



CENTRAL BANK OF
MONTENEGRO

**ECONOMIC POLICY RECOMMENDATIONS TO THE
GOVERNMENT OF MONTENEGRO FOR THE YEAR
2020**

Podgorica, December 2019

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INTRODUCTORY REMARKS

Pursuant to the Central Bank of Montenegro Law, the Central Bank of Montenegro may communicate economic policy recommendations to the Government of Montenegro.

The 2020 recommendations support medium-term development goals of Montenegro's economy set out in the national documents "2020-2022 Economic Reform Program" and "Montenegro Fiscal Strategy 2017-2020". The established goals include ongoing development of the legal and institutional infrastructure of Montenegro that is based on the following assumptions:

- Economic growth conditioned by private sector development, in particular of micro-, small and medium-sized entrepreneurship, with an emphasis on growth and recovery of all economic enterprises;
- Development and implementation of the legal framework in line with EU regulations and improvement of competitiveness of the business environment whilst taking into account the specific features of Montenegro;
- Valorisation of Montenegro's potential, primarily in prioritized fields;
- Environmental protection;
- Reduced external macroeconomic imbalances whilst maintaining financial stability and attaining fiscal sustainability, with a particular emphasis on structural reforms;
- Reducing unemployment;
- Bringing the informal sector into legal flows, i.e. reduction of informal economy.

One of the established economic policy objectives that the Central Bank of Montenegro (hereinafter: the Central Bank) prioritizes is the process of fiscal consolidation aimed at a surplus in the current government spending, expanding the economic base through the investment cycle in private and government sectors, thus expanding the tax base, all together contributing to the strengthening of fiscal sustainability and stability. Attaining economic policy objectives in 2020 against the fiscal consolidation background will be realized through the following macroeconomic indicators:

- Annual inflation rate ranging from 1% to 2%;
- Increased employment with the emphasis on domestic labour force;
- Growth in manufacturing industry and reduction of import dependence;
- Budget deficit reduction.

The recommendations are aimed at addressing vulnerabilities of Montenegro's economic system and they are grouped as follows:

- Recommendations concerning the real economy;
- Recommendations concerning the financial system;
- Recommendations concerning the fiscal policy;
- Recommendations concerning statistics.

The ultimate objective of these recommendations is increased living standard of the citizens of Montenegro.

1. RECOMMENDATIONS CONCERNING REAL ECONOMY

Montenegro's economy is characterised by high participation of micro-, small and medium-sized businesses that are still growing and developing towards more powerful and productive capacities. Fostering economic activity and improving the existing productivity are key elements of economic policy in creating new value, reducing the burden of the existing debt, increasing system liquidity, and releasing growth potentials.

Recommendations in this area relate to improving competitiveness, with particular emphasis on priority sectors and structural reforms.

1.1. Recommendations concerning competitiveness

With a view to accelerating economic growth and development, it is necessary to continue with activities aimed at improving competitiveness of Montenegro's economy and eliminating key obstacles. Therefore, the following is recommended:

- Encouraging development of competition, entrepreneurship, and the implementation of investments contributing to increasing employment in line with EU regulations, and improving competitiveness of the business environment;
- Strengthen capacities of the institutions and other bodies responsible for reducing informal economy, as well as raising the level of responsibility for the effectiveness of implementation of the defined measures for the reduction of informal economy;
- Promote the funding of projects that provide higher employment and contribute to environmental protection through increasing credit opportunities of the Investment and Development Fund of Montenegro (IDF);
- Continue implementing regulatory reforms by simplifying administrative procedures (red tape reduction) and improving public services;
- Work on improving the institutional framework for the implementation of the public-private partnership model, in line with new regulatory solutions in this field and positive experiences in practice so far;
- Improve the infrastructure to support innovation and technological development and encourage the linking of the economy with innovation hubs at home and abroad. Encourage innovation in accordance with the guidelines set out in the Europe 2020 Strategy, as well as greater participation of SMEs in the Horizon 2020 programme;
- Continue with the digitalisation of public administration and expand the one-stop-shop principle to other services both at the national and local levels;
- Create a database/registry of traded real estate;
- Continue tax reform by further reducing the burden on taxpayers, especially the tax burden on labour;
- Improve transport and communal infrastructure, especially at the entrance of tourist and cultural centers;
- Encourage the implementation of international quality standards by providing advisory support to micro-, small and medium enterprises;

1.2. Recommendations concerning the development of priority sectors

1.2.1. Tourism

Tourism is one of the priority sectors in Montenegro's development and the generator of employment in the economy so in order to strengthen this sector, the following is recommended:

- Promote diversification of the tourist offer and, to that end, accentuate the potentials for the development of cultural, religious, sports, health, congress, nautical, MICE, and other special forms of tourism;
- Implement more effective measures to prevent further devastation, over-construction and destruction of green zones, and also valorize historical sites in the territory of Montenegro whose architectural, archeological and cultural significance has not been recognized or protected;
- Improve long-distance public transport to allow visitors easier transfer and reduce the burden on transport infrastructure;
- Develop tourism-related sectors (food industry, agriculture, business services, construction) to reduce import dependency;
- Implement financial support measures for the development of innovative tourist products with a view to improving the tourist offer quality and support the obtaining of quality and environmental certificates;
- Improve the promotion of Montenegro as a tourist destination in the outbound markets with a view to increasing the tourist turnover with joint campaigns by the National Tourist Organization of Montenegro and tour operators that bring tourists from the outbound markets;
- Encourage the development of a balanced tourism offer in all regions of the country by building new hotel capacities;
- Create a model for a rational restructuring of the national airline in order to establish a sustainable business;
- Encourage the development of low-carbon tourism (increasing the number of "green" accommodation capacities) and achieving environmental standards in tourism. Address the problem of municipal and plastic waste in the sea that has a negative impact on the tourist offer.

1.2.2. Agriculture, forestry and fishery

The agriculture, forestry, and fishery sector should be developed as one of the strategic economic branches with a view to reducing economic and social imbalances and providing a more balanced regional development. Thus, in order to strengthen this sector, the Government should:

- Continue with the support programmes to agricultural production, including direct insurance subsidies, with a view to improving its volume and quality. Implement and promote the procedures of awarding funds from EU support programmes to agricultural producers;
- Promote the attractiveness of the agricultural sector for foreign investments;

- Encourage the use of new technological achievements in agricultural production through subsidies and continuous education of potential beneficiaries;
- Continuously implement the control of the process of awarding funds from international support programmes and their use;
- Implement interinstitutional measures to improve food safety together with the implementation of EU standards, strengthening the capacity of veterinary and phytosanitary inspection, and certification of agricultural producers;
- Work on developing a FADN system (Farm Accountancy Data Network) that will provide a more comprehensive record of farm structure, production, income and expenditure, and at the same time make it easier for policymakers to analyze the effects of the implemented measures;
- Continue with campaigns to raise consumer awareness of the importance of buying domestic products and better positioning of Montenegrin products in retail chains, as well as improving the cooperation of agricultural producers with tourism and catering businesses in order to increase the representation of domestic products in the tourist gastronomic offer;
- Encourage sustainable development of rural areas by accentuating the construction of road and water supply infrastructure in underdeveloped areas, as well as providing conditions for a better quality of life in rural areas through the construction of sports, cultural, health and other facilities;
- Strengthen the control and monitoring of forest use in order to protect them from illegal activities and encourage afforestation actions;
- Consider restarting the FSC (Forest Stewardship Copuncil) certification process in order to contribute to a sustainable management of forests and generating products that are competitive in a foreign market.
- Encourage the development of fishery through measures to protect and preserve the resources of lakes, rivers and sea, provide support measures for registered fishermen by improving navigational safety standards and working conditions on fishing vessels, in order to meet the relevant EU standards;
- Work on providing the necessary infrastructure for the construction of fishing harbours along the Montenegrin coast, which will significantly contribute to the development of the fishery sector;
- Continue ongoing activities aimed at combating illegal fishing in order to protect the fishery fund and the sustainable use of fishery resources.

1.2.3. Energy

Energy sector development is one of the prerequisites for supporting the economy's growth, improving the competitiveness of Montenegro's economy, and safeguarding the population's standard. To strengthen this sector, the Government should:

- Encourage energy production from renewable sources;
- Continue with connecting the electricity market with the regional and European markets;

- Transpose into the national legislation standards concerning the energy efficiency of housing objectives and the use of renewable energy sources (the Energy Performance of Buildings Directive-EPBD);
- Improve the collection and processing of energy efficiency statistics;
- Move to market-oriented support schemes for energy production from renewable sources.

1.2.4. Manufacturing industry

Manufacturing is a sector that presents great potential for the development of the Montenegrin economy which has not been sufficiently valorized.

To strengthen this sector, the Government should:

- Encourage connection of economy with scientific and research institutions; Stimulate modernization and competitiveness of the manufacturing industry through the implementation of new technologies, thereby enhancing the competitiveness of manufacturing companies;
- Increase program activities for the allocation of grants for the development of innovative market-oriented products and services; Promote the availability of funding from the EU innovation support programs through the provision of training and advisory services to facilitate access to funds. Improve the regulatory framework for the development of alternative sources of financing;
- Strengthen activities to stimulate cluster development in the manufacturing industry in order to improve production and facilitate access to the domestic and foreign markets; strengthen financial and technical support instruments for clusters and further encourage the establishment of vertical clusters;
- Stimulate the connection of the manufacturing industry with the construction sector. By using a public-private partnership model, consider creating a facility for the production of products necessary for the construction of the remaining sections of the highway and other roads, as well as the need to improve other public infrastructure;
- Encourage networking of domestic companies with the global chains;
- Improve waste management and recycling in the manufacturing industry by creating new values in the processing industry, which would further contribute to the environment protection;
- Stimulate aluminum and steel processing;
- Encourage wood processors to increase of the finalisation degree of wood industry and export of products with a higher degree of processing; to that end, stimulate connections between wood processors and wood assortment producers.

1.3. Recommendations concerning structural reforms

Establishing stable and predictable business environment is a priority for intensifying economic activity, opening up growth potentials, and raising the quality of life in the country. Structural reforms should follow fiscal consolidation as the key developmental component. To that end, an efficient institutional environment, a flexible labour market, a sustainable pension system, effective education, and quality health care should be created.

1.3.1. Institutional environment

The Government should:

- Consider the option of setting up a national structural reform committee;
- Ensure consistent implementation of the Law on Fiscalisation in the products and services turnover, in a manner that all market participants are included in this system. Enhanced inspection should ensure strict compliance with the law and reduction of illegal business;
- Increase the efficiency of cadastral services in compliance with deadlines in procedures; Consider further enhancement of the electronic system to speed up the registration process; Provide regular updating of the cadastral services database so that information on cargo and real estate data base is accurate and reliable;
- Create a software that will enable electronic registration of companies, as well as electronic applications of employees, in order to shorten the registration deadlines;
- Create a software that will allow electronic registration of goods across all border crossings;
- Increase transparency of operations of the Intellectual Property Office of Montenegro , i.e. the register of the holders of intellectual property rights, and support these holders in their creativity in order to make the best use of the potential and/or to be recognized and valued at the market by investors; Create a register of sailors;
- Consider changing tax regulations with the aim to create a simple and more transparent taxation system;
- Improve Central Registry of Commercial Entities (CRCE) by deleting inactive companies to get a real picture of the illiquidity situation; Also, increase the efficiency of the CRCE in the part of administrative procedures, in order to respect deadlines when processing requests;
- Review the tightening of criminal policy for “repeat offender” companies (especially for those in informal economy).

1.3.2. Labour market

The Government should:

- Improve labour market flexibility and mobility. To that end, it is necessary to promote the principle of safety and reduce the rigidity of legal solutions in the labor market; Continue developing lifelong learning programs that will ensure adaptability and make employees more effective at their jobs;
- Implement active employment policy measures, with the emphasis on employment programs for young people, women and especially vulnerable groups;
- Target groups i.e. identify and engage in active employment policies persons exposed to the highest risk in the labor market;
- Implement adult education and training programs, as a category of long-term unemployed persons;

- Stimulate the employment by creating conditions for new jobs through the implementation of credit lines for self-employment and entrepreneurship development, with the emphasis on the northern region;
- Intensify the mediation function in order to implement better quality training, retraining and additional training programs to reduce the structural imbalance of the knowledge and skills offered in the labor market, especially when it comes to seasonal jobs and the substitution of foreign labor force by domestic labor force;
- Establish cooperation of the Employment Service of Montenegro with local government bodies to strengthen local employment programs and initiatives, with the aim of improving capacities at the local level, through identification of deficient occupations, development of local employment strategies and plans and implementation of active employment measures and self-employment programs at the local level;
- Strengthen cooperation of the Employment Agency and centers for social work aimed at stronger activation and support to the beneficiaries of financial support for inclusion in the labor market legal flows;
- Have an active role of the labor inspection authorities and other state bodies in suppressing and reducing informal economy and legalization of undeclared work;
- Implement training activities and labor market inclusion of a higher number of persons with disabilities through vocational rehabilitation programs, public works and other forms of employment policies;
- Provide better information on the rights and employment opportunities of unemployed persons from the category of vulnerable and less employable persons and their larger inclusion in employment programs.

1.3.3. Pension system

The Government should:

- Ensure continuation of the reform, aimed at minimizing dependence on budget funding and improving financial sustainability of the pension system;
- Implement direct measures that limit early withdrawal from the labour market and early retirement;
- Take necessary measures to improve and maintain pensioners' standard through social benefits based on an objective principle, in accordance with the actual financial position of pensioners and their health (adjustment of pensions, participation in co-financing of housing construction for pensioners' needs, financial assistance and the like).

1.3.4. Social benefits and child welfare

The Government should:

- Continue activities to improve the social benefits system, supported by the information system, in terms of realistic and fair coverage of beneficiaries, in order to provide social protection to persons in social need;

- Continue cooperation between centres for social work and the Employment Agency to stimulate persons for inclusion in employment programmes and better alignment of employment policies and social protection measures;
- Pay due attention to the provision of social and child welfare services for vulnerable categories;
- Continue activities to remove barriers to difficult access to services for children, persons with disabilities and the elderly;
- Continue intensive activities to develop day care services for children with disabilities;
- Improve the protection of the elderly as to increase the number of accommodation units or day care centres for the aforementioned category;
- Provide free textbooks for students from socially disadvantaged categories.

1.3.5. Education and health

The Government should:

- Develop qualification standards based on learning outcomes, aligned with labour market needs, and prepare modularised educational programmes accordingly;
- Train teachers to implement new, modularised educational programmes;
- Develop practical education programmes and conduct dual education at the level of secondary vocational and higher education in accordance with the needs of the labour market. Also, conduct research on this education in schools, employers and students, with a report and guidelines for future implementation;
- Continuously evaluate the practical education of employers and introduce a quality system and mechanisms for its monitoring;
- Continually monitor labour market trends and perform demand analysis;
- Continuously evaluate educational programmes, ie. introduce a quality system and mechanisms for its monitoring;
- Implement vocational guidance programmes in secondary schools;
- Promote education programmes for deficient occupations through three-year programmes and dual education;
- Continually work to ensure greater inclusion and support services for children with special educational needs;
- Continue co-financing tuition fees for masters and doctoral studies in the country and abroad and travel expenses for study visits abroad;
- Reward the best students and teachers;
- Continue to improve the material position and address housing issues of employees in education system.

The Government should also:

- Enable faster and easier access to health services;
- Eliminate deficiencies in the activities of preventing contagious diseases, harmful effects of alcohol and drugs, promote preventing contagious diseases through public campaigns, and create a registry of rare diseases;
- Include children in national preventive screening programs;
- Permanently analyse the so-called basic and supplementary list of medicines in order to harmonise the needs and economic possibilities of beneficiaries and the real

possibilities of its financing, except with the social category of population. At the same time, prevent excessive consumption of medicines;

- Improve preventive health care and promote the importance of preventive examinations in prevention and the development of the disease;
- Provide funds for the planned investments, according to the territorial distribution of the population, the existing infrastructure, demographic trends, and growing needs;
- Improve the financial position of health care workers, and in particular consider the possibility of special financial stimulation of deficient and overburdened medical professionals and staff in order to reduce staff outflow;
- Continue the development of the information system in accordance with the Integrated Health Information System Strategy.

2. RECOMMENDATIONS CONCERNING FINANCIAL SYSTEM¹

The following is proposed in the area of financial services:

- Take necessary activities to initiate the procedure for drafting a proposal to amend the provisions of the Constitution of Montenegro with a view to meeting the obligations assumed from the Action Plan for Negotiation Chapter 17, namely the obligations for alignment with the acquis in the area of economic and monetary policy and the fulfillment of the second criterion for the closure of the negotiation chapter. To that end, Article 143 of the Constitution of Montenegro should be harmonised, inter alia, with Articles 127 (1) and 282 (2) of the Treaty on the Functioning of the European Union and Article 2 of the Statute of the ESCB and of the ECB;
- Initiate the establishment of a national coordinating body for financial education, which will, inter alia, draft a national strategy for financial education in line with OECD/INFE principles and international good practices;
- With the aim of stimulating savings of natural persons, initiate amendments to the Law on Personal Income Tax which would abolish/defer the obligation to calculate, suspend and pay interest income tax on natural persons;
- Encourage the use of the services of the upgraded Central Bank of Montenegro Credit Registry with the aim of receiving information on the position of the debtor and better risk management of creditors.

3. RECOMMENDATIONS CONCERNING FISCAL POLICY

With a view to continuing consolidation process of the Budget and reaching stable fiscal indicators, it is necessary to:

- Continue with the implementation of the fiscal policy consolidation measures provided by the Budget Deficit and Public Debt Recovery Plan and the Fiscal Strategy of Montenegro 2017-2020, especially in areas related to the reduction of

¹The recommendations do not include the responsibilities of the CBCG, as defined by the CBCG Policy and the Guidelines for its implementation.

expenditures with a high share in total costs (gross earnings, unproductive spending, etc.) and the collection of tax arrears;

- Implement public administration reform in accordance with the Public Administration Reform Strategy in Montenegro 2016-2020 and with the Public Administration Optimisation Plan 2018-2020 with the aim of increasing the public administration efficiency.
- Consider introducing tax relief/income tax exemption in case of reinvestment of profit in the territory of Montenegro, and especially for investments in production activities and in underdeveloped areas.
- Further work on improving the Public Debt Management Strategy, and an investor relations strategy, create enhanced fiscal rules that will avoid procyclicality and ensure consistency in implementation as well as consider the possibilities of establishing a Fiscal Council;
- Improve the process of budget planning and execution and the assessment of outstanding liabilities, so as to prevent their accumulation;
- Focus public spending on areas that achieve the highest rates of social and economic growth. Greater investment in education and health, along with labour market reforms, would improve employment and material status of the youth and help create a more productive workforce;
- The main spending on public infrastructure should be in areas where society benefits most - mitigating congestion in densely populated and visited areas (resorts in coastal and northern towns);
- Improve cash planning at quarterly and annual levels, the necessary monthly buffers. In order to improve transparency and reduce prices, create a preliminary annual calendar for the issue of government bills;
- It is necessary to create a comprehensive and detailed plan for the performance of electronic public procurement in order to improve the efficiency of the procurement process for goods, services and works, as well as to generate savings in the public sector;
- With a view to limiting the fiscal risk of potential outstanding liabilities, create a detailed database of all companies that have the state owned capital in the Ministry of Finance, implement the OECD principles of corporate governance for these companies, and strengthen their financial supervision;
- Create capacities in the Ministry of Finance that will perform the assessment, management and supervision of fiscal risk arising from public-private partnership projects;
- Carefully analyse the economic viability for the construction of the remaining highway sections and their impact on the budget and public debt;
- Consider the possibility of adjusting the form and level of fiscality at local levels;
- Consider issuing state and municipal bonds to finance infrastructure and other projects of public importance;
- Reduce unproductive budget spending, with special emphasis on the following positions:
 - costs of consulting services, with prior analysis and evaluation of their necessity;
 - costs of lawyer services, through the use of internal resources, assistance from other consumer units or the Protector of Property and Legal Interest;

- Strengthen internal financial controls in the public sector with the consistent implementation of existing regulations (Law on Public Internal Financial Control System). To this end, it is necessary to adopt a comprehensive strategy for improving the management and public internal financial control systems;
- Pursue a restrictive policy when issuing new guarantees;
- Consider the possibility of providing adequate fiscal reserves in case of materialization of certain risks that may cause additional expenses (calling of guarantees, deterioration of economic situation, and so on).

4. RECOMMENDATIONS CONCERNING STATISTICS

With a view to achieving full harmonisation of the official statistics with the EU acquis, the Government should:

- Strengthen the personnel capacities of the producers of official statistics, both in terms of their additional training, as well as by employing new staff specialized in the field of producing statistics;
- Provide financial and spatial capacities, primarily for the Statistical Office of Montenegro;
- Continue activities on introducing the ESA2010 methodology into the system of official statistics, and in this regard, continue efforts on implementing the methodology in the statistics of government finances;
- In terms of implementing the ESA2010 methodology in the statistical system of Montenegro, strengthen the interinstitutional cooperation initiated in 2016 by signing the Agreement on cooperation in the area of national accounts statistics of the general government sector and related statistics between three official producers of statistics: the Ministry of Finance, the Statistical Office of Montenegro, and the Central Bank of Montenegro.