula developed, at least 150 teachers trained to deliver teaching based on learning outcomes and eight schools equipped to deliver the modernized curricula
	2018: Fifteen curricula developed and at least 250 teachers trained to deliver teaching based on learning outcomes
	2019: Twenty curricula developed and at least 350 teachers trained to deliver teaching based on learning outcomes
Cost of implementation and impact on the annual budget	A total of EUR 184,560 from the budget and EUR 706,906.83 of IPA funding will be allocated for the implementation of this measure in 2017
Expected impact on competitiveness	Competitive labour, with professional and key competencies, capable of lifelong learning and mobility, more adaptable to changes in the labour market, which affects the quality of life of each individual. Competitive and qualified labour is the basis for economic growth.
Expected social outcomes including on employment and on social groups, in particular on gender	Labour qualifications matching labour market needs, developed in cooperation with partners, will ensure better employability.

Priority reform measure No. 18: Alignment of higher education with labour market needs

Short description	Reduce the gap between supply and demand, and unemployment, particularly of young well-educated people. Set up an efficient, sustainable and modern higher education system.
Timetable by year	2017 – Carry out internship programme for higher education graduates; implement the reformed 3+2+3 model of studies at the University of Montenegro (UoM); Tracer Study.
	2018 – Implement the new model for financing higher education (a contractual form of funding between the UoM and the Government of Montenegro)
	2019 – Assess the impact of the new financing model on the quality of work of higher education institutions as regards quality of teaching and research and the reformed model 3+2+3 of studies at the UoM.
Cost of implementation and impact on the annual budget	A total of EUR 8 million needs to be provided from the central budget for implementing this measure in 2017
Expected impact on competitiveness	Greater youth employment and an overall GDP increase. Better quality of work of the UoM through a stable and efficient funding model.
Expected social outcomes including on employment and on social groups, in particular on gender	Better youth employability, adaptation and involvement in labour, reducing poverty and social assistance.

Priority reform measure No. 19: Amendments to statutory provisions related to the labour market

Short description	Labor market regulation has very important role on labor market functioning. In that regard, increase labour market flexibility, introduce more stringent sanctions for unregistered work, better targeting of active labour market measures for both workers in risk of losing their jobs and jobseekers, and furthermore to increase market participation for different groups of jobseekers (the elderly, women, young people and welfare beneficiaries) are areas to be additionaly improved. In this regard, there is a need to draft a new Labour Law and the Law on Employment and Exercising Rights with respect to Unemployment Insurance.
Timetable by year	2017-development of the proposal fo the Labor Law - Development of the proposal of the Law on Employment and Exercising Rights with respect to Unemployment Insurance.
	2018. - beginning od the Labor law implementation - beginning of the implementation of the Law on Employment and Exercising Rights with respect to Unemployment Insurance (renamed)
Cost of implementation and impact on the annual budget	The estimated net annual impact for implementing this measure will be in excess of EUR 5.8 million from 2018 on
Expected impact on competitiveness	
Expected social outcomes including on employment and on social groups, in particular on gender	

Priority reform measure No. 20: Amendments to the Law on Social and Child Protection

Short description	The amendments to the Law on Social and Child Protection, envisaged to be applied as of early 2017, refer to a reduction in the amount of the allowance for mothers of three or more children of 20% nominally and postponing until 1 July 2017 of the introduction of child allowance for primary and secondary school children whose parents are beneficiaries of social assistance on any grounds and are registered unemployed with the National Employment Office, thus providing a better use of benefits and better targeting of those beneficiaries who need it the most.
Timetable by year	December 2016 – Amendments enacted by Parliament From early 2017 onwards – Amendments applied
Cost of implementation and impact on the annual budget	No implementation costs The estimated impact in 2017 is a reduction of budgetary expenditures by approximately EUR 15.8 million No significant reduction in the number of beneficiaries who are able to work is expected, given the substantial reduction of 45.19% already effected through better efficiency and targeting of assistance through the introduction of the new IT system. However, the impact of other measures within the scope of competences of other systems, such as the adoption of the Law on the Legalization of Informal Structures, consistent enforcement of the Law on Non-Contentious Proceedings as regards probate proceedings, will in the long run help reduce the number of beneficiaries of family cash allowance and other entitlements stemming from it.
Expected impact on competitiveness	This measure will provide for more efficiency in the activation of beneficiaries of cash allowances who are able to work, which will increase labour market competitiveness, create equal opportunities and greater employment, all of which will reduce poverty.
Expected social outcomes including on employment and on social groups, in particular on gender	This measure will provide for more efficiency in the activation of beneficiaries of cash allowances who are able to which, will increase employment. The provisions of the Law on Social and Child Protection concerning the benefits for mothers of three or more children, who made an early exit from the labour market possible for certain categories of women, will be reassessed.

Table 12: Reporting on the implementation of the structural reform measures of the 2016–2018 ERP

Priority reform measure No. 1: Introduction of the e-procurement system

Short description of actions planned for 2016	1. The tendering procedure is scheduled for Q1 2016 and planned to be completed in Q4 2016. The development of the e-procurement system is also planned in Q4.
Were the actions planned for 2016 implemented?	Yes/no/partially Yes/no/partially
If yes or partially, include: -Description of steps taken -Timeline of implemented actions -Difficulties and delays in implementation -Whether the reform will continue in 2017 If no, explain why not	The ToR for e-procurement systems was developed and published. In February 2016 the Ministry of Finance's Directorate for the Financing and Contracting of EU Assistance Funds (*CFCU*) and the Public Procurement Administration (PPA) finalized the tender dossier and tendering procedures, including the publication, evaluation and selection of the most advantageous tenders, signing of contracts and other actions to ensure the project's success. The procedure for selecting the most advantageous tender was planned to be completed before 2016. The reform measure will continue in 2017.
Actual cost of implementation and impact on the annual budget (indicate deviation from estimated costs if any)	The costs for the implementation of this measures in 2016 (approximately EUR 60,000) referred to budgetary appropriation for gross salaries of the PPA staff involved in the project implementation.

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

Short description of actions planned for 2016	The Transport Development Strategy was planned to be funded through the Operational Programme Regional Development 2012–2013 (OPRR), IPA III, Priority Axis 3, Technical support. The funding required for the implementation of the Strategy is EUR 300,000. The Strategy is planned for completion in 2017 provided the following are carried out first: the final ToR for the Strategy provided; the identification form developed and adopted; and the tendering procedures for the Framework Agreement carried out.
Were the actions planned for 2016 implemented?	Yes/no/partially Yes/no/partially
If yes or partially, include: -Description of steps taken -Timeline of implemented actions -Difficulties and delays in implementation -Whether the reform will continue in 2017 If no, explain why not	The activities were partially implemented due to a delay in providing funding for revising the Strategy, eventually provided through the IPA Operational Programme. The measure will be implemented in 2017, but since funding for the Strategy revision has been provided, it will not be included in the priority reform measures.
Actual cost of implementation and impact on the annual budget (indicate deviation from estimated costs if any)	EUR 300,000

Priority reform measure No. 3: Construction of the Smokovac–Mateševo priority section of the Bar-Boljare highway

Short description of actions planned for 2016	The Contract for the Bar-Boljare Highway Design and Construction, Smokovac–Uvač–Mateševo section (Official Gazette of Montenegro No. 54/14) set the 48-month deadline for the project implementation, which started on 11 May 2015. The contractor is obliged, within the set timeframe, to develop the main design, construct, purchase and install equipment and installations for the approximately 41-km-long Smokovac–Uvač–Mateševo section of the Bar–Boljare highway. The contractor (CRBC) will carry out works in accordance with the Work Schedule.
Were the actions planned for 2016 implemented?	Yes/no/partially Yes/no/partially
If yes or partially, include: -Description of steps taken -Timeline of implemented actions -Difficulties and delays in implementation -Whether the reform will continue in 2017 If no, explain why not	In 2016 the activities related to the priority highway section fell behind schedule due to delays in obtaining the required construction permits. This reform measure will continue in 2017.
Actual cost of implementation and impact on the annual budget (indicate deviation from estimated costs if any)	Approximately EUR 250 million was planned for this measure in 2016, of which EUR 204 million are from the Exim Bank loan. The actual withdrawals fell short of the plan.

Priority reform measure No. 4: Railway network modernization

Short description of actions planned for 2016	The Vrbnica–Bar Railway is part of the Belgrade–Bar international railway, connecting the Port of Bar and Montenegro with other Western Balkan countries and Central Europe. In the SEETO Comprehensive Network it is recognized as Route 4, as confirmed by this year's Western Balkans Vienna Summit of the heads of governments. The approved funding by international financial institutions, including the EBRD and the EIB, and IPA and WBIF funding, are earmarked for the reconstruction and modernization of the above rail route in order to increase its competitiveness compared to other rail routes and other modes of transport, and to put the Port of Bar to full use.
Were the actions planned for 2016 implemented?	Yes, partially
If yes or partially, include: -Description of steps taken -Timeline of implemented actions -Difficulties and delays in implementation -Whether the reform will continue in 2017 If no, explain why not	• The following steps have been taken: Rehabilitation works on the Trebaljevo Bridge Urgent rehabilitation of four steel bridges Rehabilitation of the Morača Bridge Repair of tracks in the Kolašin–Kos section Rehabilitation of three tunnels in the Kos–Trebješica section Dismantling of the existing traction station and purchase and instalment of a new traction station at Trebješica Inspection of 106 tunnels and preparation of main designs for urgent rehabilitation • As regards the grant approved for the railway project (WBIF IPA 2015), it is now expected that a EUR 20 million worth loan agreement will be signed (as Montenegro's 50% co-financing share). The EUR 20 million WBIF 2015 grant and the EUR 20 million EIB loan are planned to be spent over the period 2016–2020 for equipping the signalling and safety devices at Podgorica station, for rehabilitation of a large number of bridges and tunnels, and for the rehabilitation of gradients on the Bar–Vrbnica railway (at the Serbian border). This reform measure will continue in 2017.
Actual cost of implementation and impact on the annual budget (indicate deviation from estimated costs if any)	Approximately EUR 5 million in 2015 and 2016.

Priority reform measure No. 5: Interconnection of the power systems of Montenegro and Italy and construction of transmission infrastructure in the country and interconnection with Serbia

Short description of actions planned for 2016	1. Activities regarding the construction of the Lastva substation and the 400 kV Lastva–Čevo and Čevo–Pljevlja transmission lines, etc.
Were the actions planned for 2016 implemented?	Partially; it should be noted that a substantial proportion of the activities have been implemented, but with certain delays.
If yes or partially, include: -Description of steps taken -Timeline of implemented actions -Difficulties and delays in implementation -Whether the reform will continue in 2017 If no, explain why not	In 2016 the activities on the construction of the Lastva substation and the 400 kV Lastva–Čevo and Čevo–Pljevlja transmission lines were implemented and are still being implemented. The works carried out in reference to the substation include the preparation of documentation, access roads, building foundations for the transmission line pylons, etc. The difficulties encountered and subsequent delays are linked with unforeseen circumstances in the field, and property-related issues in providing access roads. Regardless of the delays, the reform measure will continue in 2017.
Actual cost of implementation and impact on the annual budget (indicate deviation from estimated costs if any)	Of the planned EUR 30 million in 2016, somewhat over EUR 20 million was disbursed until October.

Priority reform measure No. 6 : *Construction of utility infrastructure on the coast and in the Old Royal Capital of Cetinje*

Short description of actions planned for 2016	This measure includes three different projects: 1) Construction of a joint wastewater treatment plant for the municipalities of Kotor and Tivat; 2) Development of water and sanitation networks in the Municipality of Herceg Novi, including construction of 35.3 km of water supply and sewerage networks, 13 pumping stations and a underwater outflow; and 3) construction of a sewerage network in Cetinje.
Were the actions planned for 2016 implemented?	Yes
If yes or partially, include: -Description of steps taken -Timeline of implemented actions -Difficulties and delays in implementation -Whether the reform will continue in 2017 If no, explain why not	1) Construction of the joint wastewater treatment plant for the municipalities of Kotor and Tivat were realized. 2) Development of water and sanitation networks in the Municipality of Herceg Novi includes the construction of 35.3 km of water supply and sewerage networks, 13 pumping stations and an underwater outflow, The contract is expected to be completed in 2017. The project value is EUR 18,522,000. The construction of water and sanitation networks in the Municipality of Herceg Novi is funded by the KfW bank loan amounting to EUR 12,600,000. The Government's co-financing share is EUR 2,923,000 and a total of EUR 2,309,000 was provided from local budgets. So far a total of EUR 16,767,122.51 has been disbursed. 3) The Construction of the Sewerage Network in the Old Royal Capital of Cetinje was carried out through two segments: I) A segment with IPA 2011 funding, whose implementation was monitored by the EU Delegation. The value of this segment is EUR 2,733,111 (grant funding of EUR 3.2 million was approved). The contract was of the Design–Build type. All works and technical inspection were completed. The works covered the centre of Cetinje. II) Another segment was funded by the IPF MW (Infrastructure Project Facility – Municipality Window) 2008 whose implementation was overseen by "PROJECT – CONSULTING" Ltd, Podgorica (PROCON), of a total value of EUR 685,704. This was also a design–build type of project. The works were completed and technical inspection carried out. These works covered the areas from Gruda to Donje Polje. Within the framework of both segments a total of 17,356 m of faecal sewers and 4,130 m of storm sewers was built. The projects are fully finished, with all funds withdrawn. The measure was fully completed and will not continue in 2017.
Actual cost of implementation and impact on the annual budget (indicate deviation from estimated costs if any)	

Priority reform measure No. 7: Support for investments in primary agricultural production and in processing capacities with the aim of reaching EU food safety standards

A brief description of the activities planned for 2016.	1. Support for investments in primary agricultural production and processing capacities Alignment with EU food safety standards
Are the activities planned for 2016 implemented?	1. Yes/no/partially
If the answer is yes or partially, provide the following: -Description of the steps taken -Time schedule of the implemented activities - Difficulties and delays in the implementation - Will the reform continue in 2017? If not, explain why	All the planned measures in the framework of the agricultural budget were implemented and the IPARD like project was implemented. Public calls were announced in March 2016 and completed by the end of December 2016 for IPARD like. Thirty-three agreements were signed with those involved in food processing and investment of about EUR 5 million was planned. However the IPARD programme did not start in 2016 and accreditation of the Payment agency is pending, and in particular, due to infectious animal diseases: lumpy skin disease and blue tongue disease, there was a significant loss of livestock and unplanned expenses amounting to EUR 1,200,000 as compensation for damages to agricultural producers.
The actual cost of implementation and the impact on the annual budget (indicate deviations from the estimated costs, if any)	Deviations in relation to planned funds from the EU's IPA funds: EUR 7 million was implemented through the project IPARD like, and the rest will be implemented in 2017.

Priority reform measure No. 8: Boosting of investments in industry, focusing on processing industries

Short description of actions planned for 2016	Have at least one public call for funding to boost direct investments, focusing on processing industries, worth EUR 681,333 in total. In line with the interest generated among prospective investors and within the means available, it is possible to have another call during the year.
Were the actions planned for 2016 implemented?	$\boxed{\text{Yes}}$/no/partially Yes/no/partially
If yes or partially, include: -Description of steps taken -Timeline of implemented actions -Difficulties and delays in implementation -Whether the reform will continue in 2017 If no, explain why not	Based on the 2015 call, contracts were signed with three investors, and the total value of investment projects is EUR 2.5 million. It is envisaged to generate 103 new jobs in the coming three years, with a total value of subsidies per job of EUR 362,000. The beneficiary companies which started implementing the investment projects in 2016 deal with wood processing, production of animal feed and life and property insurance. - In mid-March 2016 a second call was issued for incentives for direct investments lasting two months. Of the 16 applications received, 10 investment projects met all the requirements set by the Decree, and after the review and assessment of eligibility, the investment projects were evaluated. In late-July the Government made the decision to grant funding, following which contracts were signed with three companies with investment projects in the food industry, pharmacology and tourism. The total investment value was EUR 4.7 million, generating 150 jobs in the coming three years, while the total subsidy amount was approximately EUR 1.12 million. According to the agreed schedule, now the final activities are being implemented before the investments are launched. There were no difficulties or delays. The measure is planned to continue in 2017.
Actual cost of implementation and impact on the annual budget (indicate deviation from estimated costs if any)	In comparison to the planned amount of EUR 620.000, the amount of spent budget funds for realization of the measure in 2016 amounted to EUR 681,333. Early this year, the first instalment was provided to the beneficiaries under the first call amounting to of EUR 120,666, while according to the terms of the investment project schedules, a total of EUR 70,666 was disbursed by the end of the year as a second instalment. According to the investment schedules for projects that received funding under the 2016 call, an amount of EUR 373,333 was disbursed as a first instalment, and this year EUR 116,668 has been disbursed as a second instalment.

Priority reform measure No. 9: Enhancement of tourist supply in the north by developing the necessary ski infrastructure

Short description of actions planned for 2016	1. 2. etc.
Were the actions planned for 2016 implemented?	Yes/no/partially Yes/no/partially
If yes or partially, include: -Description of steps taken -Timeline of implemented actions -Difficulties and delays in implementation -Whether the reform will continue in 2017 If no, explain why not	- The activities envisaged by current procedures and implementation schedule have been launched - The actions within this measure commenced in 2015 and intensified in 2016 - The difficulties mostly refer to weather conditions, time-consuming and complicated public procurement procedures, the absence of physical plans, lateness in executing tasks by the participants in this endeavour - This reform measure will continue in 2017 and onwards, since it involves multiannual projects.
Actual cost of implementation and impact on the annual budget (indicate deviation from estimated costs if any)	The costs did not deviate from the estimated ones, since there was no increase in the expected costs, but on some projects the degree of implementation was lower than expected, and consequently the actual costs were also lower.

Priority reform measure No. 10: Implementation of still pending recommendations from the "regulatory guillotine"

Short description of actions planned for 2016	According to the revised deadlines for Q1 2016, a total of 51 recommendations are to be followed through. The recommendations issued fall under the scope of authorities of six ministries. In Q2 2016, 26 recommendations are scheduled for implementation. A total of five ministries are obliged to implement these recommendations. Since Action Plan adoption (May 2012), and ending with Q2 2016, a total of 1,164 recommendations were followed through, out of the overall total of 1,446, or 80.50%.
Were the actions planned for 2016 implemented?	Partially
If yes or partially, include: -Description of steps taken -Timeline of implemented actions -Difficulties and delays in implementation -Whether the reform will continue in 2017 If no, explain why not	-Description of steps taken Of all the recommendations scheduled for implementation in Q1 2016 (51), 21 were followed through. Four recommendations were subsequently dropped. An additional six recommendations are expected to be implemented by the end of 2016. In addition, the implementation of 15 recommendations was put forward for 2017, and an additional five for 2018. During Q2 2016, three recommendations were followed through out of the 26 planned. Six recommendations were subsequently dropped. Seven recommendations are expected to be implemented by the end of 2016, while 10 were put forward for implementation in 2017. 2017: 105 recommendations 2018: Seven recommendations 2019: – Hence, the measure will continue in 2017, but it is in its final stage, and for this and for the reason of limiting the number of priority reform measures in the 2017 ERP down to 20, this is not proposed as a priority measure in 2017.
Actual cost of implementation and impact on the annual budget (indicate deviation from estimated costs if any)	There are no direct fiscal implications of this measure in the sense of additional costs of implementation, since this will be done with the existing administrative capacities, and no significant investments are envisaged for its implementation.

Priority reform measure No. 11: Improvement to the building permit issuing process by upgrading existing IT solutions

Short description of actions planned for 2016	1. Adoption of the Law on Spatial Development and Construction of Structures to define e-operation in physical planning and building construction
Were the actions planned for 2016 implemented?	2. partially
If yes or partially, include: -Description of steps taken -Timeline of implemented actions -Difficulties and delays in implementation -Whether the reform will continue in 2017 If no, explain why not	The Law on Spatial Development and Construction of Structures was drafted and approved by the Government.
Actual cost of implementation and impact on the annual budget (indicate deviation from estimated costs if any)	–

Priority reform measure No. 12: Cadastral offices' observance of statutory deadlines set in the Law on the State Survey and Real Estate Cadastre

Short description of actions planned for 2016	1. Observe the deadlines set in the Law on the State Survey and Real Estate Cadastre 2. Move Podgorica's local cadastral services to new offices, in respect of the fact that this local office handles the largest caseload 3. Strengthen the staffing and IT capacities of cadastral offices as the basis for upgrading and enabling access to the integrated IT system by banks, local self-governments and state authorities 4. Conclusion of the World Bank-supported LAMP project
Were the actions planned for 2016 implemented?	. Yes/no/partially – Yes, planned actions were carried out in 2016 . Yes/no/partially
If yes or partially, include: -Description of steps taken -Timeline of implemented actions -Difficulties and delays in implementation -Whether the reform will continue in 2017 If no, explain why not	Potential difficulty: Increased volume of work and caseload in some local cadastral offices, which may slow down their work. The reform is planned to continue in 2017 by drafting legislation regarding the IT system of the Real Estate Cadastre. It aims at enabling access to the integrated IT system by banks, local self-governments and state authorities in order to relieve the burden and speed up the procedure of issuing relevant documents. Within the framework of the Land Administration and Management Project (LAMP), the Real Estate Administration, in cooperation with the World Bank, carried out a customer satisfaction survey. The survey shows that the largest proportion of respondents (76.8%) had their cases dealt with within eight days.
Actual cost of implementation and impact on the annual budget (indicate deviation from estimated costs if any)	–

Priority reform measure No. 13: Introduction of e-VAT taxation in order to curb the grey economy

Short description of actions planned for 2016	It is planned that in 2016 a mixed-composition team will work in parallel on putting in place the technical preconditions (software and hardware purchase) and developing the underpinning legislation (the law and a rulebook).
Were the actions planned for 2016 implemented?	Yes/no/partially The actions planned for 2016 have not been implemented. Yes/no/partially
If yes or partially, include: -Description of steps taken -Timeline of implemented actions -Difficulties and delays in implementation -Whether the reform will continue in 2017 If no, explain why not	There is a need to test coverage with mobile telephone signals to enable data transfer and to harmonize the technical capabilities and pricing for services provided by mobile operators, which has delayed implementation of this measure so far. Continued implementation as a priority reform measure in 2017.
Actual cost of implementation and impact on the annual budget (indicate deviation from estimated costs if any)	–

Priority reform measure No. 14: Improvement of financial and non-financial support to SMEs

Short description of actions planned for 2016	As regards improving financial support to SMEs in 2016, the plan is to revise current financial tools and develop new ones aimed at providing better conditions for access to funding by business start-ups, innovative SMEs, women in business and existing SMEs. Planned activities include the following: 1. A revised credit support scheme provided by the IDF by introducing new credit lines such as loans for university graduates, loans for ICT SMEs, micro-credit and combined financial and non-financial support 2. Introduction of a new financial tool in the form of equity financing 3. Implementation of the credit guarantee tool by CKB bank providing more favourable collateral requirements for SMEs
Were the actions planned for 2016 implemented?	Yes/no/partially – Yes, all planned actions were implemented in 2016
If yes or partially, include: -Description of steps taken -Timeline of implemented actions -Difficulties and delays in implementation -Whether the reform will continue in 2017 If no, explain why not	-Description of steps taken 1. In 2016 (the situation as of 30 November 2016) a total of 406 loans were granted, worth EUR 104.7 million, of which 367 loans were worth EUR 54.5 million and 39 factoring arrangements were worth EUR 50.2 million in purchased claims, thus generating 636 new jobs and retaining 1,300 existing jobs. Broken down by industry, the largest share of loans were granted to SMEs in manufacturing and the food industry – EUR 16.4 million (30.1%), services – EUR 15.0 million (27.5%), tourism and hospitality – EUR 12.5 million (23%), trade – EUR 7.2 million (13.2%) and agriculture – EUR 3.4 million (6.2%). The total offer of financial investments, with 22 credit lines in total in 2016, is more favourable compared to 2015, by extending repayment and grace periods (a 15-year repayment period with a 5-year grace period), with interest rates down on average by 0.5–1pp and ranging between 0%–5% (most often 2.5%). As regards the revision of the existing loan support, in 2016 the IDF introduced new credit lines: Loans for University Graduates – 12 loans granted worth EUR 269,000, with a 0% interest rate enabling the setting up of 12 businesses; Support to Investments in ICT – 1 loan worth EUR 550,000; Support for Women in Business – micro-credit loans of up to EUR 10,000 in cooperation with the UNDP, 22 loans granted totalling EUR 186,000; Support for Entrepreneurship – a combination of financial and non-financial support for business start-ups, a total of 24 loans granted worth EUR 576,000. 2. In April 2016, the IDF, as an investor, joined the newly established ENIF – Enterprise Innovation Fund, thus putting in place the requirements for introducing a new financial tool of equity financing for innovative start-ups and development of innovative businesses. CKB bank continued with the loan guarantees for SMEs (EUR 30 million for 3 years, beginning of implementation in July 2015) as planned. - Financial support through loans and factoring arrangements was implemented in continuity from 1 January to 30 November 2016. – All financial support measures planned in 2016 were fully implemented, while equity financing is now being introduced and is in its initial stage. - The priority reform measure of financial support to SMEs will continue in 2017.
Actual cost of implementation and impact on the annual budget (indicate deviation from estimated costs if any)	For implementing the reform measure of improving financial support to SMEs, by 30 November 2016 the IDF had invested EUR 104.7 million compared to the EUR 100.0 million planned for 2016, and the funds were provided by the EIB, from repayment of previously granted funding and operational income from interest and loan and factoring fees.

Priority reform measure No. 15: Construction of the Innovation and Entrepreneurial Centre "Tehnopolis" in Nikšić

Short description of actions planned for 2016	1. The works are at the stage of rough construction works, adding annexes to the existing building for future laboratories, a multimedia room, etc. This will be followed by hydraulic and electrical engineering works and installations. (Q1 2016) 2. Completion of finishing works on the reconstruction and adaptation of the former Army Base in Nikšić which will house "Tehnopolis"; 2 ToRs issued within the framework of the IPA II for training "Tehnopolis" staff and providing equipment, etc. (Q2 2016) 3. Tendering procedure for furnishing and partly equipping the building; Competition for "Tehnopolis" occupants. (Q3 2016) 4. Furnishing and partial equipping of the building (computer and small equipment) and beginning of occupation of "Tehnopolis"; Signing of service agreements for training delivery and specification of equipment needed for "Tehnopolis".
Were the actions planned for 2016 implemented?	Yes/no/partially YES, the measure has been fully implemented. Yes/no/partially
If yes or partially, include: -Description of steps taken -Timeline of implemented actions -Difficulties and delays in implementation -Whether the reform will continue in 2017 If no, explain why not	All actions planned for 2016 due to date, have been fully implemented. Thus, the first Innovation and Entrepreneurial Centre, Tehnopolis, was developed in Nikšić, with the construction of its business premises completed in July 2016, and officially opened on 17 September 2016. As per the public call, 14 entrepreneurs and businesses were selected as Tehnopolis occupants.
Actual cost of implementation and impact on the annual budget (indicate deviation from estimated costs if any)	Tehnopolis financing in 2016 was carried out according to the 2016 Budget Law as follows: - As part of the Capital Budget, the reconstruction of the former Army Base in Nikšić to be adapted to house Tehnopolis, totalling EUR 805,000 - As a part of the Ministry of Science's budget, under the Tehnopolis programme, the amount of EUR 66,049 was provided in 2016.

Priority reform measure No. 16: Increase in company competitiveness by harmonization with the requirements of international quality standards

Short description of actions planned for 2016	The programme for increasing regional and local competitiveness through harmonization with the requirements of international standards includes two types of support: 1) Support for SMEs through the reimbursement of costs of accreditation of the conformity assessment body 2) Support for SMEs through the reimbursement of costs of implementing standards/certification/recertification
Were the actions planned for 2016 implemented?	Yes/no/partially YES, as planned. Yes/no/partially
If yes or partially, include: -Description of steps taken -Timeline of implemented actions -Difficulties and delays in implementation -Whether the reform will continue in 2017 If no, explain why not	The public call for the 2016 Programme was issued on 25 April and was open until 26 May. A total of 45 companies applied, of which 15 applications were incomplete, thus only 30 were approved. The funds requested by eligible applicants were calculated, and given that the total funding available for this call was EUR 95,000 (as announced in the call), thus it was possible to grant funding for the 30 eligible applicants, together with one application from 2015, due for payment in 2016 of EUR 5,000.
Actual cost of implementation and impact on the annual budget (indicate deviation from estimated costs if any)	EUR 100,000 in 2016, of which EUR 95,000 was contracted, and the actual disbursement will depend on the progress made in project implementation by beneficiaries.

__Priority reform measure No. 17: Development of qualifications based on learning outcomes matching labour market needs__

Short description of actions planned for 2016	Development of qualifications based on learning outcomes matching labour market needs
Were the actions planned for 2016 implemented?	Yes
If yes or partially, include: -Description of steps taken -Timeline of implemented actions -Difficulties and delays in implementation -Whether the reform will continue in 2017 If no, explain why not	The methodologies which enable drafting curricula based on learning outcomes have been adopted by the Qualifications Council. The curricula to be revised or redrafted based on learning outcomes have been chosen, based on the review done. Currently teachers are undergoing training in active teaching methods and competence- and outcome-based teaching and learning. Twenty occupational standards are currently being developed together with employers, which reflect labour market needs and will serve as a basis for credit-based modular curricula. The envisaged activities were carried out in 2016. No difficulties were encountered. The reform measure will continue in 2017.
Actual cost of implementation and impact on the annual budget (indicate deviation from estimated costs if any)	The cost of implementation as provided by the 2016 budget amounts to EUR 120,600.

Priority reform measure No. 18: Service agreements and grant schemes for improving human resources and increasing employment

Short description of actions planned for 2016	1. Training of staff in the Ministry of Labour and Social Welfare and the National Employment Office to design, monitor and evaluate active labour market measures, and local employment plans. Piloting of active labour market measures – "Eliminate the Grey Economy". Labour market analysis and existing active labour market measures. Improved client relations (with the unemployed and employers) in the National Employment Office. 2. Sign grant agreements within the "Youth, Women and the Long-Term Unemployed in the Labour Market" grant scheme and start their implementation over 12 months with the aim of increasing the capacities of the target groups, their employability and actual employment.
Were the actions planned for 2016 implemented?	Partially Partially
If yes or partially, include: -Description of steps taken -Timeline of implemented actions -Difficulties and delays in implementation -Whether the reform will continue in 2017 If no, explain why not	1. The above activities were implemented in continuity once the agreement was signed, i.e. from 10 December 2015. Training events and workshops were organized as planned and the 2016 Training Plan was developed and approved. In addition, surveys with employers and unemployed people were completed and are now being analysed. 2. The evaluation of applications received under the call for the "Youth, Women and the Long-Term Unemployed in the Labour Market" grant scheme was completed and agreements are to be signed with the selected grant beneficiaries. - The evaluation of applications was a demanding and complex task taking several months to complete. This delayed the planned signing of agreements, but it is expected to be completed by the end of October 2016. - Service agreements and grant schemes will continue in 2017.
Actual cost of implementation and impact on the annual budget (indicate deviation from estimated costs if any)	A total of EUR 3,612,531.00 is envisaged for this activity over the period 2015–2017. Within this amount, budgetary co-financing will amount to EUR 541,881.07 while the EU (IPA) funding will amount to approximately EUR 3,070,650.80. - The amount disbursed so far pursuant to service agreements under "Active Labour Market Measures for Employability" amounted to EUR 396,157.56, of which EUR 335,083.35 is from IPA funding, and EUR 59,132.51 from the central budget. The remaining funds will be disbursed by August 2017, as planned. - The disbursements within the "Youth, Women and the Long-Term Unemployed in the Labour Market" grant scheme have not started yet, since the agreements are yet to be signed.

Priority reform measure No. 19: Building of preschools to increase coverage of children by preschool education

Short description of actions planned for 2016	The construction of two new preschools in Podgorica, in the districts of Stari Aerodrom and Zagorič, and one in Bar should start in Q1 2016. The completion date for all buildings is 12 months after the commencement of works.
Were the actions planned for 2016 implemented?	Partially
If yes or partially, include: -Description of steps taken -Timeline of implemented actions -Difficulties and delays in implementation -Whether the reform will continue in 2017 If no, explain why not	The preschool building in Zagorič will be completed on 19 December 2016. The construction of the remaining two preschools will not be completed in 2016, given that the tendering procedure is still pending. This reform measure will continue in 2017, not as a priority (given that the number of possible priority measures is limited down to 20 in the 2017 ERP), but as one of the measures within the overall education sector reform.
Actual cost of implementation and impact on the annual budget (indicate deviation from estimated costs if any)	The total cost for partial implementation in 2016 amounted to EUR 1.2 million, of which EUR 972,000 is from the Council of Europe Development Bank (CEB), and EUR 228,000 from the central budget.

ANNEX 2:

EXTERNAL CONTRIBUTION TO PREPARATION OF THE DRAFT ECONOMIC REFORM PROGRAMME 2017–2019

COMMENTS ON THE DRAFT PROGRAMME

1. Contribution of the Parliament of Montenegro

The draft Economic Reform Programme 2017–2019 was the object of debate in the meeting of the Parliamentary Committee on Economy, Budget and Finance held on 18 January 2017. During the session of the Committee, which was open to the media, MPs gave constructive comments and suggestions on the draft document.

The Chairman of the Board, MP Prof. Vujica Lazović, said in the introductory part of the meeting that the draft Economic Reform Programme for Montenegro for the period 2017–2019 was being submitted to the Parliament of Montenegro for the first time. Also, he assessed as positive the correspondence of the Government of Montenegro and the European Commission in the part referring to the involvement of parliamentary committees in giving suggestions and comments to improve economic reforms before adoption by the Government. He said that the submitted document presented measures of fiscal policy of structural reforms with macrofiscal sector-related impacts that were implemented by the end of 2016 or are planned for 2017, which also represent a response to the six recommendations of the ministerial meeting held in Brussels in May 2016. Also, he noted that along with the draft Programme, an annex was submitted containing: tables of the pre-accession economic programme and their updated versions; overview of direct fiscal impact of 20 priority reform measures; a summary of the structural reform measures for 20 priority reform areas; the Report on the implementation of the reform measures from the Economic Reform Programme for 2016–2018 and the priority development projects on which the projections of economic growth for 2017–2019 are based.

In his speech, MP Vujica Lazović repeated that it was a very significant document which is important in terms of economic viability and presents the agenda according to which the Montenegrin economy should develop in the next two years. In further remarks, he said that the situation in Montenegro in terms of the overall economic system should be considered optimistically, and that taking into account the previous period over the last 10 years, it can be concluded that Montenegro has almost doubled its GDP, earnings and pensions, and that there is a constant growth of foreign direct investment. He also expressed a dilemma about whether the economic growth projections were realistic, i.e. whether these are realistic and sustainable, given that in the past for various reasons, the rates of economic growth have been overestimated, but that certain problems would occur at some point later. He said that the clear objectives must be defined in the Economic Reform Programme in Montenegro because it might happen that in the future the European Commission will pose the question of whether the projections turned out to be realistic. In this regard, he referred to the lacking infrastructure in transport, energy, utilities and tourist infrastructure. In this respect, Mr. Lazović made a suggestion regarding the need for a more realistic consideration of investment in infrastructure.

In relation to the structural measures, he pointed out that it was necessary to increase the competitiveness of the economy and ensure economic growth, which would, in turn, continue to provide higher employment and ultimately improve the quality of life of the citizens. He also commented on the number of employees in the public sector and the need for greater efficiency in public administration. In this respect, he noted that it was necessary to accurately evaluate the realistically achievable structural reforms in this period.

He pointed out that it was necessary, especially when preparing important documents, to clearly separate labour market policy from social policy and commit to solving the problem of unemployment, especially unemployment of highly educated staff, because of the trend of growth in this segment. In this regard, he stated the fact that, according to some estimates, about 32% of university graduates in some EU member states are unemployed, and it is estimated that in developing countries such as Montenegro the most vulnerable category of the population are the unemployed, in terms of all economic parameters and the quality of life, and that such a situation must be solved by creating new jobs in those sectors where Montenegro can be particularly competitive.

In relation to the programme of professional development for university graduates, there were some opinions that it was producing certain effects, but, unfortunately, it had to be admitted that there were certain problems in the implementation and effects of the programme, in terms of job retention, acquired knowledge and skills and so on. Given the above, Mr. Lazović, recommended that, if there is room for it, the Economic Reform Programme should provide changes to the concept of professional development and that the amount of funds allocated at this point should be allocated so as to finance jobs with employers who would be willing to provide for the employment of those who go through the training programme. He also stressed that it is necessary to align higher education with labour market needs.

(*Proceeding/opinion of the proponent of the document in relation to the comments of Prof. Lazović on the draft Economic Reform Programme 2017–2019*

The proponent is of the opinion that in section 4.3.7 of Chapter IV, there are two adequately proposed priority reform measures to harmonize education with labour market needs. Regarding the comments on the macroeconomic projections, in particular tax revenues, the Ministry of Finance considers that the revenue projections were made in a very conservative manner, and the projections took into account fiscal consolidation measures. All the comments made by the Chairman of the Committee on Economy, Finance and Budget on the 2017–2019 ERP will be considered in the continuation of the implementation of the existing reforms and launching of the new structural reforms important in order to increase competitiveness and stimulate economic growth, particularly in the context of the forthcoming analysis in key areas of economic policy that the Government of Montenegro will develop in the future and that will be important in proposing further reform measures in the programmes of economic reforms in the forthcoming period, as well as in other key documents of the Government in the area of economic development policies. The proponent agrees with the view that the range of measures to increase the competitiveness is broader than described in the draft 2017–2019 ERP but the methodology of drafting this document limits their number to 20. Also, the proponent agrees that in the preparation of these important documents, one should observe the labour market and social policy separately from each other as possible, with a view to solving the problem of unemployment, especially unemployment of highly educated staff. Methodology for the preparation of this year's ERP allows for separation of the labour market and social policy, even though there is still a high level of correlation between these areas in Montenegro.

MP Genci Nimanbegu evaluated as good the introduction of the practice of the Committee to consider the draft Economic Reform Programme, but also pointed out that it had been delivered late on and that there was no room for detailed consideration of the proposed measures, etc. He said that he agreed with the Chairman of the Committee that Montenegro had significantly improved its macroeconomic indicators over the past 10 years when it comes to the growth of GDP, earnings, pensions, social benefits and investment, but that the question remained open as to whether citizens felt that real needs could be matched with what we, as a small economic system, have and how. Also, he noted that the ERP does not foresee an increase in the minimum wage, and that, in his opinion, an increase in the minimum wage, which is now at a level of EUR 193.00, would lead to the elimination of problems faced by employees in the private and public sectors, with particular emphasis on the private sector, bearing in mind that it is economically unsustainable for the public sector to compete with the private sector. With regard to the reform measures in the field of education, he said that the reform in higher education has brought about a situation in which there are still university graduates who are not competitive on the market, and that the above recommendation is perceived with a lot of pessimism. He expressed the view that it was necessary to conduct an analysis of the education reform in order to consider its outcome. Concerning investments, he had objections, stating that these were the consequences of what had been done in the previous system. He stated that there are a large number of investments aimed at improving the tourist infrastructure, but they are still predominantly in municipalities that have an above-average level of development in Montenegro.

In relation to investment in transport infrastructure, he was of the opinion that it would not yield results for a long time, given the lack of infrastructure connections when it comes to, for example, rail traffic. He also pointed to problems in maritime and air transport, stating that the national airline company is close to bankruptcy, and that this might be the result of opening the airspace up to low-cost operators, while stressing that he is not in favour of a monopoly position, but that one primarily has to bear in mind how much it contributes to the economy in Montenegro. He also expressed his regret over the fact there was no mention in the coming period of the Adriatic–Ionian Highway project in Montenegro.

Proceeding/opinion of the proponent of the document in relation to the comments of Mr. Nimanbegu on the draft Economic Reform Programme 2017–2019

On the basis of Mr. Nimanbegu's comment, section 4.3.7 of Chapter IV, "Education and skills" was extended, where two priority reform measures to harmonize education with labour market needs were already proposed. The analysis of further education reform is something that is still to come, as Mr. Nimanbegu suggested. Pursuant to his comment on the improvement of the tourist and transport infrastructure, in Chapter IV, item 4.3.2.2 in the field of transport, the priorities relating to the upgrading of airports and maritime transport have been additionally underscored.

Also, in accordance with the suggestion, the text in the subsection on traffic (4.3.2.2) was extended to cover the activities of the Adriatic–Ionian Corridor project.

At the MP's suggestion, the proponent clarified in the text of the 2017 ERP the link between individual reform measures and the Regional Development Strategy 2014–2020.

As for the comments on increasing the minimum wage, the above cannot be included in the 2017 ERP until a detailed analysis of the effects of a possible change in the minimum wage on the cost of doing business, and employment on one hand and on budget revenue on the other is prepared. The proponent did not include this in the Economic Reform Programme 2017–2019 since it is necessary to conduct a detailed analysis of the net effects of possible changes to the minimum wage prior to this change taking place. Also, any step towards amending the minimum wage should be previously consulted upon by all stakeholders.

MP Predrag Sekulić said that the ERP had been well drafted in terms of its methodology. With regard to the projected indicators and questionable growth rates, he pointed to the experience of Croatia, which had a high growth rate of 2.2% last year, bearing in mind that it spent six years in recession due to investments in highways, a high level of external debt, and so on. He also expressed the expectation, despite the fact that projected growth has not been achieved due to the construction of the highway and bearing in mind that a large part of the materials for the construction of the highway are imported, that the FDI would be higher than projected. He said that when making an overview of macroeconomic developments in the region, the European Union and the Eurozone, one has to be satisfied, regardless of the fact that after the rapid economic growth after restoring independence, a slight decline ensued. He pointed out that some countries in the region, EU member states, had been in recession for a long time, that most of the countries in the EU would not be able to fulfil the Maastricht criteria, and that when all this is taken into the account we can be satisfied with the macroeconomic projections, regardless of the fact that the level of public debt is often mentioned among the public, and that if it were not for the highway construction, the level of public debt would amount to 60.5% in 2017 and would have a downward trend in 2018 and 2019 to a level of 57% and 54.9% of GDP respectively. Regarding the construction of the highway, he said that failure to invest in it for a longer period would lead Montenegro towards unfavourable economic trends, and that the underlying idea was to connect the north of Montenegro into a single economic unit, in order to develop the region in the way it is being done in the south of Montenegro. He said that despite the projected growth trend of public debt and deficit, a downward trend is expected post-2019. He expressed his expectation that after the ERP is sent to the European Commission, feedback in the form of comments and possible remarks to the document would be received, and that it is very difficult to envisage individual projections, and that both the World Bank and the International Monetary Fund have repeatedly corrected their own projections not only when it comes to Montenegro, but also other countries in the region. Also, he assessed as positive the fact that Montenegro has had an upward trend for years when it comes to GDP. In relation to the lack of coverage of imports by exports, he said that everything should be done in order to make that percentage decrease, but it should be also borne in mind that Montenegro is a tourist destination, which in many ways, leads to such a balance.

Proceeding/opinion of the proponent of the document in relation to Mr. Sekulić's comments on the draft Economic Reform Programme 2017–2019

Regarding Mr. Sekulić's comments, an overview of positive trends in the economy over the last 10 years is given in Chapter 2, but due to limitations in the number of pages in accordance with the methodology of the ERP, it is not possible to elaborate in more detail the macroeconomic framework of the document. As for the suggestions related to the issue of the lack of coverage of imports by exports, the proponent identified it in the diagnosis of the situation in Area 3: "The development of economic sectors", in Area 4: "The business environment and reduction of the informal economy" and in Area 6: "Foreign trade and investment promotion" and points out that the root cause of it lies in insufficient diversification of the economy and the low level of value added in manufacturing, which is why in the Economic Reform Programme 2017–2019 lists priority reform measures in the field of industry, agriculture and services (subsections 4.3.3.1, 4.3.3.2 and 4.3.3 of the document) and Areas 4 and 6 of this year's ERP. At the same time, most of the other proposed priority reform measures serve to expand the manufacturing base of the economy and have greater diversification of exports.

MP Petar Smolović stated that the Economic Reform Programme 2017–2019 is comprehensive, analytical and contains different scenarios, and pointed out that much had been done in terms of fiscal consolidation in the past. He stressed, however, that more needs to be done in the field of the development component, i.e., the real sector, and in this regard he stated that in relation to the data on p.12 of the submitted document, in the part that relates to employment, it was necessary to analyse what had brought about a surge in unemployment of over 25% in the period September 2015–September 2016 and to determine the reasons for such a situation. In relation to the priority economic reforms, he pointed out that in terms of priority measure No. 8 – *Support for modernization and development of the industrial sector*, the allocated funds were very small, as well as the amount of aid which is provided in accordance with these funds. In relation to measure No. 10 – *Improvement of the tourist offer in the north of Montenegro through construction of required infrastructure at ski resorts*, he said that it was good, but that the data does not correspond to the real situation, i.e. that the activities had been inaccurately listed. Also, he noted that it is necessary to pay attention to the Law on Restitution and the Law on Expropriation in terms of improving the business environment through amendments to it, which, in his opinion, at this point are slowing down capital projects. Citing measure No. 11 – *Introduction of e-services in the work of cadastral services*, Mr. Smolović, pointed out that the essence of the problem was in the quality of the database, because in most municipalities there is still a land cadastre in force instead of the inventory cadastre, and cited the example that in the business zones there is an inventory cadastre but no division of land, making it impossible to obtain a construction permit, prepare a floor subdivision plan, put it on the market, etc., and pointed to the need to make the transition as soon as possible from the inventory cadastre to a land cadastre. In relation to measure No. 13 – *Improving financial support for the sector of small and medium-sized enterprises*, Mr. Smolović, said that the budget provides for only EUR 13,000 for non-financial assistance, which is a very small amount, bearing in mind that in Montenegro there are about 80,000 companies. With regard to financial assistance in this area, he indicated that it is institutionalized through the Investment and Development Fund (IDF), but also stressed the need for the IDF to stimulate the so-called real real sector, which has the capacity to substitute imports, and stressed the need to specifically emphasize the regional component of the IDF as a legal obligation, with looser criteria and collateral for businesses from underdeveloped areas, especially in northern Montenegro. Also, Mr. Smolović said that in terms of measure No. 14 – *Improvement of non-financial support to the sector of small and medium-sized enterprises*, the establishment of a State Agency for Export Insurance should be considered and that countries in the region have such agencies generating significant results in encouraging exports. In relation to development of the agricultural sector, he pointed to the need to include in the repro chain of, for example milk producers, buyers who produce end-products and domestic trade chains, which should help the marketing of domestic products. Commenting on the part of the programme relating to employment and the labour market, he said that the Labour Law was too rigid for employers and referred to inflexible limiting of temporary service contracts, fixed-term labour, etc., and pointed out that social partners must understand that the employer cannot be forced to hire someone or to have an employee if there is no need for one. Also, in connection with the problem of unemployment in the north of Montenegro, he suggested that consideration be given to "stricter" measures, namely abolishing all contributions for those newly employed for a period of 5 years. In connection with measure No. 18 – *Alignment of higher education with the needs of the labour market*, he noted that it is necessary to deal with alignment of secondary education with the needs of the economy and markets, and cited the example of northern Montenegro, where wood processing is a priority, but in secondary vocational schools there are no classes for carpenters, plasterers, etc.

Finally, as a general comment on the proposed draft Economic Reform Programme, Mr. Smolović noted that it does not deal with the Strategy for a balanced regional development, nor the Strategy for resource use and concession policy. He pointed out that detailed attention was paid to the part on electricity generation. He also expressed the opinion that if there is no operational authority for the alignment and operational coordination of measures in the implementation of the Economic Reform Programme, one should be established immediately.

Proceeding/opinion of the proponent of the document in relation to the comments of Mr. Smolović on the draft Economic Reform Programme 2017–2019

In accordance with Mr. Smolović's suggestions, priority reform measure No. 14 – Improvement of non-financial support for the small and medium enterprises *has been corrected in terms of the introduction of the total funds from the state budget which are geared towards non-financial support to SMEs, as well as donor funds, not just funds within the Directorate for SME Development in the Ministry of Economy. In addition, based on the comments on the necessity of improving the cadastral base, a portion of text was added in section 4.3.4.1 of the Programme, in order to identify the said barriers. Priority reform measure No. 10 relating to the improvement of the tourist offer in the north through the construction of the necessary infrastructure at the ski resorts has been rephrased and clarified. The proponent agrees with the comments in the field of agriculture and linkages within the repro chain, and this is connected with the proposed priority reform measures in the areas of agriculture, industry and the development of SMEs in Chapter IV of the Programme.*

As for the comments on employment and the labour market, taking into account the comments in a broad consultative process, the working group for drafting the 2017–2019 ERP accepted suggestions regarding the necessity for more specific activities in order to increase flexibility in the labour market, and the drafting of the new Labour Law (which should be agreed upon with all stakeholders during the drafting) has been included in the final text of the 2017–2019 ERP as priority reform measure No. 19. Adoption of the new Labour Law is also necessary in the process of alignment of legislation with the EU and the International Labour Organization.

In accordance with the suggestion of the MP, the proponent clarified in the text of the 2017 ERP the links between individual reform measures with the Regional Development Strategy 2014–2020.

As for reporting, the proponent points out that reporting on implementation the 2017 ERP is in the pipeline before the Government working bodies, and that it will be dealt with by the Council for Competitiveness that the Government plans to establish.

MP Jovanka Laličić expressed the opinion that the submitted material was well done and provides a large amount of information. She agreed with Mr. Smolović's comment that a special body should be formed to monitor the implementation of the priority reform measures. Bearing in mind the reform of public administration and the challenges ahead, she pointed out the need to strengthen administrative capacity at all levels. She also stated that the submitted document did not address the capacity of local government and central government to use European Union funds, and raised the question of whether such a document should include details of that issue. She expressed the expectation that the priority measures would be implemented and emphasized the need for better communication between local government and central government, and mentioned the example of utility charges, as an important component that would allow better collection of these revenues by local governments.

Proceeding/opinion of the proponent of the document in relation to Ms. Laličić's comments on the draft Economic Reform Programme 2017–2019

The proponent agrees that the implementation of the document will be monitored by the working bodies of the Government and the Council for Competitiveness once it is established. As far as the capacity to use EU funds, it is not explicitly elaborated in detail as one of the measures, but it has been taken into account in the overall fiscal projections and priorities of structural reforms in the document.

MP Filip Vuković said that this document could not be analysed in a quality manner in the short term and referred to the part that relates to the construction of the second block of TPP Pljevlja and expressed the opinion that a mistake had been made in the dynamics of the implementation of the project because, in his view, it is technically and theoretically impossible to implement it. He cited as an example the fact that the construction of the existing block of TPP Pljevlja, without some of the preparatory works, lasted about 8 years. In the part relating to the imports and exports from the country, he was of the opinion that Montenegro, first of all, needs quality staff that cannot be found in Montenegro, bearing in mind all the natural limitations.

Proceeding/opinion of the proponent of the document in relation to Mr. Vuković's comments on the draft Economic Reform Programme 2017–2019

In line with Mr. Vukovic's suggestion, the proponent clarified the dynamics in the text of Chapter IV and priority reform measure No. 4 "Construction of the second block of TPP Pljevlja" within the 2017–2019 ERP.

MP Vujica Lazović said that the document must provide a realistic dimension of what is achievable bearing in mind that, relatively soon, a comment by the European Commission on the implementation of the commitments that Montenegro has agreed to undertake on its own will be submitted. Therefore, the document should be a realistic prediction of our economy in the given period. He pointed out that the document defines, as one of the main measures, an increase in public revenues, and he was interested in whether the adoption of that measure is realistic considering that a calculation by a simple proportion, i.e. by a principle of calculation always using the same tax base, and thus obtaining revenue growth, cannot be done. In this regard, he noted that recent amendments to the Law on Value Added Tax, which increase the tax rate on IT equipment from 7% to 19%, might not be the best solution and expressed a dilemma regarding the calculated value of expected revenue growth of EUR 1.5 million on that basis. He concluded that the most important resource, namely people, had been neglected in the past.

In the area of fiscal discipline, he emphasized that the Government should show the structure of the tax debt and communicate the reasons for its emergence, bearing in mind that it covers business entities that closed down 10 years ago. He considers that fiscal discipline is the basis for competitiveness and real-market competition, and that it provides a non-discriminatory position for entrepreneurs in the market. It is necessary to encourage small and medium-sized enterprises, because they must be the cornerstone of the flexibility and sustainability of the Montenegrin economy. In this regard, he expressed the opinion that it is necessary to establish a development bank that would support the development of small and medium-sized enterprises and large capital and investment projects, bearing in mind that the IDF appears in the role of a commercial bank in certain cases. It is necessary to take into account the experience of other countries which were at a similar level of economic development when they applied the aforementioned instrument and created a different environment. He therefore said that a part of this programme must be committed to creating a positive environment for attracting foreign direct investment, because in the long term, Montenegro will need about EUR 350 million of such investments on an annual basis. He pointed out that achievement of the above, i.e. a positive business environment, involves the strengthening of the institutions of the system, the fight against crime and corruption, the creation of a favourable business environment and an efficient public administration.

He noted the many years of efforts to find an adequate solution to the tax policy in a way that would, on one hand not burden the economy and the private sector too much, and on the other hand provide enough revenues to be able to provide necessary social benefits. Therefore, the question is whether the existing model of tax policy strikes the right balance, given that there are still dilemmas regarding the provision of social justice.

Bearing in mind Mr. Smolović's suggestions, he recommended that during the finalization of this document, the possibility of establishing a separate agency tasked with managing capital databases of national importance should be considered. In terms of import substitution, he stressed the need to ensure the greatest possible benefits for domestic production.

In his closing remarks, he concluded that the establishment of a development bank and the transformation of the professional development programme for graduates should be insisted on, as well as the management and exploitation of forests, where it is necessary to establish a public company to perform these tasks, and thus consistently implement the policy of the Government, in terms of increasing the final processing and export of final products.

Proceeding/opinion of the proponent of the document in relation to Mr. Lazović's comments on the draft Economic Reform Programme 2017–2019

The proponent agrees that there are several areas that should be considered in the medium term from the aspect of improving competitiveness and achieving sustainable economic growth. All of the above will be considered on the occasion of developing a comprehensive analysis of multiple areas of economic policy and development policy in the coming period. Part of this is likely to be included in the next programmes of economic reforms which are updated annually.

The representatives of the proponent, Nina Vujošević and Iva Vuković, stated during the session of the Committee on the Economy, Finance and Budget of the Parliament of Montenegro that the suggestions from the committee members expressed during the debate, which, among other things, related to the assessment of public revenues, increasing the efficiency of tax administration, facilitating doing business in Montenegro, import substitution, infrastructure projects in the field of tourism with an emphasis on the northern region of the country, the improvement of maritime and air transport, employment growth, etc. would be considered as soon as possible and that the Government would bear them in mind on the occasion of adopting the Programme. The above has been considered to the greatest extent possible, given the limited time limits and the number of pages for the preparation of this document.

* * *

Following the debate, the Chair of the Committee, Vujica Lazović stated during the session of the Committee that the Committee had familiarized itself with the text of the draft Economic Reform Programme for Montenegro 2017–2019 and assessed the submitted document as positive.

It was agreed to submit the opinions, comments and suggestions put forward in the form of draft minutes, in accordance with Article 71, paragraph 4 of the Rules of Procedure of the Parliament of Montenegro, in electronic form, to the representative of the proponent, to ensure that they are taken into account in the drafting of the final text of the Economic Reform Programme 2017–2019.

2. *Stakeholders' contributions during and following the roundtable discussion held on 20 January 2017*

a) Non-government organizations

Institute for Entrepreneurship and Economic Development (IPER).

Dragana Radevic of the IPER pointed out that this is a high-quality draft Economic Reform Programme, in the drafting of which the EC methodology was relatively well observed. In her review, she highlighted several expectations:

-IPER: Since one of the recommendations of the EU ministerial meeting in Brussels is related to the facilitation of access to funding for small and medium-sized enterprises, it is expected that the Government will soon adopt a new Strategy for the Development of Small and Medium-Sized Enterprises.

Proceeding/opinion of the proponent of the document in relation to the comments of the IPER on the draft Economic Reform Programme 2017–2019

The Ministry of the Economy will in 2017, in consultation with the broader public, prepare a Strategy for the development of small and medium-sized enterprises.

-The IPER pointed out that in most of the measures under Chapter IV of the 2017 ERP, it is necessary to better show the connection with the objectives of the South-East Europe Development 2020 Strategy, which is cited as one of the key strategies, which, in addition to other development documents, represents the basis for preparation of the 2017 ERP.

Proceeding/opinion of the proponent of the document in relation to the comment on the draft Economic Reform Programme 2017–2019

This suggestion was accepted by the Working Group for drafting the ERP (the proponent), and the introductory part of Chapter IV and individual measures clearly indicate a connection between the measures and implementation of the South-East Europe Development 2020 Strategy.

- IPER: In the field of reforms in the labour market, the draft Economic Reform Programme 2017–2019 provides for no concrete measures relating to the adoption and amendment of legislation to increase the flexibility of the labour market (in particular the Labour Law, in the drafting of which the following should be considered: instituting fixed-term labour contracts, disciplinary proceedings, etc.).

Proceeding/opinion of the proponent of the document in relation to the comment on the draft Economic Reform Programme 2017–2019

Since this was a comment by representatives of employers who were at the roundtable discussion as well as MPs, and since the development and harmonization of the draft of the new Labour Law is planned by the Ministry of Labour and Social Welfare in accordance with the obligations in the process of negotiations for EU membership under Chapter 19, the suggestion was endorsed that the adoption of the new Labour Law should be proposed within the Economic Reform Programme 2017–2019 as a special measure, i.e. priority measure No. 19 in the final document of the Economic Reform Programme 2017–2019.

- IPER: It is necessary to clarify comments that could be heard in public recently about the possibility of increasing the minimum wage.

Proceeding/opinion of the proponent of the document in relation to the comment on the draft Economic Reform Programme 2017–2019

The proponent considers that any activity concerning a change in the amount of the minimum wage is an issue to be discussed with stakeholders and that any thoughts regarding changing the minimum wage must be preceded by a detailed analysis of the effects of the above, which requires a great deal of time, and therefore the answer to this question cannot be included in the 2017–2019 ERP.

b) *University of Montenegro*

Faculty of Economics

Prof. Gordana Djurović PhD, positively assessed the document and pointed out that:

- In Table 2.3 on p.14 a comment should be included to explain why the net errors and omissions are so substantial, especially in 2016.

Proceeding/opinion of the proponent of the document in relation to the comment of the Faculty of Economics on the draft Economic Reform Programme 2017–2019

The proponent of the document, i.e. the Working Group for drafting the 2017–2019 ERP, accepted the suggestion to include a clarification of the table in section 2.1.5.1 below Table 2.3 in the part "net errors and omissions".

- Prof. Djurović pointed out that p.4 of the draft 2017–2019 ERP requires a technical correction (the wording "association process" should be modified to "accession process").

Proceeding/opinion of the proponent of the document in relation to the comment of the Faculty of Economics on the draft Economic Reform Programme 2017–2019

This correction has been made by the proponent.

- Prof. Djurović pointed out that Table 2.7 includes inter-company debt aggregated with total external debt, hence this should be clarified, as well as its impact on the banking sector.

Proceeding/opinion of the proponent of the document in relation to the comment of the Faculty of Economics on the draft Economic Reform Programme 2017–2019

The proponent did not supplement the text in this case; it is considered that Table 2.7 aims to show the structure of the total debt.

c) Representatives of business associations

The Chamber of Commerce of Montenegro. The representative of the Chamber of Commerce, Ljiljana Filipović, took part in the roundtable discussion, while the Chamber of Commerce submitted its comments in written form, as follows:

The Chamber of Commerce of Montenegro expressed satisfaction with the development of the Economic Reform Programme for Montenegro for the period 2017–2019 especially given the fact that this is a key strategic document of the country, whereby the structural reforms needed to remove barriers to economic growth and to strengthen the competitiveness of the Montenegrin economy are planned and agreed. Also, we thank you for the opportunity to express an opinion on the draft of this document.

The Economic Reform Programme for Montenegro for the period 2017–2019 is a comprehensive document which defines the key priorities for structural reforms over the next three years, which meet the criteria in terms of implementation, overcoming the existing challenges and contributing to economic growth and improving competitiveness. In addition to the 20 priority reform measures included in this document, we believe that it is necessary to supplement the following segments:

- Chamber of Commerce: We suggest that the part related to agriculture be amended to include actions aimed at the long-term lease of agricultural land owned by the state, which is in accordance with the "Information on priority development projects in the field of agriculture" prepared by the Ministry of Agriculture and Rural Development and adopted by the Government at the end of 2016. Namely, despite the fact that Montenegro has a fairly high degree of arable land per capita, the problem is with arable land that is divided into smaller plots (fragmented holdings), which further complicates agricultural production. On the other hand, there are a small number of large plots, which are mostly state-owned, which should be strategically allocated and used purposefully, because this would have a direct impact on an increase in agricultural production for domestic consumption and export, which will, in turn, have a direct impact on reducing the trade deficit.

Proceeding/opinion of the proponent of the document in relation to the comment of the Chamber of Commerce on the draft Economic Reform Programme 2017–2019
The proponent partly accepted the stated suggestion, adding, under section 4.3.3.2, in addition to the fragmentation of plots, insufficient utilization of agricultural plots in state ownership as one of the barriers to the development of agriculture. Thus, within the priority reform plans, the text was expanded to cover other support measures from the agricultural budget that are, among other things, related to the better utilization of agricultural land.

Chamber of Commerce: The document does not define any measures in the field of forestry and wood processing (except generally, within the manufacturing industry), although the forests that cover 60% of the area represent the most important resource in the north of Montenegro. We propose that this segment should include the process of forest certification according to FSC standards, confirming that the forestry products are manufactured by responsible forest management and proving that there is no uncontrolled exploitation of forests. The certification of forests would help the domestic timber industry to sell its products to the European market, where the requirement exists that timber comes from certified forests, which are managed in a sustainable way.

Proceeding/opinion of the proponent of the document in relation to the comment of the Chamber of Economy on the draft Economic Reform Programme 2017–2019
The document does not specifically single out the area of forestry, primarily due to the limited number of areas and measures that can be analysed in the ERP, which does not mean that it is a less important area in the context of overall reform priorities. When it comes to wood processing, this area is analysed in the ERP as a part of industrial production (section 4.3.3.1) and this section puts forward two measures to improve the competitiveness of the industry, thus including wood processing. Also, the priority reform measures related to the area of support for the development of small and medium-sized enterprises are also geared towards the support and development of wood processing.

Chamber of Commerce: Section 4.3.2.1 relating to energy does not encompass the construction of large hydroelectric power plants, although in recent years, a number of activities have been carried out in preparation for the implementation of projects of construction of hydroelectric power plants on the rivers Morača and Komarnica[72].

[72] On 23 October 2015, a Memorandum of Understanding for the construction of hydroelectric power plants on the rivers Morača and Komarnica was signed between the Government of Montenegro and the Chinese company NORINCO International Corporation Ltd; On 26 October 2015, a Memorandum of Understanding on cooperation in the field of hydroelectric power development in Montenegro was signed in Ljubljana between the Ministry of the Economy of Montenegro, the Ministry of Foreign Affairs of the Republic of Slovenia and the Ministry of Forestry and Water Management of the Republic of Turkey; on 18 December 2015, a Memorandum of Understanding was signed for the construction of hydroelectric power plants on the rivers Morača and Komarnica between the Government of Montenegro and the Turkish company Bereket Enerji; on 5 November 2016, the Minister of the Economy adopted the Decision on the appointment of the Commission for the evaluation of bids by potential investors for the construction of a hydroelectric power plant on the River Morača.

Proceeding/opinion of the proponent of the document in relation to the comment of the Chamber of Economy on the draft Economic Reform Programme 2017–2019

This was not covered in detail in the 2017 ERP on the grounds that the document should contain measures which are likely to be implemented intensively in 2017.

Chamber of Commerce: Our opinion is that in the part relating to the strengthening of the transport infrastructure, the project of rebuilding Tivat Airport should be added since it was planned in the medium term, and airline accessibility which is characterized as limiting the competitiveness of tourism is contained in the information. In addition, it would be extremely important to mention/define the activities on the implementation of the highway section from the border with Croatia to the border with Albania, including the Verige Bridge. When it comes to transport, special attention should be paid to re-launching the Bar–Bari maritime route, as well as the development and perspectives of the maritime navigation companies Crnogorska plovidba and Barska plovidba.

Proceeding/opinion of the proponent of the document in relation to the comment of the Chamber of Commerce on the draft Economic Reform Programme 2017–2019

The suggestion was partly accepted through the detailing of the text "priority reform plans" in section 4.3.2 on transport, stating improvements in the airport infrastructure, as well as the infrastructure for the development of maritime transport.

Chamber of Commerce: Section 4.3.6 – *Foreign trade and investment* should include, in addition to the proposed measures, some other reform measures, particularly given the high trade deficit. Although measures have been defined which can indirectly contribute to the improvement of exports, it is our opinion that a measure is necessary that will have a direct impact on improving export performance. Namely, only by increasing the share in exports of products with higher value added, is it possible to achieve long-term competitiveness and higher levels of employment. It is therefore necessary to introduce as a priority measure the activation of existing and/or construction of new processing facilities with certain benefits.

Proceeding/opinion of the proponent of the document in relation to the comment of the Chamber of Commerce on the draft Economic Reform Programme 2017–2019

The proponent considers that the answer to this suggestion is already contained in the proposed reform measures in the area of sectoral development (industry, agriculture and services), which clearly point out the activities to increase value added in manufacturing, as well as in the reform areas 4 and 6, i.e. in the chapter relating to the improvement of the business environment, foreign trade and promotion of investment.

Chamber of Commerce: In the non-financial support to SME development (information and advisory services, training in entrepreneurship, mentoring services, business networking and organized fair presentation) that are continuously extended by the Ministry of the Economy/SME Development Directorate, we believe that it is necessary to also incorporate the activities and services provided by other institutions, primarily the Chamber of Commerce of Montenegro.

Proceeding/opinion of the proponent of the document in relation to the comment of the Chamber of Commerce on the draft Economic Reform Programme 2017-2019

The proponent accepted the aforementioned suggestion, adding the importance of other business associations for the development of small and medium-sized enterprises.

Chamber of Commerce: In section 3.3: *Developing the service sector* (p.17), except for priority reform measure No. 10: *Improvement of the tourist offer in the North of Montenegro through construction of* *required infrastructure in ski resorts*, it is necessary to add, according to the Government's Work Programme for 2017[73], two more activities, as follows:

- Improvement of the nautical offer through the construction of tourist complexes, marinas and supporting infrastructure

- Improvement of the tourist offer through the construction of tourist settlements and hotels

The financial aspects of these two activities are listed in Annex 2, Table 8.1: Priority development projects that underpin economic growth projections 2017–2019 (Part: TOURISM).

In addition, given that the Government's programme envisages drafting the Rural Development Strategy 2018–2022, we believe that this strategic document should be supplemented with these activities.

Proceeding/opinion of the proponent of the document in relation to the comment of the Chamber of Commerce on the draft Economic Reform Programme 2017–2019

The proponent largely accepted the said suggestion (in section 4.3.3.2: Development of tourist services) within the priority reform plans.

Chamber of Commerce: The part regarding the projected GDP growth (p.28) reads: "this scenario foresees an increase in the rates of accommodation and food services, which partly cover the tourist sector, to 4.5%. Phased completion of the investment in tourism will increase the offer of higher-category facilities, which is a prerequisite to strengthen the contribution of this sector to GDP growth." According to the estimates of the World Travel and Tourism Council, the next 10-year period is expected to see growth at an average rate of 8.8% annually (a total contribution of tourism in 2024 of EUR 1877.3 million, or 37.2% of GDP).[74]

Proceeding/opinion of the proponent of the document in relation to the comment of the Chamber of Commerce on the draft Economic Reform Programme 2017–2019

Trends in 2016 indicate that these are not the most realistic projections. The value for the share of tourism out of GDP in 2024 of 37% is quite optimistic. A share of 37% of GDP is possible, assuming that all other sectors would grow at a rate of 0%, which is unrealistic, bearing in mind the projected trends of the rest of the economy. Therefore, this suggestion was not acceptable to the proponents and we deem the projected growth realistic.

Chamber of Commerce: The section: *Risks to the realization of macroeconomic scenarios* (p.28) reads: "... - Adverse weather conditions can significantly affect the sectors of tourism, agriculture and electricity generation..." We believe that in addition to weather conditions, the traffic infrastructure and thus the availability of the destination, the informal economy and the lack of high-quality accommodation facilities and qualified professional staff are the key challenges/risks to the development of tourism in Montenegro.

Proceeding/opinion of the proponent of the document in relation to the comment of the Chamber of Commerce on the draft Economic Reform Programme 2017–2019

In the projection, the risks are considered to be risks concerning its realization, not a description of the current situation, i.e. what is already known at the moment of projection. That is, we believe that this suggestion cannot be accepted.

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[73] From the Government's Programme of Work for 2017 (p. 5)
- Utilizing the sites of Bjelasica and Komovi, Durmitor.
- Construction of tourist complexes, a marina and the supporting infrastructure Porto Montenegro, Tivat, Kumbor – Herceg Novi.
- Construction of the tourist settlements Luštica – Tivat and Plavi Horizonti – Tivat.
- Construction of the Kraljičina Plaža Hotel – Sveti Stefan and Kristal Rivijera Hotel – Petrovac

[74] Data of the Ministry of Tourism and Sustainable Development.

Chamber of Commerce: Section 2.2.1.2: *Potential growth* (p.29) reads: "...The tourist sector recognizes the lack of high-category hotel accommodation, poor transport links, low environmental awareness and disadvantages related to the non-accommodation offer. The workforce supply is another limiting factor, as a mismatch between supply and demand for labour is evident..." should be supplemented as follows: "...The tourist sector recognizes the lack of high-category hotel accommodation, poor transport links and thus poor accessibility of the destination, low environmental awareness and disadvantages related to the non-accommodation offer. The workforce supply is another limiting factor, as a lack of eligible professional staff is evident, since the system of education and training for work in the tourist industry still does not correspond to the requirements and needs of tourist companies. Improving educational programmes to a greater orientation towards practical work, the application of a dual system of education, scholarships for students and promotion of tourist occupations, as well as promoting employment of the local workforce should be among the priority activities in the field of improving professional staff..."

Proceeding/opinion of the proponent of the document in relation to the comment of the Chamber of Commerce on the draft Economic Reform Programme 2017–2019

The proponent considers that the essence is the same as in the proposed text, and that it is not necessary to change it.

Chamber of Commerce: Section 2.2.1.4: *The external sector and its medium-term sustainability*, should be reformulated or the paragraph deleted (p.31), which reads: "... In the case of Montenegro, due to the use of the euro as legal tender, as well as substantial cash payments, especially in the field of tourism (the informal economy), it is not easy to cover all transactions because there is no possibility of distinguishing domestic euros from euros of foreign origin."

Proceeding/opinion of the proponent of the document in relation to the comment of the Chamber of Commerce on the draft Economic Reform Programme 2017–2019

This wording has been slightly modified according to the suggestion, but the paragraph is retained as it partly explains the increase in net errors and omissions in the Balance of Payments.

Chamber of Commerce: In section 2.1.4: *The external sector and its medium-term sustainability*, the passage (p.33) reads: "...Measuring the competitiveness of the Montenegrin economy by the usual indicators of the real effective exchange rate is not reliable, given that Montenegro has significant sources of income from tourism that are seasonal in nature, so the weightings for calculating the effective exchange rate vary during the year (the weighting of Russia, due to the high influx of revenue from tourism in the summer months). This points to shortcomings in the analysis of the competitive position of Montenegro measured by the REER, by the inclusion of tourism, which makes up a significant share of the economy of Montenegro, and has a pronounced seasonal character. Analysis of the REER in the field of tourism shows that the disposable income for consumption in Russia in 2016 decreased due to high inflation of around 7%, with a stable exchange rate of the rouble against the euro, while disposable income in Serbia is at the same level, due to the stable dinar–euro exchange rate and relatively low inflation. Forecasts for 2017 predict a further decline in the purchasing power of Russian citizens, which can have a negative effect on tourist revenues ..."

It should be rephrased as follows: "...The measurement of the competitiveness of the Montenegrin economy by the usual indicators of the real effective exchange rate is not reliable, given that Montenegro has significant sources of revenue from tourism, which is characterized by highly pronounced seasonality and reliance on a small number of source markets (foreign tourist overnight stays from 10 countries account for 83% of total overnight stays) so the weightings for calculation of the effective exchange rate vary during the year. This indicates shortcomings in the analysis of the competitive position of Montenegro measured by the REER, by the inclusion of tourism, which makes up a significant share of the economy of Montenegro...”

Proceeding/opinion of the proponent of the document in relation to the comment of the Chamber of Commerce on the draft Economic Reform Programme 2017–2019

The proponent considers that the essence is the same as in the proposed text, and that it is not necessary to change it.

Chamber of Commerce: Section 2.1.4: *The external sector and its medium-term sustainability*, the paragraph (p.32), reads: "...Comparison of revenues from tourism and the number of overnight stays generates a constant (EUR 79.00), which implies a constant average income of foreign tourists. This does not correspond with the strengthening of the offer through the construction of high-category facilities (and therefore expectations of higher average revenue per night), and thus the estimated tourist revenues indicate the possibility of their significant underestimation and may partly explain the high level of errors and omissions in the balance..."

This should be amended as follows: "...Comparison of revenues from tourism and the number of overnight stays generates a constant (EUR 79.00), which implies a constant average income of foreign tourists. This does not correspond with the strengthening of the offer through the construction of high-category facilities (and therefore expectations of higher average revenue per night), because Montenegro has an unfavourable structure of accommodation capacities dominated by individual accommodation (74%). Tourists who mainly reside in private accommodation have a lower consumption on a daily basis, which indicates that a growth in the number of overnight stays does not follow the growth in total revenues at the same pace. Thus estimated tourist revenues indicate the possibility of their significant underestimation and may partly explain the high level of errors and omissions in the balance....”

Proceeding/opinion of the proponent of the document in relation to the comment of the Chamber of Commerce on the draft Economic Reform Programme 2017–2019

The proponent considers that the essence is the same as in the proposed text, and that it is not necessary to change it.

-Montenegro Business Alliance. Director of the Montenegro Business Alliance, Zoran Vujović took part in the work of the first roundtable discussion

As a participant in the roundtable discussion within the public debate on the draft Economic Reform Programme in Montenegro 2017–2019, the Montenegro Business Alliance (MBA) submitted its comments in writing. The comments read as follows:

MBA:

"In the section on Employment and the Labour Market (section 4.3.7, p.79), in the framework of the priority reform plans it is stated that one of the measures envisaged is the adoption of the new Labour Law. However, the priority reform measure in this area (No. 19) reads "The implementation of the service contract and grant scheme with the aim of improving human resources and increasing employability". We believe that it is necessary to attach more importance in the document to the passing of the Labour Law and we do not see why this would not be a priority reform measure. We believe that the debate and adoption of the new Labour Law should not be delayed, especially if, as stated in the document "the working version has been prepared and represents the basis for further negotiations with social partners".

Proceeding/opinion of the proponent of the document in relation to the comment on the draft Economic Reform Programme 2017–2019

Since the development and harmonization of the draft of the new Labour Law is planned by the Ministry of Labour and Social Welfare and poses an obligation in accordance with the Action Plan under Chapter 19, as well as since in the course of the public debate there were several suggestions to consider the problem of insufficient flexibility of the labour market, the proponent of the Economic Reform Programme has accepted the suggestion that the adoption of the new Labour Law should appear in the Economic Reform Programme 2017–2019 as an individual measure, and it is included as priority measure No. 19 in the final document of the Economic Reform Programme 2017–2019.

MBA:
Also, the document does not mention the minimum wage. In the past, we had the opportunity to hear conflicting announcements relating to this instrument. We consider it important that the Economic Reform Programme clearly indicates the Government of Montenegro's plans in this area. In any event, any discussion on the minimum wage must be based on a thorough analysis of the effects and in consultation with employers. Otherwise, the risk of a possible increase in the minimum wage triggering a counter-effect by reducing total employment and causing an increase in informal employment is substantial.

Proceeding/opinion of the proponent of the document in relation to the comment on the draft Economic Reform Programme 2017–2019

The proponent considers that any activity towards a change in the amount of the minimum wage is an issue to be discussed with all stakeholders, and that any activity geared towards a change in the amount of the minimum wage must be preceded by a detailed analysis of the effects of the above, which requires a lot of time, therefore, this is why this issue cannot be covered in the 2017–2019 ERP.

MBA:
We are also of the opinion that the possibility of extending the deadline for employees, hired based on a fixed-term contract, up to 24 months should be considered, after which, according to the Labour Law, the employer is obliged to terminate the employment relationship with the employee or enter into a contract for an indefinite period of time. Such a legal solution exists in several developed countries.

Proceeding/opinion of the proponent of the document in relation to the comment on the draft Economic Reform Programme 2017–2019

The above suggestion will be considered on the occasion of drafting the new Labour Law and will be subject to consensus.

MBA:
In the part of the draft programme entitled *Improving the business environment*, we deem that the following could be inserted: "Continuation of the promotion of cooperation with business associations which are engaged in the creation of as favourable a business environment as possible."

The above suggestion has been partially accepted and included in the Economic Reform Programme 2017–2019, while the said cooperation applies not only to business associations, but to all stakeholders that contribute through their activities in cooperation with the Government for the improvement of the business environment.

d) Trade unions

The Union of Trade Unions (USSCG). Srđa Keković, the Secretary General, took part in the work of the roundtable discussion and subsequently submitted comments on the draft Economic Reform Programme in writing as stated below.

USSCG: The key remark of the USSCG is that the fiscal consolidation measures envisaged in the draft Programme are mainly based on a reduction of the salaries of employees (decrease of pay level based on previous length of service, extension of the validity of the crisis tax for three years) and the reduction of social benefits (reduction of benefits on the basis of having three or more children and the prolongation regarding the right to child allowance). In this way, the burden of the budget crisis, for the umpteenth time, is being resolved at the expense of employees and citizens who cannot in any way be held responsible for the budget deficit and growth in public debt. The proposed measures will contribute to the additional collapse of their already poor financial situation and increase the gap between the handful of enormously wealthy and privileged individuals and the majority of Montenegrin citizens, which will further raise social tensions.

We note that the USSCG, as a responsible social partner, is interested and ready to contribute in preserving the stability of the budget and reducing the public debt. However, we believe that fiscal consolidation measures should be based on taking from those who have and were spared and privileged throughout all these years of transition. The USSCG therefore proposes that, in the draft Programme, the above mentioned measures of fiscal consolidation be replaced by the following measures:

An increase in profit tax. (Our profit tax is currently the lowest in Europe, and there is sufficient room for its increase. On the other hand, the low profit tax has not brought about the expected attracting of investments, especially not high-quality investments, in which case the profit tax is not essential for investing in a country.)

Proceeding/opinion of the proponent of the document in relation to the comment on the draft Economic Reform Programme 2017–2019

The answer of the proponent of the Economic Reform Programme is that since the fiscal consolidation measures have already been passed by Parliament, these suggestions could not have the effect of altering the text of the Draft Programme. As for the increase in profit tax rates, any consideration of changes to tax rates must be subject to more detailed analysis in order to consider their effects, which requires extra time, and cannot be the subject of this year's Programme. The proponent disagrees with the statement that "the profit tax has not brought about the expected attracting of investments", since net foreign direct investment in Montenegro over the course of the 10 years since the restoration of independence has amounted to an average of around 19% of GDP annually. This has contributed to economic growth, and the average rate of real economic growth has been 3.2% over the same 10 years. GDP per capita in PPS has increased to 42% of the EU average. Although it is still far from the EU level, the fact is that it is precisely the competitive tax environment that has contributed to attracting investment, increasing GDP and increasing employment.

Of course, considering any changes in tax rates would require detailed analysis and the assessment of the pros and cons.

USSCG: Further growth in tax debt should be stopped. (In the period from 2013 to the present, the tax debt has been growing by an average of EUR 120,000,000 annually. This means that simply by preventing the formation of a new tax debt in 2017 in the budget, revenue of at least EUR 120,000,000 can be anticipated.)

Proceeding/opinion of the proponent of the document in relation to the comment on the draft Economic Reform Programme 2017–2019

The above represents a regular activity of the tax authorities, and the Working Group for drafting the ERP certainly agrees that all possible measures should be taken to ensure that the tax debt does not increase in the future. The Government has already considered this in the course of preparing the Recovery Plan and Economic Reform Programme in the area of strengthening fiscal discipline, and the above comment by the USSCG is in accordance with that.

As for the information on the average increase in tax debt, it is not clear how this was established, and whether it is based on the assumption that in Montenegro there was also a tax debt before 2013.

USSCG: Tax and other incentives to favoured companies should be abolished, especially since many of them leave room for manipulation at the expense of the budget. (This refers to incentives such as exemption from taxes and contributions, reduced fuel prices, reduced VAT rates...)

Proceeding/opinion of the proponent of the document in relation to the comment on the draft Economic Reform Programme 2017–2019

Tax incentives are important in terms of the country's competitiveness as an investment destination. Of course, this part of the tax policy and its effects will be the subject of a more detailed analysis of the key elements of economic policy in the future, requiring additional time, and cannot be the subject of this year's 2017 ERP. Tax exemptions have already been taken into consideration in drafting the Recovery Plan and the elimination of one of the tax exemptions is one of the measures already proposed in the Recovery Plan and the 2017–2019 ERP.

USSCG: The transfer to legal employment of people who work "off the books" should be introduced. (According to unofficial data used for years at the level of official institutions, there are approximately 40,000 people working "off the books". This requires specific, not declaratory activity, so that a part of this population would be transferred to legal employment, which requires dedicated and well-designed comprehensive action at the level of the state authorities.
In addition to supplementing the budget, the benefits to society would be great and manifold, such as eliminating unfair competition against socially responsible companies and entrepreneurs who respect their legal obligations to society.)

Proceeding/opinion of the proponent of the document in relation to the comment on the draft Economic Reform Programme 2017–2019

The proponent is not familiar with the official data of the state authorities that "in our country there are approximately 40,000 people working off the books". There is an assessment that the UNDP carried out on informal employment in Montenegro, as well as data from the Labour Force Survey, based on which it is also possible to make an assessment, but there is no official data about it.
We agree with the suggestion to strengthen measures aimed at increasing informal employment and it is already a part of the Recovery Plan of December 2016 (as part of measures to increase fiscal discipline). Also, the answer to this suggestion is contained within the framework of Areas 7, 8 and 9 of the draft Economic Reform Programme, which are related to education, the labour market and social inclusion and in which informal employment has been identified as one of the obstacles to increased competitiveness and an improved quality of life of citizens. Also, in accordance with the majority of comments that can be heard from the interested public, including this suggestion of the USSCG, as well as in accordance with the obligations from the Action Plan under Chapter 19 of the process of accession negotiations for EU membership, the Government will start preparing the new Labour Law, which should be finalized with the consensus of social partners. This will contribute to greater labour market flexibility and a reduction in informal employment, which is in line with the suggestions of the USSCG.

USSCG: Budget funds should be spend with due diligence, which entails a drastic sanctioning of any irresponsible and illegal conduct in the management of budget funds. (The fact is that there is an annual outflow of tens of millions of euros on this basis, in the form of costs incurred as a result of wrong decisions by people in charge.)

Proceeding/opinion of the proponent of the document in relation to the comment on the draft Economic Reform Programme 2017–2019

The 2017 ERP contains one of the measures in the field of public finance management in Chapter IV, which is geared towards strengthening managerial accountability in the public sector.

USSCG: A luxury tax should be introduced (taxing surplus housing area, expensive cars, yachts, etc.)

Proceeding/opinion of the proponent of the document in relation to the comment on the draft Economic Reform Programme 2017–2019

The answer is the same as for the previous comments, relating to the necessity of preparation of detailed analysis in this area.

USSCG: Proceeds from illegal activities should be detected and confiscated more efficiently.

Proceeding/opinion of the proponent of the document in relation to the comment on the draft Economic Reform Programme 2017–2019

The above is a matter of legal procedure and certainly serves the purpose of contributing to an increase in budget revenues.

USSCG: The privilege of public officials receiving for a year, or three years if that is the time remaining until their retirement, salary compensation from the budget should be abolished. (This institute brings in an unjustified way already privileged individuals to an advantageous position compared to all other civil servants and state employees, while leaving at the same time plenty of room for manipulation at the expense of the budget.)

Proceeding/opinion of the proponent of the document in relation to the comment on the draft Economic Reform Programme 2017–2019

This legal norm exists due to the fact that public officials, in accordance with Article 15 of the Law on the Prevention of Corruption, cannot for a period of two years after termination of public office, take up employment or establish a business cooperation with a legal entity, entrepreneur, international or another organization, which acquires gains based on the decisions of the authority where the public official was discharging office. There are several points in Article 15 of this Law, which restrict former public officials from taking up a new job, which is why the Law on the Salaries of Employees in the Public Sector provides the above transitional period of one year, which makes it easier for the former public official to get through the period after leaving public office, because of the restricted possibility of taking up new employment.

USSCG: In addition to the above, the USSCG particularly disagrees with the conclusions of section 4.3.7 "Employment and the Labour Market". Namely, as the diagnosis of this section pointed out, the labour market is characterized by low employment, high inactivity of the workforce and long-term unemployment. This section, unfortunately, does not provide for the creation of new jobs, nor for consistent compliance with labour relations as a possibility to solve these problems, but recognizes as an underlying cause of this state only the Labour Law which is, completely unfoundedly, considered the greatest barrier to creating flexibility in the labour market. The term 'flexibility' always implies the possibility of easy laying off of employees by employers. At the same time, the creator of the draft Programme neglects the fact that fixed-term labour contracts have become the rule rather than the exception in practice, unlike what is prescribed by the Labour Law, as evidenced by the percentage of fixed-term labour contracts concluded. In addition, the Labour Law stipulates the institute of the

Agency for the Temporary Assignment of Employees which is one of the most frequently misused institutes of the Labour Law and which, as such, provides the ability for employers to avoid hiring for an indefinite period for the type of positions which fall under the job description's activities and for which there is a constant need. On the other hand, the Labour Law and General Collective Agreement recognize 19 situations in which an employer may terminate an employment contract, of which in eight cases there is no requirement to respect the termination notice period, while in five cases there is no obligation to conduct disciplinary proceedings. It should be particularly underscored that in a very simplified procedure, the employer may terminate an employment contract on the basis of technological or economic redundancy with the obligation of payment of, usually, symbolic severance pay. Also, when it comes to one's first job, an internship is not included in the time limit applicable to an employment contract for an indefinite period, which further extends the deadline for hiring the employee for an indefinite period by an additional six or nine months. It concerns us that the creators of the Draft Programme do not comment even a single word on the concept of flexibilization through the security of employees in the labour market (so-called flex-security), i.e. they have not analysed the situation of employees hired on the basis of unstable employment contracts, which are usually deprived of many rights since they are in a subordinate position to the employer.

Proceeding/opinion of the proponent of the document in relation to the comment on the draft Economic Reform Programme 2017–2019

Since the trade unions and business representatives, MPs in the Parliament and the Government have recognized/identified similar problems in the labour market, i.e. low activity, high unemployment, a high rate of informal employment, etc. labour legislation is certainly one of the aspects that should be considered in order to overcome these problems. Some legal solutions in the field of labour and social welfare in Montenegro are recognized also by the reference international institutions and organizations as a barrier that discourages the creation of new jobs. In Recommendation No. 6 of the ministerial meeting held in Brussels in May 2016, the EU recommended Montenegro "reduce the disincentives to work". Therefore, in accordance with this suggestion of the USSCG, but also in accordance with the suggestions of employers, as well as in accordance with Montenegro's obligations under the Action Plan for Chapter 19 in the process of negotiations for membership of the EU, the 2017 ERP includes a reform measure that will refer to the drafting of the new Labour Law and its adoption after reaching a consensus with all stakeholders.

USSCG: The USSCG has been suggesting for years that the Government should implement said measures through its economic policy in practice, but to date none of above measures has been applied. At the same time, we cannot help but notice that this public debate on the draft Economic Reform Programme for Montenegro 2017–2019 is being held *post festum*, after the Parliament passed some legal solutions for the implementation of some of the proposed fiscal consolidation measures late last year, while the Parliamentary Committee on Economy, Finance and Budget had already adopted the draft Programme at the session held on 18 January 2017.

Proceeding/opinion of the proponent of the document in relation to the comment on the draft Economic Reform Programme 2017–2019

That statement is not correct, since the Government had already envisaged part of the proposed measures on strengthening fiscal discipline and reducing the informal economy in the Recovery Plan and the draft 2017–2019 ERP.

*Also, in terms of the "*post festum*" statement, the proponent points out that the proposed and adopted measures of fiscal consolidation are a key part of the fiscal framework of the Economic Reform Programme, since the ERP covers the period to which the Recovery Plan relates as well, i.e. the period 2017–2019, so that measures may be consistent.*

We recall that the draft Economic Reform Programme was left with the Parliamentary Committee on Economy, Finance and Budget in order to be informed within the wider consultation process, which does not mean that the document was also adopted by the Committee. This documenti is adopted by the Government of Montenegro.

e) Citizens and companies

1) Zarija Pejović, a citizen and a member of the Working Group, proposed:
A progressive corporate tax should be introduced for legal entities. He believes that revenue from the progressive taxation of corporate tax should be a substitute for the revenue derived from the introduced excise duty on fuel, which would be abolished.

Proceeding/opinion of the proponent of the document in relation to the comment on the draft Economic Reform Programme 2017–2019

The answer of the proponent of the Economic Reform Programme is that since the fiscal consolidation measures have already been adopted by the Parliament, these suggestions could not have the effect of altering the text of the draft Programme. As for the increase in corporate tax rates, any consideration of changes to tax rates must be subject to more detailed analysis in order to consider the overall effects, and is not the subject of this year's Economic Reform Programme.

- The introduction of a higher rate of value added tax, which would apply to hospitality facilities in the coastal municipalities, in order to make better use of the tourist season.

Proceeding/opinion of the proponent of the document in relation to the comment on the draft Economic Reform Programme 2017–2019

The answer of the proponent of the draft Economic Reform Programme is that this proposal could not be taken into account in the Economic Reform Programme 2017–2019, since the above would have to be subject to detailed analysis, in terms of whether a VAT increase on the coast would result in the growth of the informal economy and a slowdown in economic growth, since tourism makes a significant contribution to economic growth.

- Selective reduction of the benefits for mothers with three or more children, rather than linear reductions for all beneficiaries of the benefits. The reduction should be made in accordance with the assets and income made by a family. Mothers in affluent families would be left without the benefits, while the benefits would be retained in families in a state of social need. The criteria and determining of the amount of compensation would be carried out in coordination with the Centres for Social Work.

Proceeding/opinion of the proponent of the document in relation to the comment on the draft Economic Reform Programme 2017–2019

The opinion of the proponent of the Draft Economic Reform Programme is that this proposal can be partly taken into consideration, and that the priority reform area No. 9 refers to increasing social inclusion and a reduction of unemployment by amendments to this Law that were already considered in Parliament at the end of 2016. Of course, it is expected that the full implementation of the second phase of the project of Social Cards will contribute to greater fairness in the distribution of social funds from the state budget. Hence, the proposal will be considered in the forthcoming comprehensive analysis of the effects of the existing economic and development policies and consideration of new measures.

- Promotion of investment in production through the organization of business forums (as a supplement to priority reform measure No.16: *Development of business zones in order to encourage direct investment and increase employment*.

Proceeding/opinion of the proponent of the document in relation to the comment on the draft Economic Reform Programme 2017–2019

The comment is accepted by the proponent and priority reform measure No. 14 is supplemented (not No. 16) in the document referring to non-financial support for small and medium-sized enterprises.

Mr. Pejović also suggested the establishment of a national innovation centre (as a supplement to priority reform measure No. 15: *Establishing a science and technology park in Podgorica*).

Proceeding/opinion of the proponent of the document in relation to the comment on the draft Economic Reform Programme 2017–2019

In this case, there is an overlap with the existing measures in the field of science and innovations that are in the pipeline.

8 ANNEXES

Table 8.1: Priority development projects as the basis for 2017–2019 economic growth projections.

PRIORITY DEVELOPMENT PROJECTS (PDP) 2017–2019 € millions	
Project title	Total 2017–2019
TRANSPORT TOTAL	839.8
I Bar–Boljare Highway (Smokovac–Uvač–Mateševo section)	602.4
II Regional roads and highways	191.3
III AIR TRANSPORT	29.7
IV RAIL TRANSPORT	12.4
V MARINE TRANSPORT	4.0
ENERGY AND INDUSTRY TOTAL	845.1
Construction of small hydroelectric power plants	76.7
Construction of wind turbines	143.0
ENERGY EFFICIENCY IN PUBLIC BUILDINGS PROGRAMME PHASE II	14.3
ENERGY EFFICIENCY IN MONTENEGRO – ADDITIONAL FACILITY	1.7
Construction of Block 2 of TPP Pljevlja**	295.1
Undersea interconnection between Montenegro and Italy – CGES part	61.8
TERNA	123.0
Investments in the metal industry – Tošćelik Nikšić	16.2
Investments in the metal industry – KAP	56.9
Programmes of support for entrepreneurship, SMEs and industry	3.8
Pljevlja Coal Mine	19.5
Lignite Mine	6.0
Bauxite mines	12.7
TOURISM –TOTAL	1,353.6
Resort development in Kumbor (Herceg Novi)	180.0
Luštica resort development (Tivat)	180.0
Resort development at Plavi Horizonti (Tivat)	162.0
Resort development – Porto Montenegro	75.0
Other major resorts and hotels:	270.0
- Monterose	140.8
- Maljevik	70.0
- Kraljičina plaža – Dubovica	30.0
- Developments in the north	35.0
Development of Kraljičina Plaža Hotel in Sveti Stefan	50.0
Valorization of the resources of Bjelasica and Komovi	33.0
Valorization of the resources of Durmitor	19.8
Development of the Hilton Hotel in Podgorica,	0.0
Development of the Kristal Rivijera Hotel in Petrovac,	14.0
Other smaller, high-end establishments	80.0
Mamula Island – Herceg Novi (utilization)	14.0
TOTAL – AGRICULTURE	105.8
IPARD like 2	10.0
Agricultural budget support	25.5
ADMAS	25.6
IFAD	2.7
IPARD	42.0
TOTAL – PDP	3,144.2

* Information obtained from developers and provisional estimates

Table 8.2:

Public spending	2016		2017		2018		2019	
	EUR million	% GDP	EUR million	% GDP	EUR million	% GDP	EUr million	% GDP
Own source revenues	1683.66	45.14	1758.03	44.75	1832.99	43.88	1868.61	42.9
Taxes	999.70	26.81	1069.77	27.23	1114.62	26.69	1143.74	26.2
Personal income tax	153.90	4.13	161.17	4.10	165.11	3.95	168.69	3.9
Corporate profit tax	45.54	1.22	46.92	1.19	48.73	1.17	50.75	1.2
Property tax	13.47	0.36	14.70	0.37	14.99	0.36	15.28	0.4
Value added tax	494.45	13.26	524.75	13.36	556.53	13.32	574.84	13.2
Excise tax	182.52	4.89	210.48	5.36	215.11	5.15	217.91	5.0
Tax on foreign trade and transactions	24.04	0.64	24.43	0.62	24.96	0.60	25.29	0.6
Local taxes	76.52	2.05	77.67	1.98	79.22	1.90	80.80	1.9
Other state taxes	9.26	0.25	9.66	0.25	9.96	0.24	10.18	0.2
Contributions	464.32	12.45	492.16	12.53	504.59	12.08	515.63	11.8
Fees	19.43	0.52	19.83	0.50	20.24	0.48	20.61	0.5
Charges	122.90	3.30	78.45	2.00	100.07	2.40	101.90	2.3
Other revenues	51.58	1.38	50.16	1.28	51.24	1.23	52.00	1.2
Receivables from credit repayment	5.43	0.15	5.51	0.14	5.63	0.13	5.71	0.1
Donations	20.29	0.54	42.14	1.07	36.59	0.88	29.03	0.7
Public spending	1826.82	48.98	1996.22	50.81	2064.53	49.43	2033.17	46.7
Current spending	1677.32	44.97	1678.14	42.72	1686.13	40.37	1702.27	39.1
Current expenditures	816.46	21.89	839.50	21.32	801.00	19.18	818.39	18.8
Gross salaries and contrib. borne by employers	482.51	12.94	486.75	12.35	487.01	11.66	490.60	11.3
Other personal income	17.82	0.48	17.57	0.45	17.82	0.43	17.98	0.4
Expenditures for supplies and services	95.88	2.57	99.59	2.53	101.01	2.42	103.47	2.4
Routine maintenance	28.25	0.76	26.30	0.66	25.85	0.62	26.45	0.6
Interests	81.39	2.18	101.36	2.58	95.40	2.28	104.20	2.4
Rent	9.88	0.27	9.93	0.25	9.82	0.24	9.94	0.2
Subsidies	27.73	0.74	25.91	0.65	26.51	0.63	27.53	0.6
Other expenditures	36.96	0.99	35.97	0.94	37.57	0.90	38.22	0.9
Current budget capital expenditures	36.04	0.97	36.11	0.92	40.40	0.97	37.00	0.8
Social security transfers	578.61	15.51	574.19	14.62	581.13	13.91	590.88	13.6
Social entitlements	89.68	2.40	117.99	3.00	120.05	2.87	121.01	2.8
Funds for redundancies	25.72	0.69	20.60	0.53	15.40	0.37	15.00	0.3
Pension and disability insurance entitlements	438.11	11.75	411.15	10.47	419.15	10.03	427.15	9.8
Other healthcare entitlements	15.00	0.40	15.93	0.41	16.50	0.40	17.20	0.4
Other health insurance entitlements	10.10	0.27	8.53	0.22	10.03	0.24	10.53	0.2
Transfers to instit.. individuals. NGOs & public	211.92	5.68	205.24	5.25	203.52	4.87	206.36	4.7
Capital budget	149.50	4.01	318.08	8.10	378.40	9.06	330.90	7.6
Loans and credits	3.13	0.08	3.02	0.08	3.15	0.08	3.16	0.1
Reserves	20.54	0.55	16.19	0.43	18.93	0.45	16.47	0.4
Guarantee payment	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.0
Net commitment increase	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.0
Repayment of commitments from prev. years	46.66	1.25	40.00	1.02	38.00	0.91	30.00	0.7
Surplus/deficit	-143.16	-3.84	-238.19	-6.07	-231.54	-5.54	-164.56	-3.8
Corrected surplus/deficit	-143.16	-3.84	-238.19	-6.07	-231.54	-5.54	-164.56	-3.8
Primary deficit	-61.77	-1.66	-136.82	-3.48	-136.14	-3.26	-60.36	-1.4
Debt repayment	440.91	11.82	253.42	6.45	221.20	5.30	585.55	13.4
Principal repayment to residents	65.66	1.76	81.91	2.09	137.00	3.28	171.00	3.9
Principal repayment to non-residents	311.25	8.35	137.79	3.51	69.20	1.66	399.55	9.2
Repayment of commitments from previous years	64.00	1.72	33.72	0.86	15.00	0.36	15.00	0.3
Funding gap	-584.07	-15.66	-491.60	-12.52	-452.74	-10.84	-750.11	-17.2
Funding	584.07	15.66	491.60	12.52	452.74	10.84	750.11	17.2
Loans and credits from domestic sources	112.39	3.01	110.00	2.80	60.00	1.44	110.00	2.5
Loans and credits from foreign sources	446.95	11.98	363.17	9.25	376.34	9.01	627.67	14.4
Privatisation and sale of assets proceeds	6.77	0.18	5.00	0.13	7.00	0.17	8.00	0.2
Transfers from the Budget	2.75	0.07	3.00	0.08	3.00	0.07	4.00	0.1
Use of state deposits	15.21	0.41	10.43	0.27	6.40	0.15	0.43	0.0

GDP (inEUR million)	3729.5		3928.5		4176.9		4357.8	
Budget of Montenegro	Estimate 2016		Estimate 2017		Estimate 2018		Estimate 2019	
	EUR million	% GDP	EUR million	% GDP	EUR million	% GDP	EUR million	% GDP
Own source revenues	1484.1	39.8	1551.6	39.5	1602.4	38.4	1633.5	37.5
Taxes	876.1	23.5	944.3	24.0	986.6	23.6	1013.2	23.2
Personal income tax	118.8	3.2	125.6	3.2	128.8	3.1	131.7	3.0
Corporate profit tax	45.5	1.2	46.9	1.2	48.7	1.2	50.8	1.2
Property tax	1.4	0.0	2.5	0.1	2.5	0.1	2.5	0.1
Value added tax	494.4	13.3	524.7	13.4	556.5	13.3	574.8	13.2
Excise tax	182.5	4.9	210.5	5.4	215.1	5.2	217.9	5.0
Tax on foreign trade and transactions	24.0	0.6	24.4	0.6	25.0	0.6	25.3	0.6
Other state taxes	9.3	0.2	9.7	0.2	10.0	0.2	10.2	0.2
Contributions	464.3	12.5	492.2	12.5	504.6	12.1	515.6	11.8
Fees	13.5	0.4	13.8	0.4	14.1	0.3	14.4	0.3
Charges	72.5	1.9	23.4	0.6	24.0	0.6	24.3	0.6
Other revenues	39.0	1.0	37.4	1.0	38.2	0.9	38.7	0.9
Receivables from credit repayment	5.2	0.1	5.3	0.1	5.4	0.1	5.5	0.1
Donations	13.4	0.4	35.2	0.9	29.5	0.7	21.8	0.5
Public spending	1613.7	43.3	1785.4	45.5	1831.6	43.9	1803.6	41.4
Current spending	1497.9	40.2	1502.3	38.2	1509.2	36.1	1529.7	35.1
Current expenditures	730.4	19.6	751.0	19.1	750.7	18.0	762.0	17.5
Gross salaries and contributions borne by employers	434.7	11.7	438.2	11.1	437.5	10.5	440.1	10.1
Other personal income	10.6	0.3	10.2	0.3	10.3	0.2	10.3	0.2
Expenditures for supplies and services	79.2	2.1	82.6	2.1	83.7	2.0	85.8	2.0
Routine maintenance	23.2	0.6	21.2	0.5	20.7	0.5	21.2	0.5
Interests	76.6	2.1	95.4	2.4	88.9	2.1	96.7	2.2
Rent	9.3	0.2	9.3	0.2	9.2	0.2	9.3	0.2
Subsidies	26.8	0.7	24.9	0.6	25.5	0.6	26.5	0.6
Other expenditures	34.0	0.9	33.0	0.9	34.5	0.8	35.1	0.8
Current budget capital expenditures	36.0	1.0	36.1	0.9	40.4	1.0	37.0	0.8
Social security transfers	575.4	15.4	570.9	14.5	577.8	13.8	587.5	13.5
Social entitlements	86.5	2.3	114.7	2.9	116.7	2.8	117.6	2.7
Funds for redundancies	25.7	0.7	20.6	0.5	15.4	0.4	15.0	0.3
Pension and disability insurance entitlements	438.1	11.7	411.2	10.5	419.2	10.0	427.2	9.8
Other healthcare entitlements	15.0	0.4	15.9	0.4	16.5	0.4	17.2	0.4
Other health insurance entitlements	10.1	0.3	8.5	0.2	10.0	0.2	10.5	0.2
Transfers to institutions. individuals. nongovernmental and public sectors	171.0	4.6	163.7	4.2	161.1	3.9	163.1	3.7
Capital budget	115.7	3.1	283.1	7.2	322.4	7.7	273.9	6.3
Loans and credits	2.6	0.1	2.4	0.1	2.6	0.1	2.6	0.1
Reserves	18.7	0.5	14.3	0.4	17.0	0.4	14.5	0.3
Guarantee payment	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net commitment increase	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Repayment of commitments from previous years	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Surplus/deficit	-129.6	-3.5	-233.8	-6.0	-229.1	-5.5	-170.1	-3.9
Corrected surplus/deficit	-129.6	-3.5	-233.9	-6.0	-229.1	-5.5	-170.1	-3.9
Primary deficit	-53.0	-1.4	-138.4	-3.5	-140.2	-3.4	-73.4	-1.7
Debt repayment	417.9	11.2	220.4	5.6	187.2	4.5	549.5	12.6
Principal repayment to residents	44.7	1.2	51.9	1.3	107.0	2.6	139.0	3.2
Principal repayment to non-residents	309.2	8.3	134.8	3.4	65.2	1.6	395.5	9.1
Repayment of commitments from previous years	64.0	1.7	33.7	0.9	15.0	0.4	15.0	0.3
Funding gap	-547.44	-14.7	-454.2	-11.6	-416.34	-10.0	-719.67	-16.5
Funding	547.44	14.7	454.2	11.6	416.34	10.0	719.67	16.5
Loans and credits from domestic sources	100.0	2.7	100.0	2.5	50.0	1.2	100.0	2.3
Loans and credits from foreign sources	444.9	11.9	354.2	9.0	366.3	8.8	619.7	14.2
Privatisation proceeds	2.5	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Deposit increase/decrease	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

GDP (in EUR million)	3729.5		3928.5		4176.9		4357.8	
Local self-governments	2016		2017		2018		2019	
	EUR million	% GDP	EUR million	% GDP	EUR million	% GDP	EUR million	% GDP
Own source revenues	199.57	5.35	206.41	5.25	230.54	5.52	235.15	5.40
Taxes	123.64	3.32	125.50	3.19	128.01	3.06	130.6	3.00
Personal income tax	35.06	0.94	35.59	0.91	36.30	0.87	37.0	0.85
Property sale tax	12.06	0.32	12.24	0.31	12.49	0.30	12.7	0.29
Local taxes	76.52	2.05	77.67	1.98	79.22	1.90	80.8	1.85
Fees	5.91	0.16	6.00	0.15	6.12	0.15	6.2	0.14
Charges	50.39	1.35	55.00	1.40	76.10	1.82	77.6	1.78
Other revenues	12.58	0.34	12.77	0.33	13.03	0.31	13.3	0.30
Receivables from credit repayment	0.20	0.01	0.20	0.01	0.21	0.00	0.2	0.00
Grants	6.84	0.18	6.94	0.18	7.08	0.17	7.2	0.17
Local self-government current spending	179.37	4.81	175.84	4.48	176.94	4.24	172.6	3.96
Current expenditures	86.11	2.31	88.54	2.25	90.69	2.17	93.4	2.14
Gross salaries and contributions borne by employers	47.78	1.28	48.50	1.23	49.47	1.18	50.5	1.16
Other personal income	7.27	0.19	7.38	0.19	7.52	0.18	7.7	0.18
Expenditures for supplies and services	16.72	0.45	16.97	0.43	17.31	0.41	17.7	0.41
Routine maintenance	5.00	0.13	5.08	0.13	5.18	0.12	5.3	0.12
Interests	4.79	0.13	6.00	0.15	6.50	0.16	7.5	0.17
Rent	0.60	0.02	0.61	0.02	0.62	0.01	0.6	0.01
Subsidies	0.98	0.03	0.99	0.03	1.01	0.02	1.0	0.02
Other expenditures	2.97	0.08	3.01	0.08	3.07	0.07	3.1	0.07
Social security transfers	3.22	0.09	3.27	0.08	3.34	0.08	3.41	0.08
Social entitlements	3.22	0.09	3.27	0.08	3.34	0.08	3.4	0.08
Transfers to institutions. individuals. NGO & public sector	40.93	1.10	41.55	1.06	42.38	1.01	43.23	0.99
Capital budget	33.77	0.91	35.00	0.89	56.00	1.34	57.0	1.31
Loans and credits	0.58	0.02	0.59	0.02	0.60	0.01	0.6	0.01
Payment of arrears	46.66	1.25	40.00	1.02	38.00	0.91	30.0	0.69
Reserves	1.87	0.05	1.89	0.05	1.93	0.05	2.0	0.05
Payment of guarantees	0.00	0.00	0.00	0.00	0.00	0.00	0.0	0.00
Net commitment increase	0.00	0.00	0.00	0.00	0.00	0.00	0.0	0.00
Surplus/deficit	-13.57	-0.36	-4.43	-0.11	-2.40	-0.06	5.57	0.13
Corrected surplus/deficit	-13.57	-0.36	-4.43	-0.11	-2.40	-0.06	5.57	0.13
Primary deficit	-8.78	-0.24	1.57	0.04	4.10	0.10	-1.93	-0.04
Debt repayment	23.06	0.62	33.00	0.84	34.00	0.81	36.00	0.83
Principal repayment to residents	20.98	0.56	30.00	0.76	30.00	0.72	32.0	0.73
Principal repayment to non-residents	2.07	0.06	3.00	0.08	4.00	0.10	4.0	0.09
Repayment of commitments from the previous period	0.00	0.00	0.00	0.00	0.00	0.00	0.0	0.00
Funding gap	-36.62	-0.98	-37.43	-0.95	-36.40	-0.87	-30.43	-0.70
Funding	36.62	0.98	37.43	0.95	36.40	0.87	30.43	0.70
Loans and credits from domestic sources	12.39	0.33	10.00	0.25	10.00	0.24	10.0	0.23
Loans and credits from foreign sources	2.00	0.05	9.00	0.23	10.00	0.24	8.0	0.18
Privatisation and assets sale proceeds	4.27	0.11	5.00	0.13	7.00	0.17	8.00	0.18
Use of local governments' deposits	15.22	0.41	10.43	0.27	6.40	0.15	0.43	0.01
Transfers from the central budget	2.75	0.07	3.00	0.08	3.00	0.07	4.0	0.09