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EUROPEAN  
COMMISSION

Brussels, 18.4.2016  
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**COMMISSION STAFF WORKING DOCUMENT**

**ECONOMIC REFORM PROGRAMME**

**OF**

**MONTENEGRO**  
**(2016-2018)**

**COMMISSION ASSESSMENT**

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## 1. EXECUTIVE SUMMARY

**Montenegro's economic activity has strengthened, supported by construction and tourism.** Growth is set to remain robust in the coming years if the investment pipeline, including a major highway project, develops as planned. Private consumption is expected to strengthen following recent increases in public sector wages and pensions and a modest recovery of credit activity. External imbalances are of structural nature, reflecting a small and open economy with a very limited production base and large investment needs. The tourism industry contributes to a gradual reduction of the current account deficit, but high external financing needs and limited policy discretion makes the country highly vulnerable to external shocks. The unemployment rate remains high, hindered by poor labour mobility, labour market rigidities and widespread skills mismatches.

**A high and growing public debt and depleted fiscal buffers put fiscal sustainability at risk.** Also, political uncertainty emerges in the electoral year 2016 as a risk for the sustainability of public finances and the implementation of the structural reform agenda. The main challenges in these respects include the following:

- **Enhancing the growth potential is crucial to further reduce the share of external and internal debt in GDP.** While strong investment activity helps in this regard, at this juncture the key challenge facing Montenegro is to find new ways to boost productivity and competitiveness so as to sustain sources of growth beyond the current investment cycle.
- **The banking sector, while liquid, is still struggling with a high but slowly declining, share of nonperforming loans.** This situation constrains banks' disposition to lend to private domestic companies and reduces the growth potential of the economy. Moreover, banks are trying to maintain profitability by keeping lending rates high, which further hampers lending, in particular to small businesses.
- **The fiscal framework does not offer an appropriate policy response to a high and rising public debt.** On the contrary, the 2016 budget and recent increases in pensions, social benefits and public sector wages confirm the existing expenditure pressures, which are partially related to the electoral cycle. Montenegro would need larger fiscal buffers and additional consolidation measures to stabilise and eventually bring down its public debt ratio and to compensate for growing wage and pension expenditure.
- **High transportation costs and weak regional energy connectivity are limiting Montenegro's economic growth.** The country's infrastructure is constrained by its difficult topography, which results in high investments and maintenance costs. Montenegro's Economic Reform Programme (ERP) has a strong focus on large infrastructure and public investment projects. It is important that such investments are based on a sound cost-benefit analysis and complemented by less costly regulatory reforms. Montenegro's continued efforts are needed to strengthen trade integration, including the implementation of soft measures that tie in with the regional connectivity agenda.
- **Montenegro's economy is dominated by services, in particular the all-important tourism sector. By contrast, the industrial and agricultural sectors suffer from low competitiveness.** Poor access to finance, in particular for SMEs, remains a key barrier to increasing competitiveness. Informality, access to electricity, licensing, contract enforcement and cumbersome tax administration procedures are the other weaknesses of the business environment identified by the business community. Further efforts are needed to build up high quality business support services,

strengthen the rule of law, reduce the informal sector, and tackle corruption. This will ensure that regulatory improvements translate into an improved investment climate.

- **High long-term unemployment and low labour market participation of youth and women remain a challenge.** Widespread skills-mismatches limit employment opportunities, particularly for young people. Lack of activation measures, coupled with low outreach of labour market policies, wide-ranging of informal work and early labour market exits are hindering employment growth. Insufficient coverage and targeting of social assistance is likely to create disincentives to formal work. There are weaknesses in social protection system and providing incentives to work.

**The macroeconomic, fiscal and structural reform frameworks offer a mixed picture.** While the ERP's macroeconomic framework is consistent and provides an adequate basis for policy discussion, this is not the case of the fiscal reform agenda, which appears insufficient to address the ambitious policy objectives and challenges. The structural reform section of the ERP is comparable to last year in terms of compliance with the guidance note. It identifies correctly some of the obstacles to Montenegro's growth and competitiveness and outlines a number of relevant measures to address them, even though in some cases their linkages are not always well justified.

**Last year's policy guidance has been partly addressed, except for the recommendations in the area of public finance.** Although there was some progress on the financial sector, labour market and other structural reforms, the results are particularly negative on the fiscal side due to the adoption of a series of budget expenditure increases defying fiscal sustainability. Notably, the commitment to fiscal discipline derailed due to a significant deviation from the plan and the inadequate fiscal response presented for the 2016 budget. Moreover, the plans for reducing early retirement, rationalising public sector wages and reviewing the financial sustainability of the old-age pension resulted, inversely, in further growth of these expenditures. Contract enforcement was further streamlined, the single sector pipeline for investment priorities was set up and steps were taken to improve the quality of the land registry. A comprehensive medium-term employment and social reform programme and an employment strategy were adopted, but their implementation has not yet started. In the area of education, the review of existing educational programmes is underway and higher education graduates are offered practical experience through professional training programme. Policy recommendations and an action plan to tackle the high incidence of informal work were adopted, but as of yet no results have been seen. Several other structural reforms remain at a preliminary stage with no concrete steps planned or taken.

## 2. ECONOMIC OUTLOOK AND RISKS

**Surging public and private investments are set to drive economic growth in the next few years.** The baseline macroeconomic scenario projects average growth at around 4% in 2016 and 2017, which seems plausible as several key public investments are underway or in an advanced state of preparation. Moreover, the recent increase in public sector wages, pensions, and social benefits for mothers are likely to support private consumption due to spill-over effects from public sector wages to the private sector. The programme also forecasts an increase in government consumption, but only as a one-off in 2016. After peaking in 2016, gross fixed capital investments growth is projected to fall to 10.8% in 2017, before plunging to 1.7% in 2018. The latter figure seems in contradiction with planned investments, as works on the new motorway is due to continue until mid-2019 (at least), and work on the new thermal power plant project could also have started by then. Meanwhile, the impact of economic growth on the labour market is low.

**Consumer prices increased moderately despite falling oil prices, flat communications costs and virtually frozen wages and pensions.** In fact, 'domestic' demand (reflected in a revival of retail sales) improved thanks to fast growth in the number of tourists. As a result, services (in particular accommodation and restaurants) as well as food prices sustained average headline inflation of 1.4% in 2015. The recovery of core inflation also reflects the closing up of the output gap in 2015 thanks to the strong inflow of investments into the country. However, the ERP seems to underestimate the impact of foreign capital inflows in the medium-term inflation forecast, presenting the same inflation rates for 2016 as for the year before and a modest average rate of 2% for each of the outer years covered by the programme.

Table 1:  
Comparison of macroeconomic developments and forecasts

	2014		2015		2016		2017		2018	
	COM	ERP	COM	ERP	COM	ERP	COM	ERP	COM	ERP
Real GDP (% change)	1.8	1.8	3.9	4.3	4.0	4.1	4.1	4.0	n.a.	3.0
<i>Contributions:</i>										
- Final domestic demand	2.1	2.1	2.6	4.0	4.5	4.7	3.9	3.6	n.a.	1.5
- Change in inventories	1.0	1.0	0.6	n.a.	0.5	n.a.	1.0	n.a.	n.a.	n.a.
- External balance of goods and services	-1.3	-1.3	0.7	0.8	-1.0	-1.4	-0.8	-0.3	n.a.	1.2
Employment (% change)	1.2	1.2	1.5	1.2	1.5	0.9	1.9	0.8	n.a.	0.5
Unemployment rate (%)	18.2	18.0	17.6	17.0	17.2	16.6	16.8	16.2	n.a.	16.1
GDP deflator (% change)	1.0	1.0	2.1	1.5	2.0	1.5	2.3	2.0	n.a.	2.0
CPI inflation (%)	-0.5	-0.5	1.5	1.5	1.9	1.5	2.2	2.0	n.a.	2.0
Current account balance (% of GDP)	-15.2	-15.2	-12.9	-12.6	-13.4	-13.8	-13.9	-13.8	n.a.	-12.2
General government balance (% of GDP)	-3.1	-3.1	-7.0	-6.5	-6.6	-6.1	-6.1	-6.1	n.a.	-2.8
Government gross debt (% of GDP)	58.5	58.5	61.4	65.5	65.8	70.7	68.9	74.4	n.a.	77.9

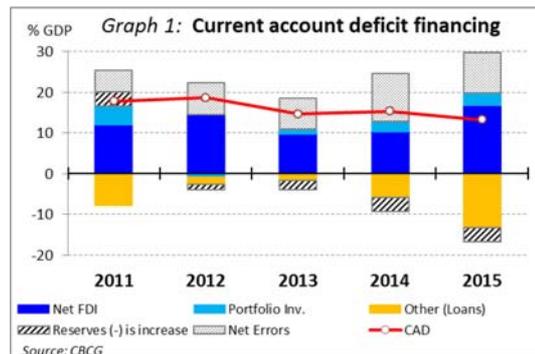
Sources: Economic Reform Programme (ERP) 2016, Commission Winter 2016 forecast (COM)

**The current account imbalance is of structural nature, reflecting a small and open economy with large investment needs but insufficient domestic savings.** However, tourism started to yield strong results in 2015 after investment in tourist capacities and the opening of some 30 new four and five star hotels in the last three years. The growth in tourism, boosting the surplus in the balance of services by an additional 5% of GDP over the year, has become the main factor in the improvement of the external deficit in spite of some further deterioration of the trade deficit. Also, the increase of surpluses in the primary and, to a lesser extent, in the secondary income balances contributed to the reduction of external imbalances. Overall, the current account gap narrowed to 13% of GDP in 2015, compared with a 15% deficit a year before. After the strong performance of tourism in 2015, the ERP forecasts a moderation in exports in 2016 and some gains in

2017. Meanwhile, import growth is projected to slow gradually after 2015. However, this seems unlikely as the work on the motorway is due to speed up in 2016 and 2017, resulting in higher imports.

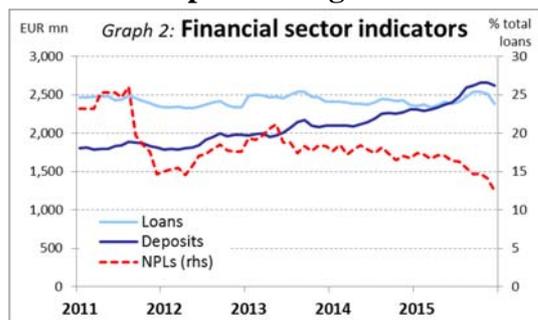
**Gross external financing needs remain high, making the country vulnerable to changes in market sentiment.**

The external deficit is largely financed by a sustained and non-debt creating inflow of FDI which has remained at above 10% of GDP since 2004 and is expected to average 13.5% of GDP until 2018. Other large transfers relate to tourism and remittances, which are listed under net errors and omissions. Since 2012, net outflows from other investment (mostly bank loans) and reserves have increased gradually. Overall, the sustainability of the current account balance could be endangered by a multitude of factors, like a sudden decrease in FDI inflows, a reversal of investor sentiment, political or financial instability or any other factor which could have a negative impact on tourism.



**The depreciation of the euro together with stagnant wages provided marginal, although insufficient, support to domestic competitiveness.** The sharp devaluation of the Russian rouble makes Montenegro's tourism market more expensive compared with its competitors in the Mediterranean southern shore. However, political instability in that region is so far benefiting Montenegro's tourism market. The weakening of the euro against the US dollar resulted in savings of some 1% of GDP from imports of petroleum products in 2015, and also supported Montenegro's aluminium export, which are traded in US dollars. The ERP's analysis of competitiveness based on unit labour costs (ULC) presents some marginal gains due to the stagnation of domestic wages. The ERP also mentions the impossibility –for the time being– of calculating the net international investment position (NIIP) of Montenegro due to data shortcomings.

**The banking sector, while liquid, is still struggling with a high but slowly declining share of nonperforming loans.**



private domestic companies, whose loans stock grew by a mere 2% year-on-year in 2015. So far, the restructuring of impaired loans by banks has been carried out on a client-bank basis instead of using the restructuring framework offered by the Law on voluntary financial restructuring (known as the 'Podgorica approach'). Nevertheless, between the adoption of the law in May 2015

until the end of the year, the stock of non-performing loans fell by 22%. The fact that interest rates remain high also exacerbates the risk of a feedback loop from the real economy to the financial sector, as expensive loans makes more difficult for companies to service their loans on time. After several years implementing a risk-averse lending policy, banks show high liquidity, with deposits growing by 14% year-on-year in 2015. Also, the aggregated capital adequacy ratio improved markedly, reaching 16% at the end of 2015, well above the regulatory minimum of 10%. However, banks profitability remains particularly weak.

### 3. PUBLIC FINANCE

**The 2015 budget misalignment was driven by the repayment of unplanned obligations from previous years.** In 2015, the central government cash-base deficit surged to 7.9% of GDP, significantly exceeding the full year target of 6.7%. While part of the expenditure increase was expected due to the planned increase in public investments by 4.5% of GDP, overall capital spending turned out to be 20% below the plan at the end of the year as some projects were delayed. Budget revenue remained broadly in line with the annual plan, thanks to growing social security contributions compensating for the decline from tax income, and in particular from much higher VAT returns than a year before. However, the main reason for the budget deviation was due to the unplanned repayment of arrears worth some 2% of GDP.

**A high and growing public debt and depleted fiscal buffers put fiscal sustainability at risk.** In practical terms, the medium-term fiscal framework is to remain largely constrained by the financing of the priority section of the motorway to Serbia. The highway project, which commenced in 2015, represents a considerable budgetary cost of some 20% of GDP spread over four years. Therefore, the main scope for consolidation will remain concentrated on the current budget. To keep this one balanced, a series of ad-hoc revenue measures are planned, such as new fees on fuel and other excise duties. However, given the large proportion of non-discretionary items on the expenditure side of the budget, savings need to be of a structural nature, as proposed in the Economic and financial Dialogue policy guidance of May 2015 (see Annex II). This would require the rationalisation of the public sector, restrictions for early retirement, and restructuring tax arrears of local governments. In an effort to attract private investments, Montenegro's fiscal policy also offers tax exemptions for investments in priority areas, like tourism, energy, transport or agro-industry.

*Table 2:*  
Composition of the budgetary adjustment (% of GDP)

	2014	2015	2016	2017	2018	Change: 2015-18
<b>Revenues</b>	44.8	41.9	42.9	40.7	39.6	-2.3
- Taxes and social security contributions	38.1	35.4	35.5	34.6	33.8	-1.6
- Other (residual)	6.7	6.5	7.4	6.1	5.8	-0.7
<b>Expenditure</b>	47.9	48.4	48.9	46.8	42.4	-6.0
- Primary expenditure	45.7	46.2	46.8	44.3	40.1	-6.1
<i>of which:</i>						
Gross fixed capital formation	3.4	7.8	9.8	9.3	6.3	-1.5
Consumption	25.6	23.5	21.5	20.3	19.5	:
Transfers & subsidies	14.8	14.3	14.4	13.8	13.5	-0.8
Other (residual)	1.9	0.6	1.1	0.9	0.8	0.2
- Interest payments	2.2	2.2	2.1	2.5	2.3	0.1
<b>Budget balance</b>	-3.1	-6.5	-6.1	-6.1	-2.8	3.7
- Cyclically adjusted	:	-6.5	-6.1	-6.1	-2.8	3.7
<b>Primary balance</b>	-0.9	-4.3	-4.0	-3.6	-0.5	3.8
<b>Gross debt level</b>	58.5	65.5	70.7	74.4	77.9	12.4

*Sources: Economic Reform Programme (ERP) 2016, MoF update.*

**Contrary to the ERP's spirit of budget consolidation, the 2016 budget is a reflection of spending pressures that have already materialised.** The central government budget for 2016, adopted by the Parliament on 29 December 2015, envisages a fiscal deficit of 7.15% of GDP. This is basically on account of the commitment of 6.8% of GDP for the capital budget to finance the priority section of the motorway this year. In this context, pension and disability rights increased from January following the re-activation of the indexation formula (frozen since 2012). This raised pension benefits by 1.2% year-on-year starting from January. However, in March the government also adopted the indexation for the second half of the year too, setting further 3% increase from July for normal pensions and a 20% increase for minimal pensions. Conditions for early

retirement of workers from companies with (any) public ownership formally ceased to exist in 2015. Amendments to the Law on Social and Child Protection provide as of 2016 for mothers of any age with three or more children and with 15 years or 25 years of contributory period to receive a monthly benefit of between 40% and 70% of the national monthly average salary. Despite having to renounce their pension, the benefit is likely to be more favourable. While the measure, intended to encourage the birth rate and make up for gender wage inequalities, it will likely push women away from the labour market and burden budget expenditures (annual cost are estimated at EUR 13 million, but the figure could end up reaching some EUR 50 million, or 1.3% of GDP). The new Law on Wages of Public Sector employees, adopted on 24 February 2016 with the intention of setting uniform and transparent rules for all salaries across public institutions, will result in substantial increase of salaries by up to 16% (depending on the category of workers). The Law also introduces some budget sustainability clauses, like the reduction of public sector wages if the budget deficit (excluding spending on the new highway) rises above 2% of GDP. The reduction from 13% to 11% from January 2016 of the higher tax rate on personal income paid by the employer was designed to stimulate the economy. This reduction will result in a decrease in this tax revenue. The net budgetary impact would be mitigated to some extent by deducting the savings for the State itself as employer.

**The announced revenue measures will not suffice to compensate for the expenditure increases even if introduced in 2016.** Overall, total expenditure from new measures represent some 2.76% of GDP, similar to the expected income from new revenue sources (around 2.65% of GDP). However, further actions might be required soon to balance the budget as 0.6% of extra revenue in 2016 comes from a one-off measure, while spending already appears underestimated. On the revenue side, the 7 eurocent fee per litre of fuel introduced in April 2015 managed to collect some EUR 10 million until October, but at that point the measure was declared unconstitutional. To replace this source of revenue, the government adopted a similar increase in excise on fuel and oil derivatives. The measure, which is still to be adopted by the Parliament, is expected to increase budget revenue by some EUR 10 million. The budget will also be reinforced by a one-off concession of radio electric frequencies to broadcasters (i.e. the digital dividend), and by a series of new or revised taxes to support municipalities budgets, like the upwards revision of the real estate tax and the new tourist tax for vessels used in nautical tourism. The Ministry of Finance has also announced a plan to introduce criminal penalties for irregularities over taxes and social security contributions on salaries. However this measure seems to lack of sufficient support for its adoption.

**There is scope for improving budget planning, especially on the expenditure side.** General government revenue projections are often realistic, but unplanned costs materialises repeatedly on the expenditure side. In previous years, budget targets derailed by the calling in of unplanned guarantees in bankrupt industries, unplanned redundancy and early retirement plans, the clearance of liabilities from state funds and municipalities, and unfavourable court decisions against the State.

**Contingency measures are needed to maintain the budget in line with the plan.** For instance, setting up an appropriate fiscal buffer instead of resorting –too often– to borrowing. In this way, the budget could plan additional increase in reserves in the annual budget and design measures for an equivalent increase in revenue (or savings). Such measures would free up space to deal with an unexpected slippage or, if this does not occur, provide a stronger position for the following year. The alternative low-growth scenario confirms the need for prudence and a fiscal buffer. The main risks identified in the ERP are a refugee crisis or a terrorist threat, which would impact negatively on tourism and related services. This would cause the economy to slow down and tax revenue to decline, amplifying the budget deficit.

**The electoral cycle emerges as an additional risk for public finances in 2016.** Parliamentary elections are scheduled to be held in the autumn of 2016. Relations between the government and the opposition have been tense recently, culminating in a vote of confidence in January – which the Prime Minister won. In order to overcome the current political situations, negotiations are ongoing for the establishment of a new government, with opposition participation, tasked with organising the elections. The structural reform programme could be delayed during the pre-election period or in a situation where the government may find it hard to obtain sufficient support to get important laws through Parliament, further compromising fiscal stability.

**Box: The budget for 2016**

- \* On 21 October 2015, the Ministry of Finance presented to the government the State draft budget for 2016. The budget was adopted by the government on 14 November and by the Parliament on 29 December.
- \* The deficit target is 7.15% of GDP, basically on account of the commitment of 6.8% of GDP to build the priority section of the motorway.
- \* The macroeconomic scenario supporting this budget is the same as the ERP 2016 baseline scenario, which also estimates real GDP growth of 4.1% and average inflation of 1.5%.
- \* The main expenditure measures are the introduction of social benefit for mothers and the increase in public sector wages. The main measures on the revenue side they are the increase in fuel excises, and the (one-off) proceeds from the 'digital dividend'.

Table: Main measures in the budget for year 2016

Revenue measures*	Expenditure measures**
<ul style="list-style-type: none"> <li>• Increase in public sector wages (by up to 16%) -implicit tax revenue– under new Law on the wages of public sector employees (0.36% of GDP)</li> <li>• Digital dividend (purchase of freed up radio-broadcasting spectrum) (0.65 % of GDP) [one-off]</li> <li>• Increase in excise duty on mineral oil (0.26% of GDP)</li> <li>• Collection of tax arrears through taxpayers' assets (0.26% of GDP)</li> <li>• Law on real estate (increase in the tax rate from 0.1% to 0.25%,) (0.54% of GDP - allocated to municipalities)</li> <li>• Tourist tax for vessels used in nautical tourism (0.01% of GDP - allocated to municipalities)</li> <li>• Criminalisation of tax evasion (on social security contributions) (0.52 % of GDP)</li> <li>• Higher income from other taxes (e.g. coffee) (0.05 % of GDP)</li> </ul>	<ul style="list-style-type: none"> <li>• Increase in public sector wages (by up to 16%) under new Law on wages of public sector employees (0.80% of GDP)</li> <li>• Reduction from 13% to 11% of the personal income tax maximum tax rate paid by the employer (other than the State) (0.1% of GDP net)</li> <li>• Pension indexation (0.19 % of GDP)</li> <li>• Early retirement pensions for workers of bankrupt public companies (0.10 % of GDP)</li> <li>• Amendments to the Law on Social and Children's care (benefit for mothers of 3 or more children) (1.29% of GDP)</li> <li>• Other social care transfers (0.28 % of GDP)</li> </ul>
<p><b>Total from revenue measures: 2.65% of GDP</b> (of which, 0.65% of GDP is a one-off)</p>	<p><b>Total from expenditure measures: 2.76% of GDP</b></p>

\* Estimated impact on general government revenues.  
 \*\* Estimated impact on general government expenditure.  
 Source: ERP, Ministry of Finance

**The budget is expected to show signs of improvement in 2018, the last year of financing for the highway.** According to the ERP's medium-term framework, budget revenue and expenditure would remain broadly constant over the year in 2017. With no other budgetary measure announced in the programme, 2018 could witness a decrease of some 3% of GDP in capital expenditure when the last (and substantially lower) final instalment is paid for the highway construction. As a result, the general government deficit would almost halve, from 6.1% of GDP in 2017 down to 2.8% in 2018.

**Maintaining access to capital markets appears as a key challenge.** Gross financing needs are very high, totalling around one third of GDP in the period 2016-2018. In March 2016, the government completed a EUR 300 million five-year sovereign sale. However, weak demand compelled the government to scale back the original offering target of EUR 480 million to obtain a coupon interest rate of 5.75%. This was significantly higher than the 3.87% rate obtained a year earlier. Currency risk concerns some 12% of the total public debt denominated in US dollars. However, a weakening of the euro would increase the cost of servicing the US-dollar denominated loan for the construction of the highway, which is worth some 20% of GDP. To reduce this risk, the ERP announces the possible subscription to a hedging arrangement.

**Box: Debt dynamics**

**Implementation of structural reforms is becoming more pressing as the public debt stock will further grow** by some additional 7% of GDP in the 2016-2018 period. The public external debt is set to further increase in the medium term driven by further borrowing in international capital markets to finance a budget deficit fuelled by capital spending, and in particular, withdrawals from the loan to finance the highway. The share of domestic debt (around 12% of the total debt stock in 2015), would further decrease to 3.5% of GDP by the end of 2018; This is because part of this debt is composed of legacy state bonds (i.e. restitution, and frozen foreign currency savings bonds) which are gradually cleared each year.

*Table :*

Composition of changes in the debt ratio (% of GDP)				
	2015	2016	2017	2018
<b>Gross debt ratio [1]</b>	<b>65.5</b>	<b>70.7</b>	<b>74.4</b>	<b>77.9</b>
Change in the ratio	5.9	5.2	3.7	3.5
<i>Contributions [2]:</i>				
<b>1. Primary balance</b>	<b>4.3</b>	<b>4.0</b>	<b>3.7</b>	<b>0.5</b>
<b>2. "Snow-ball" effect</b>	<b>-0.9</b>	<b>-1.4</b>	<b>-1.6</b>	<b>-1.2</b>
<i>Of which:</i>				
Interest expenditure	2.2	2.1	2.5	2.3
Growth effect	-2.3	-2.5	-2.7	-2.1
Inflation effect	-0.8	-1.0	-1.3	-1.4
<b>3. Stock-flow adjustment</b>	<b>2.5</b>	<b>2.6</b>	<b>1.6</b>	<b>4.2</b>
<i>Memorandum item</i>				
<b>Highway loan [3]</b>	<b>4.9</b>	<b>6.4</b>	<b>6.0</b>	<b>3.2</b>

**Notes:**

- [1] End of period.
- [2] The snow-ball effect captures the impact of interest expenditure on
- [3] Includes loan and government own contribution.

Source: Economic Reform Programme (ERP) 2016, ECFIN calculations

**The government is preparing a series of strategies to reinforce public debt sustainability. However, the situation requires prompt implementation of corrective measures.** In June 2015, the government adopted the debt management strategy for the period 2015-2018. The strategy sets the share of domestic debt with fixed interest rate to remain between 65% and 75% of the total debt, introduces a lower limit for euro-denominated public debt at 70% of the total debt stock, as well as an upper limit to the stock of domestic T-bills of EUR 70 million at the end of 2016, and a minimum level of government deposits of EUR 20 million. In addition, under Montenegro's fiscal rules, once the public debt reaches the limit of 60% of GDP the government should present a plan to bring the debt below this threshold in the next five years. According to the ERP, such a plan is expected to be adopted in November 2016, just after the elections.

**There is room for further improvement in Montenegro's tax administration performance.** The major obstacle to tax collection is the lack of an integrated information system, an issue which is currently being addressed with technical assistance from the IMF and World Bank experts. The efficiency of the budgeting process is also particularly weak at municipal level, often characterised by underspending and accumulation of arrears (towards banks, providers and the tax administration). The situation could improve if the memorandum of understanding subscribed by several municipalities with the Ministry of Finance for support on restructuring local debt in exchange for streamlining their workforce and limiting their expenditure is correctly implemented.

#### 4. STRUCTURAL REFORMS

**Montenegro's economy is dominated by services, in particular those related to tourism.** The industrial sector is being transformed from the past predominance of metal production to other industries, such as energy. Industrial and agricultural products in particular suffer from low competitiveness, low value-added production, and a marginal inclusion in global supply chains. Access to finance, in particular for SMEs, remains a key barrier to increasing growth and competitiveness. Banks are confronted with a high level of non-performing loans and problems of debt recovery (securing and selling collaterals), resulting in scarce and expensive credit.

**Structural reform needs are essentially concentrated on the labour market, human and physical capital as well as business support services to facilitate the internationalisation of SMEs.** The labour market is characterised by high youth unemployment, low participation of women, and high long-term unemployment. More labour market flexibility and effective active labour market policies are needed, together with education reform. Addressing transport bottlenecks in a fiscally sustainable and transparent manner, based on sound cost-benefit analyses, will contribute to more efficient transport links within the country and across the Western Balkans. Business support services need to be enhanced, also in view of better integrating local companies in regional and international production processes. The rule of law is still weak, corruption substantial and the informal sector large, creating unfair market conditions.

**The policy guidance of the Economic and Financial Dialogue with the EU of May 2015 was partially addressed.** Contract enforcement was further streamlined, the single project pipeline for investment priorities was set up and steps were taken to improve the quality of the land registry. However, several structural reforms remain at a preliminary stage. There is a need to further pursue financial sustainability of the pension system. Moreover, the newly introduced life-long social benefits for mothers of three children (adopted without an appropriate fiscal impact assessment) may negatively affect the labour market participation of women. Adoption of a new labour law is planned only for 2017.

**The Economic Reform Programme correctly identifies the key obstacles to growth and competitiveness, and outlines a number of relevant measures to address them.** The 19 reform measures are in line with the government's goals and are appropriate for fostering growth and competitiveness. However, the link between the obstacles and the reform measures could be strengthened and their expected results and impact on competitiveness remain essentially unquantified. The ERP has a strong focus on infrastructure and large public investment projects. Given the significant budgetary deficit and a rapidly growing public debt, less costly regulatory reforms could be prioritised. With regard to public finance management (PFM), sector developments and business environment, the reform measures are broadly relevant and, if implemented, will contribute to increased competitiveness. Implementing PFM and education reform could potentially yield higher and more sustainable returns in the medium to long term.

##### *Public finance management*

**Weaknesses in public finance management undermine fiscal discipline and transparency.** The existing fiscal responsibility framework is weak, and the deficit and debt thresholds established by the fiscal rule were exceeded in the executed budget for 2015 as well as in the fiscal framework 2016-18. This raises issues about the enforceability of the current framework. The fiscal reporting remains weak with successive fiscal data revisions, especially on the spending side. There is scope for improving reporting on municipal arrears. Other areas for reform concern weaknesses in

medium-term financial planning, internal audit capacities, as well as public procurement. The public procurement system accounts for 13.6% of GDP, similar to the EU average. It suffers from the almost exclusive use of price (acquisition cost) as the only award criterion, which detracts from the quality of the items procured. Moreover, the area of concessions is not aligned with EU rules. A public investment management system which uses sound cost-benefit analyses to inform budgetary priorities would improve fiscal control and increase transparency. Against this background, the full implementation of the comprehensive Public Finance Management (PFM) reform programme, adopted in December 2015, would help tackling identified weaknesses. Therefore, a clear reference to the PFM reform programme in the ERP structural reform part would have been appropriate.

**The measure to introduce e-procurement could have a positive impact on transparency in the use of public funds and could potentially lead to increased competition for public tenders.** Planning appears credible and realistic and the measure is consistent with the PFM reform programme. The ERP also recognises the need to regulate concessions and public private partnerships in line with the EU acquis. This will regularise the way the state establishes partnerships with businesses and help ensure a level-playing field for businesses, while stimulating further economic development and competitiveness. A law on concessions and public-private partnerships has been in preparation for several years and further delay could hinder private investments.

### *Infrastructure*

**Weak regional connectivity and high infrastructure costs hinder economic growth.** Infrastructure development is constrained by the country's difficult topography, which results in high investments and maintenance costs. Montenegro could become more competitive in energy by contributing to the development of a regional energy market and exporting potential surplus energy. The large public investments in roads, railway, and power interconnectors are broadly in line with the priorities agreed under the connectivity agenda, but weigh heavily on the fiscal framework. Investment planning needs to take into account the fiscal constraints and be accompanied by sound cost-benefit analyses and good infrastructure management. Embedding capital investment in infrastructure in wider sector policies, including regulatory measures, can bring significant benefits for relatively little cost. On this issue, further efforts are needed to improve railway safety and interoperability, including ensuring sufficient capacity for and independence of the rail regulatory body and rail safety authority. In the area of energy, for the effective separation of the energy entities, in line with the EU's third energy package, proper safeguards can be put in place. This way, the market's opening benefits customers through guaranteeing, for instance, obstacle-free supplier switching for customers.

**The recommendation to strengthen the transport development strategy and ensure alignment with the regional connectivity agenda has not yet been addressed.** However, Montenegro has included this as a reform in the ERP 2016-2018 and has ongoing discussions with IFIs to secure funding and set up a clear implementation timetable.

**The measure on continuing the construction of the Bar-Boljare motorway could bring substantial benefits in the long run, but at the expense of postponing other important investments.** The ERP points to a number of substantial competitiveness benefits linked to building of the motorway, such as improved flow of goods and people, more balanced regional development, and growth in tourism. However, the full benefits of the Bar-Boljare motorway, as Montenegro's biggest-ever public infrastructure investment project, are likely to materialise only when the entire network is finalised,

linking the port of Bar to Belgrade, via Podgorica. Opportunity costs of not investing in other areas and the expected benefits need to be carefully considered. Due to the resources invested in this project, other important transport bottlenecks may not be properly addressed. The high costs and fiscal risks create an urgent need to take complementary measures that ensure the sustainability of public debt.

**Infrastructure-related measures have significant potential to improve the competitiveness of the economy, when complemented by regulatory reform.** The measure to modernise Bar-Vrbnica section of the rail network could ensure that climate-friendly transportation options are available. It is well developed with a good level of project maturity, but it is dependent on financial support from donors and IFIs for its implementation. The impact also depends on similar steps being undertaken by Serbia to rehabilitate the rest of the line to Belgrade. As regards energy, the planned inter-connection to the EU and Serbian electricity markets presents a good opportunity for electricity exports, in particular from hydro sources, and will increase network stability. Risks of negative environmental impacts should be accounted for and mitigated. The measure needs to be complemented by soft measures that encourage competition on the energy market, as well as promote energy efficiency. The implementation of obligations under the Energy Community Treaty should be given priority. The measure on the construction of a waste water purification plant and water-supply and sewage networks seeks to improve the availability of services of general interest and compliance with environmental standards in this area. However, it remains vague in terms of its potential impact on competitiveness and to what extent it addresses a key growth constraint.

### *Sector development*

#### *Agricultural sector development*

**Montenegrin agriculture is characterised by low production due to a difficult topography with limited fertile land, the small size and fragmentation of plots, outdated technology and limited access to credit.** Dependence on agricultural imports is high. To reach a more favourable business environment for farmers, Montenegro needs to develop a multiannual agro-budget, a system for consolidating land, provide support to education and training of farmers, and assist producers in developing and marketing products.

**Progress has been recorded in the field of EU food safety and sanitary and phytosanitary standards through the adoption of several framework laws.** They were complemented by a strategy for transposing and implementing the EU *acquis* for food safety, veterinary, and phytosanitary policy. However, the strategy does not identify the products' level of preparation for EU accreditation or specific areas where Montenegro perceives the biggest export potential, as suggested by the 2015 policy guidance.

**Montenegro is right to continue support for investments in primary agricultural production and expanding it to manufacturing capacities, envisaged under the priority reform measure and this is in line with the diagnostic.** To develop this area, Montenegro needs to allocate adequate resources and to strengthen the capacity of all IPARD bodies to take on budget implementation tasks.

#### *Industry sector development*

**Although the share of industry in Montenegro's economy is declining, an increased diversification from metals into other sectors like energy or pharmaceuticals has been noted.** The production of competitive higher value-added products remains limited. The local industry is characterised by low labour productivity and marginal participation

in global supply chains. Access to finance, in particular for SMEs, remains a key barrier to increasing competitiveness. Financial support has increased in recent years, but largely depends on external funding from IFI loans. The SME Policy Index 2016 highlights that while Montenegro has established a solid institutional framework for SMEs, additional work is required to enhance the provision and range of business support services as well as to improve SME access to foreign markets.

**Incentives to invest in the industrial sector aim to support new production technologies and create new jobs. The measure already anticipates an impact on employment.** Support is concentrated on the manufacturing industry and is limited to established businesses for their expansion on condition of creating new jobs. Six projects were selected during the first call in 2015 which are expected to create almost 300 new jobs with a total own investment of EUR 21 million, supported by EUR 620,000 in subsidies. Monitoring and evaluating the effectiveness of the scheme, including terms of its impact on production, increased sales, and exports, will allow a good allocation of the resources.

### *Services sector development*

**Services remain the main engine of the economy.** The sector accounts for more than 70% of gross value added. Montenegro aims to become a high-end tourism destination. For this, challenges are in particular the lack of R&D business uptake, the need for more quality accommodation infrastructure, as well as the development of a sustainable natural and cultural offer. Other services sectors could benefit from more regulatory alignment with EU rules. The country has not yet aligned its legislation with the EU Directive on Services. Also, an important facilitator for the development of the service sector is an effective ICT broadband infrastructure, which includes a legal and regulatory framework. Furthermore, enhancing the independence of the telecommunication regulator and requiring network operators to coordinate their engineering, to share their infrastructure, and to specify the conditions for granting aid, will amongst other things lead to increased competition between fixed and mobile operators as well as among them.

**The measure to develop skiing infrastructure in the north of Montenegro seeks to diversify the tourism offer and reduce strong seasonality.** So far, most tourists remain concentrated on the coast during the summer while the north of the country is not sufficiently developed. The programme proposes the development of basic infrastructure to attract investors for the further development of some winter resorts through public-private partnerships. However, the lack of interest from private investors is a cause for concern.

### *Business environment, corporate governance and reduction of the informal economy*

**The business environment is improving but there is ample room for further progress.** The main obstacles identified by the business community are: the informal economy, access to electricity, weak contract enforcement, limited access to credit, and cumbersome tax administration procedures. Further efforts are needed to strengthen the rule of law, to reduce the informal sector, and to tackle corruption to ensure that regulatory improvements translate into an improved investment climate. The outcome of judicial proceedings is at times difficult to predict as court orders are not always enforced or followed by law enforcement institutions.

**The ERP includes five reform measures that are all relevant to improving the business environment.** The upgrade of ICT systems to improve the functioning of one-stop shops introduced in 2012 for issuing construction permits has the potential to significantly shorten the time needed to issue such permits. The budgetary commitment this year indicates that the timeline is realistic. By ensuring the correct implementation of

the amended Law on state survey and immovable property cadastre (adopted in July 2015), Montenegro seeks to make the land registry better and increase its coverage through streamlining the registration process for ownership rights. However, the description of this measure remains vague and does not set out any further steps.

The completion of the regulatory simplification project is delayed until 2017, when Montenegro also plans to evaluate its results and effectiveness. The introduction of electronic fiscal invoices will allow a further reduction of the informal economy by strengthening tax discipline. The measure is specific, its budgetary impact estimated, and has a precise timetable for implementation.

The improvement of financial support to SMEs seeks to expand the range of instruments and credit lines to make them more effective. The financial support channelled through the Investment and Development Fund (IDF) has increased in recent years from some EUR 66 million in 2013 to EUR 115 million in 2015. For 2016, the ERP announces support of approximately EUR 100 million. IFIs and the EU are the main supporters of the IDF lending instruments. While basic services for SMEs and start-ups are available, Montenegro could expand the range of services offered, including through the development of private business support providers.

### *Technological absorption and innovation*

**Montenegro recognises the importance of research and innovation as a driver for competitiveness and is in the process of taking several measures to link academia to industry.** However, the number of domestic innovative and internationally competitive enterprises is low. R&D investment amounted to 0.38% of GDP in 2013. R&D personnel represented 0.26% of the workforce in 2013.

**The construction of the first Science and Technology Park 'Tehnopolis' in Nikšić remains a priority in the measures, but was delayed by a year to 2016 due to procurement-related problems.** It is important that Montenegro elaborates on how to attract academia and industry and the services they want to offer. For example, funds for training and equipment have not yet been secured. Strengthening the current limited research capacity inside and outside universities, including innovative SMEs, will contribute to an increased technology and innovation absorption capacity. In order to maximise the impact, research funding would need to focus on a limited number of key research areas, such as organic food, sustainable tourism, marine science or bio-ICT, and other areas to be identified in a Smart Specialisation Strategy. Montenegro's Innovation Strategy 2016 (under preparation) may provide further clarity.

### *Trade integration*

**Trade openness in Montenegro is high, reflecting a strong dependence on goods imports and exports of services.** The trade and current account deficits are substantial, totalling some 40% and 13% of GDP respectively in 2015. Exported goods consist predominantly of low added-value products with only a few companies that trade internationally. The expansion of SME support services will improve SME internationalisation and foster their inclusion in global value chains.

**Enhanced harmonisation with the requirements of international quality standards will be encouraged by direct support scheme for SMEs.** The scheme contributes to higher quality domestic companies and their products, increased consumer confidence, thus strengthening competitiveness. While the ERP reports a 'pronounced interest' among SMEs, there is no information on the results and impact achieved to date (e.g. on increases in sales). The ERP could also have given more prominence to foster regional trade integration, including the ongoing CEFTA negotiations on the liberalisation of

trade in services and trade facilitation. There are significant gains to be made on intra-regional economic integration, especially if combined with regulatory approximation with EU rules in related areas.

### *Employment and labour markets*

**High long-term unemployment and low labour market participation of youth and women remain a challenge.** Young people suffer from an unfavourable position on the labour market, greatly as a consequence of the skills-mismatch. Widespread engagement in informal work coupled with weak activation remains a challenge, given the existence of disincentives to work and early exits from the labour market. The recently adopted measures for mothers of three children are likely to largely discourage women from participating in the labour market.

**There was some formal progress in developing employment strategies and aligning education and skills with labour market needs.** A comprehensive Employment and Social Reform Programme 2015-2020 and Employment Strategy 2016-2020 were adopted, but implementation has not yet started. Educational programmes are being reviewed and a programme for professional training of university graduates is being rolled out. Adoption of the new labour law is planned for 2017. Combatting undeclared work was prioritised through institutional and operational reforms, but the results will only be visible in the future.

**There is a need to improve vocational education and training outcomes in line with labour market needs.** By 2017, Montenegro plans to carry out activities to develop new or modify existing qualifications and programmes - based on learning outcomes - accompanied by training for teachers. Focus needs to be given to introducing work-based learning, promoting entrepreneurship and career guidance. Furthermore, weak learning outcomes in basic education and soft skills are a further element of concern, in particular as these not only affect performance on higher educational levels, but also impact future employment and social situation of the population.

**While targeting has improved somewhat, the outreach and coverage of active labour market policies (ALMPs) remain low.** Measures aiming at better inclusion cover both areas of labour market and social protection. Action is planned to strengthen ALMPs and employment services, through staff trainings and reviewing of existing ALMPs. A grant scheme will offer capacity building and training programmes for the long-term unemployed, women, youth and other hard to employ groups. Nevertheless, there remains a wide scope to increase the low coverage of ALMPs, particularly for groups vulnerable on the labour market and for the less advantaged in order to achieve better integration and participation on the labour market.

### *Fostering social inclusion, combating poverty and promoting equal opportunities*

**Weak activation measures, gender inequalities and insufficient social and child care services are key challenges.** Insufficient coverage and targeting of social assistance is likely to create disincentives to work, especially combined with the opportunities in Montenegro to engage in informal work. Tackling key social challenges requires increasing labour market participation, and strengthening social assistance and care provision to better target those in need.

**Reconciling work with family life for women appears difficult due to disincentives to work and insufficient coverage of child care.** In 2015, changes to the Law on social and child protection introduced a measure which allows mothers with three or more children to obtain life-long social benefits, amounting to 40-70% of average wage after only 15-25 contributory years or inscription in the employment registry. This is highly

likely to discourage women from participating in the labour market and will encourage early exits in the same way as early retirement, while the costs will put further pressure on social protection expenditures. There is insufficient focus given on prolonging working lives, which could be linked to measures on reducing early retirement.

**Further support measures are necessary to improve the social protection system.** To address this challenge, Montenegro plans an analysis of the social situation, tying it with the ongoing “Social Card” reform project, aiming at establishing an integrated social protection information system, strengthening the capacities of social welfare centres and linking social services with the activities of employment offices, thereby introducing activation measures for the most disadvantaged. However, stronger focus is missing on addressing regional disparities and targeting the most disadvantaged groups, such as Roma, Egyptians and Ashkali and people with disabilities. Better focus is lacking to improve access to social services at the local level and on decentralisation of social services, while community-based organisations should also be targeted.

**Participation and coverage of pre-school education is a priority, although the focus appears to be on facilities only.** Under the Council of Europe Development Bank project, seven new pre-school institutions will be built and existing ones renovated by the end of 2017. While investments in pre-school education are an important aspect of social inclusion, there is no mention of complementary measures and activities to increase participation in and the quality of pre-school education and upbringing. Infrastructure development lacks accompanying measures of investment in teachers. The measure is linked with the strategy for early and pre-school education but there is no indication on how the proper management of the institutions will be ensured.

## **ANNEX 1: OVERALL ASSESSMENT OF PROGRAMME REQUIREMENTS**

Montenegro's second Economic and Reform Programme (ERP 2016-2018) was submitted to the European Commission on 30 January 2016. The ERP represents the economic policy of Montenegro and the basis for economic dialogue with the Commission. The authorities submitted one further update of the programme, on 15 February 2016, providing summary information on the implementation of the policy guidance adopted at the Economic and Financial dialogue with the EU of May 2015.

### *Ownership and internal coordination*

The preparation of the ERP was centrally coordinated by the Office of the Deputy Prime Minister, the Ministry of Finance, and the Ministry of Economy. The programme was formally adopted by the government in January in 2016 and submitted on time. An inter-ministerial ERP working group involving line Ministries worked on its preparation.

The proposed 19 priority reform measures are in line with the Government's goals, national strategies, SEE2020 Strategy, EC report on Montenegro and correspond to a certain extent to the joint recommendations of the May 2015 Economic and Financial dialogue. The level of maturity of the proposed measures varies in scope, financial impact and time horizon. Measurable indicators need to be associated to each measure. Additionally, there is a high overlap with last years' measures.

### *Stakeholder consultation*

The ERP working group first developed the draft and further discussed it with the stakeholders in initial phase. The draft ERP was published on the Government's website from 18 December 2015 to 24 December 2015. No comments or suggestions were presented. The Government, additionally, organised a consultative roundtable on 23 December 2015. In addition to relevant line Ministries, representatives from the Parliament, Central Bank of Montenegro, MONSTAT, Union of Municipalities, State Audit Institution as well as UNDP or the Office of the World Bank in Podgorica attended the event. While well attended, the event is not considered to have brought substantial added value to the process. Several prominent Montenegrin NGOs, as well as representatives of professional bodies including the Employers Federation, were not present. The draft ERP 2016-2018 was not shared with the relevant Parliament's Committee for comments.

### *Macro framework*

The programme presents a clear and concise picture of past economic developments. The baseline macroeconomic scenario supporting economic policy seems plausible given the fact that several large investments supporting the overall strategy are already commenced or are in an advanced state of preparedness. Analytical capabilities are gradually improving, in particular on the analysis of the cyclical position of the economy and the sustainability of the external sector, although some further fine-tuning is still required. The ERP 2016 also presents –for the first time– the set of external assumptions underlying the programme's macroeconomic projections (although these are still incomplete for 2018). Like last year, some data coverage remains incomplete, in particular on the labour market and external sector developments. However, the baseline framework appears coherent, consistent and sufficiently comprehensive. The programme also offers an alternative but cautious low-growth scenario based on the occurrence of two potential risks: deterioration in the refugee crisis and the threat of terrorism. Both risks would have negative repercussions on tourism, one of the key engines of growth and with multiplicative effects on sectors like transport, culture or catering. In this

scenario, aggregated demand would contract due to the reduction of exports, investments, and private consumption.

### *Fiscal framework*

The fiscal framework appears insufficient to support the ambitious policy objectives. At first glance, the measures presented in the programme are broadly balanced, with both revenue and expenditure measures accounting for some 2.7% of GDP each. However, on the revenue side there are some one-off measures, or they still depend on uncertain political support for adoption. By contrast, the measures on the expenditure side have been already adopted. Often, their final costs surpass the ERP's early estimations, calling for corrective measures, and possibly, a budget rebalancing too. The programme also offers an alternative low-growth fiscal scenario. However, this alternative scenario is much less developed than the macroeconomic one, failing to provide any estimate or rationale for the effects of the economic downturn on some components of the budget, like on interest rates or state guarantees. Work is continuing under the action plan for implementation of ESA2010 methodology in the government finance statistics, with full implementation planned for the end of 2017.

### *Structural reforms*

The section on structural reform priorities follows the guidance note in presenting a diagnostic per area, rather than for each measure. The ERP 2016-2018 correctly identifies some of the obstacles to Montenegro's growth and competitiveness and outlines a number of relevant measures to address them. However, the diagnostic is at times vague or too general in some areas. The linkages with the chosen reform measures are not always well justified. The reporting of the implementation of the policy guidance can be improved and provide more precise information about the actions taken and their impact. As a result, assessing the state of play of the policy guidance has been at times unnecessarily complicated, requiring extra research and clarifications. Tables 10-12 are properly filled in following the guidance note. Montenegro's ERP 2016 does not integrate Annex 2 which includes information on the consultation process of external stakeholders on structural reform priorities and fulfilment of SEE 2020 national targets before the ERP is drafted. No information was included on the consultations of stakeholders before the ERP drafting.

## ANNEX 2: IMPLEMENTATION OF THE POLICY GUIDANCE ADOPTED AT THE ECONOMIC AND FINANCIAL DIALOGUE IN 2015

2015 policy guidance	Summary assessment
<p><b>PG 1:</b> Sustain the commitment to fiscal discipline, establish a credible track record on the basis of the new rules-based fiscal framework and revise the public debt management strategy to bring the public debt into a downwards trajectory in line with the ERP medium-term framework. In this context, municipalities are also called to contribute by strengthening their own budgetary position. In order to improve transparency, develop the necessary administrative capacity to implement the European System of Accounts (ESA2010).</p>	<p>Montenegro has not addressed the PG 1:</p> <ul style="list-style-type: none"> <li>• Budget expenditure deviates significantly from the target due to the unplanned repayment of arrears. Moreover, the decisions to increase public sector wages and benefits will further derail public finances.</li> <li>• In June 2015, the government adopted the Public Debt Management Strategy for the period 2015-2018. Another plan to reduce the debt below Montenegro's fiscal rules threshold is announced for November 2016.</li> <li>• In July 2015, the Ministry of Finance improved the fiscal position of 14 municipalities bringing forward by one year the programme for restructuring their debts. This was in exchange for a plan (to be implemented) for the municipalities to optimise their number of employees.</li> <li>• Activities continue under the Action plan for implementation of ESA2010 methodology in the government finance statistics. Full implementation is planned in 2017.</li> </ul>
<p><b>PG 2:</b> Consider additional reforms for attaining long-term sustainability of the budget, such as the introduction of further restriction for early retirement and the consideration of options for individual participation into the old-age pension system on a mandatory basis, as well as the implementation of a common policy for public sector wages in the context of rationalisation and modernisation of the public sector.</p>	<p>Montenegro has not addressed the PG 2:</p> <ul style="list-style-type: none"> <li>• There have been measures taken to reduce early retirement. In 2015, amendments to the Law on pension and disability insurance restricted early retirement to miners and parents of children with severe disability. While staying on the labour market is financially incentivised by a further pension increase, the motivation to stay at work appears low.</li> <li>• On old age pensions, the government decided to postpone further development of the second pillar (individual compulsory participation) due to budget constraints.</li> <li>• Implementation of policy guidance had opposite effects than expected for public sector wages. The simplification of public sector wages across government institutions to rationalise costs, will not be neutral but result in an increase in salaries of up to 16%.</li> </ul>
<p><b>PG 3:</b> Implement the planned voluntary financial restructuring programme (the so-called "Podgorica approach") to address the high burden of non-performing loans on bank balance sheets from a flow perspective. In order to address the NPL stock issue, improve deadlines and efficiency of contract enforcement. Introduce effective supervision of factoring companies to improve the transparency of the financial system.</p>	<p>Montenegro has partially addressed the PG 3:</p> <ul style="list-style-type: none"> <li>• The plan for voluntary financial restructuring (i.e. Podgorica approach) was adopted but it failed to yield the expected results.</li> <li>• There was some fine-tuning of secondary legislation supporting the work of public bailiffs. But some additional measures are still necessary to facilitate banks' collateral execution and contract enforcement.</li> <li>• Regulation of factoring companies has been included in the 2016 government programme.</li> </ul>
<p><b>PG 4:</b> Amend labour legislation in order to introduce further market flexibility. Reinforce sanctions to discourage undeclared work. Better target active policies for workers at risk of losing their employments and enhance labour market</p>	<p>Montenegro has partially addressed the PG 4:</p> <ul style="list-style-type: none"> <li>• Labour law is in preparation, planned for adoption in 2017.</li> <li>• Government recommendations and action plan to fight informal economy were adopted in</li> </ul>

<p>participation in view of an ageing population.</p>	<p>2015.</p> <ul style="list-style-type: none"> <li>• The 2015-2020 Employment and Social Reform Programme and the 2016-2020 Employment Strategy were adopted in 2015. ALMPs focus on the long-term unemployed, youth and women, but no evaluation of their effectiveness has been provided. There is little focus on participation in life-long learning and no specific focus on the labour market participation of older workers.</li> </ul>
<p><b>PG 5:</b> Actively continue education reform with a view to better aligning education and skills with labour market needs, and strengthening cooperation between education and business.</p>	<p>Montenegro has partially addressed the PG 5:</p> <ul style="list-style-type: none"> <li>• Educational programmes are being reviewed and Sectoral committees and the Qualifications Council provide a link with employers over the development of qualifications.</li> <li>• A programme for professional training of university graduates is in place and a similar programme is planned for vocational training.</li> <li>• A feasibility study was conducted into establishing a tracking system for university graduates.</li> </ul>
<p><b>PG 6:</b> Strengthen the transport development strategy ensuring alignment with the regional agenda on connectivity, with a particular focus on the core investment priorities (core network), and establish a credible planning and funding mechanism in the form of a single sector pipeline.</p>	<p>Montenegro has partially addressed the CPG 6:</p> <ul style="list-style-type: none"> <li>• The revision of the transport development strategy has been included as a priority reform in the 2016 ERP, but the required resources have not yet been secured.</li> <li>• A National Investment Committee was set up in May 2015. A Single List of Transport Priority Infrastructure Projects has been designed.</li> </ul>
<p><b>PG 7:</b> Further improve the business environment by ensuring the timely implementation of the so-called "regulatory guillotine" (simplification) project, enhancing the functioning of one-stop shops at municipal level for the issuing of construction permits and the quality of the land registry.</p>	<p>Montenegro has partially addressed the PG 7:</p> <ul style="list-style-type: none"> <li>• Out of 1446 measures from the "Regulatory Guillotine", 1103 have been implemented by mid-2015; completion is foreseen by end-2017.</li> <li>• Implementation of one-stop-shops is ongoing, but the upgrade of the IT system was delayed. This is now foreseen under this year's ERP.</li> <li>• In July 2015, amendments to the Law on State Survey and Immovable Property Cadastre were adopted in order to strengthen and streamline the process of land registration. A measure to monitor its application is included in the ERP 2016.</li> </ul>
<p><b>PG 8:</b> Make further progress with a comprehensive and strategic approach in the field of EU food safety and sanitary and phytosanitary standards to receive accreditation for exporting agricultural and food products to the EU. Efforts in this direction should commence with those products where preparations are advanced and where Montenegro sees the biggest export potential.</p>	<p>Montenegro has partially addressed the PG 8:</p> <ul style="list-style-type: none"> <li>• In September 2015, Montenegro passed the Food Safety Law, as one framework law in this area, covering among others competent authorities, import &amp; export, registration of establishments, official controls and specific rules for feed. Other framework laws were adopted to facilitate meeting the conditions for the export of food products to the EU.</li> <li>• The government also adopted a Strategy for Transposing and Implementing the EU Acquis for Food Safety, Veterinary, and Phytosanitary Policy. However, the strategy does not include a detailed plan for receiving accreditation for exporting different agricultural and food products to the EU.</li> </ul>