



CENTRAL BANK OF  
MONTENEGRO

**ECONOMIC POLICY RECOMMENDATIONS TO THE  
GOVERNMENT OF MONTENEGRO FOR THE  
PERIOD 2022 - 2024**

**Podgorica, July 2022**

## INTRODUCTORY REMARKS

The Central Bank of Montenegro has been making recommendations to the Government of Montenegro for conducting economic policy for many years, in accordance with the Law on the Central Bank of Montenegro.

The Central Bank of Montenegro has prepared a Report on the results of the analysis of macroeconomic risks facing Montenegro for 2022 which is intended for economic policy makers. The timeliness of this Report does not call into question the time that has elapsed since its adoption, given that it contains an analysis of short-term and long-term macroeconomic risks, risks existing in the banking system, fiscal risks, inflation risks, external risks and others, which represented a good basis for the preparation of this document.

Recommendations to the Government of Montenegro for economic policy for the period 2022-2024 were prepared based on an overview, analysis, and assessment of the key challenges and risks facing Montenegro's economy. These include: (i) tensions caused by the international geopolitical situation, (ii) continued price growth, disrupted supply chains, and limited availability of goods on world markets, (iii) tightening of financial conditions on international markets, and (iv) fiscal sustainability and risks. It should be emphasized that regardless of the fact that the risks that the Montenegrin economy is facing are largely external in nature and are difficult to tackle with national policies, the Central Bank points to the need to implement a prudential and targeted economic policy in order to mitigate potential risks and protect the living standard of citizens and preserve the growth potential of the economy. To that end, the Central Bank highlights that the priority for economic policy should be aimed at creating measures to curb inflation and ensure fiscal sustainability.

In addition to the recommendations for the anti-inflation package of measures and recommendations for fiscal policy, the document also includes recommendations in the real economy (agriculture, tourism, energy), recommendations for the green economy, statistics and other areas of importance for the pursuit of economic policy.

## KEY CHALLENGES AND RISKS

Available statistical data indicate that a significant economic growth of 7.2% was achieved in the first quarter of this year. Employment was 3% higher in April this year compared to December 2021, whilst unemployment declined by 11.9%. Nominal gross earnings rose some 9% over the first four months of the current year.

At the same time, despite the recorded growth, there are numerous challenges and risks that Montenegro's economy is facing. These are related to the development of the geopolitical situation and the resulting tensions, pronounced inflationary pressures, uncertainty regarding the development of the pandemic, then the effects of expected normalisation and tightening of monetary policies of the leading central banks, as well as the development of risks in the fiscal sphere and the maintenance of fiscal stability. Uncertainties connected with future developments in Ukraine and the intensity of its consequences will determine the intensity of the impact on macroeconomic, financial and fiscal trends.

**Continued price growth, disrupted supply chains, and limited availability of goods on world markets** - The initial expectations of key central banks and international financial

institutions that the rise in inflation is of a temporary nature, i.e. that the market will play the role of a regulatory mechanism regarding inflation, have not aligned with the reality. The external shock, namely the situation in Ukraine, further increased inflationary pressures related to disruptions in the world market of energy, food raw materials, production inputs, disruptions in supply chains, and increased prices of transporting goods. Inflationary pressures and disturbances on the international market spill over into the domestic prices of food, oil derivatives and transportation and, consequently, open an inflationary upward spiral of price growth of other products, which is why the inflation rate in Montenegro has been increasing over months. The latest available data shows that this rate stood at 11.7% in May this year.

The acceleration of inflation and growing inflation expectations are currently the most pronounced short-term macroeconomic risks, and there is a possibility that this short-term risk of accelerated inflation growth will turn into a long-term risk. A further increase in energy prices may adversely affect the increase in the value of imports and, consequently, lead to deterioration of the balance of payments. Global supply chains have already been disrupted, and their further collapse cannot be ruled out. Disruptions in supply chains that encourage price growth can additionally represent a large burden on the environment, especially the population with lower income, and the economy, and also induce social tensions and exert pressure on the government budget. Therefore, it is important to ensure timely safety and stability of basic food supply for the population.

Growing inflation expectations has an unfavourable effect on planned investments. The pace of investment plans could be slowed due to problems caused by disrupted global supply chains as well as rising prices of production inputs, i.e. deteriorating investment funding conditions, and general instability and uncertainty.

All of the above has a negative impact on the economic perspective and can be reflected in the slowdown of economic activity.

**Tightening of financial conditions** – Against the backdrop of growing inflation, normalisation and/or tightening of monetary policies is expected along with raising reference interest rates of the key central banks. The European Central Bank (ECB) has announced the normalisation of monetary policy and a gradual mild increase in reference interest rates, so to avoid a negative impact of inflation growth on economic growth of the still vulnerable European economies. For now, the ECB is sticking to its original plan to end the stimulus packages during the third quarter of 2022 and is it has announced an increase in the reference interest rate in July by 0.25 percentage points and again in September by the same or slightly higher amount, which will depend on the key economic indicators and inflation and GDP trends. In contrast to the precautionary approach of the ECB, the central bank of the United States (FED) has suddenly started to tighten its monetary policy. Namely, the FED already increased its interest rate by 0.25 percentage points in March, then again in May by 0.5 percentage points, and by 0.75 percentage points in June. The FED's announcements indicate that they could continue with additional tightening of monetary policy even after June in order to curb inflation.

Increasing the reference interest rate could gradually increase the cost of new borrowing as well as the debt repayment burden for existing borrowers with variable interest rate loans. Due to the expected change in monetary policy, the short-term and long-term costs of financing the state will increase. The higher and longer-lasting the inflation rate, the higher and longer-lasting risk of interest rate growth, and the more serious the negative consequences on real economic activity, in the context of a potential recession.

**Fiscal sustainability and risks** - The estimated fiscal risk in 2021 is slightly lower compared to the previous year. The risk assessment was influenced by the following factors:

- Reduction of (gross) public debt of 5.58% compared to end-2020, primarily owing to the reduction of external debt, i.e. debt repayment based on Eurobonds issued in 2016. Also, the absence of new borrowing during 2021, the repayment of internal debt based on loans and treasury bills, as well as a significant growth of the gross domestic product due to the recovery of economic activity contributed to a significant reduction in the share of public debt in GDP at the end of 2021 (84.75% of GDP) compared to the debt balance at the end of 2020 (105.34% of GDP).
- Reduction of the budget deficit in 2021 (to the level of 2.03% of GDP) as a result of an increase in budget revenues that were 16.65% higher compared to 2020, this primarily owing to a successful summer tourist season, the application of electronic fiscalisation of tax registers, and the application of temporary measure of the Government of Montenegro and the Central Bank of Montenegro to reduce the negative impact of the Covid-19 pandemic by securing liquidity for the real sector. At the same time, consolidated expenditures declined by 2.60% due to a fewer withdrawals of funds for highway construction, as well as smaller allocations of funds from the budget reserves, i.e. reduced financing of costs of aid to the economy.

The 2022 Budget Law of Montenegro envisages a budget deficit for this year of 3.86% of the estimated GDP. The budget deficit amounted to 36.6 million euros or 0.69% of GDP in the first five months of 2022 and preliminary data of the Ministry of Finance indicate that the current budget revenues and expenditures were 12.66% higher and 8.30% lower than planned for this period, respectively. However, in order to get a real picture of the fiscal situation, it is necessary to include all outstanding liabilities, including those related to the Health Care Fund and the future planned liabilities such as those for pension increase.

However, disruptions in the European and world markets induced by the events in Ukraine gave rise to growing uncertainty when it comes to public finances of Montenegro. The rise in the prices of oil and oil derivatives, as well as basic food supplies, may necessitate new measures by the Government of Montenegro in order to mitigate the negative effects on the country's population and economy, which could result in additional pressure on the budget and new government borrowing, resulting in an increase in public debt. In the current situation of high uncertainty and disruptions on the global market, problems and risks may also come from the operations of the majority state-owned enterprises and thus further increase the deficit.

In addition to providing a strong fiscal stimulus to the economy and the population, primarily through the reduction of the overall fiscal burden on labour, progressive taxation and salary increases, the "Europe Now" program also carries an additional risk for fiscal sustainability. While the increase in wages has preserved the purchasing power of households this year, it has also partially contributed to the growth of inflationary pressures and a potential risk of growing fiscal imbalances and, consequently, external imbalances.

Also, bearing in mind the announced necessary increase in social and pension benefits during this year, the further expected growth of public spending and its impact on the deficit should be monitored with special attention. When it comes to the expenditure side of the budget, another pronounced risk to which the aforesaid program "Europe Now" has contributed refers to the cancelling of the mandatory contribution for health insurance, namely, the insufficient provision of funds for the financing of the Health Care Fund of Montenegro. Finally, this

program is subject to negative risks in the event that the economy grows less than expected against the backdrop of global financial tightening, which would slow down planned investment and employment.

Despite the reduction in 2021, the public debt remains high, especially when we speak of the external debt. The public debt has a potential to grow in the coming period, especially if there are unforeseen pressures on the government budget and the absence of expected positive effects of the new fiscal program measures, as well as an unstable situation on the world markets of oil and basic food supplies, and the global financial tightening. A slowdown in economic growth and an increase in the cost of public debt financing sources, due to the rise in reference interest rates, could further jeopardise the Montenegro's fiscal position.

As the public debt remains the key medium-term challenge, fiscal sustainability should be improved by redefining the medium-term fiscal strategy in terms of expanding the tax base, rationalising tax exemptions, and proposing new initiatives for collecting budget revenues that could compensate for the negative effects of the previously adopted measures that have reduced the revenue side of the budget, which would contribute to the optimisation of the fiscal space and the reduction of public debt.

**Having considered all of the above, the Central Bank of Montenegro points to the need to implement a cautious and targeted economic policy in order to mitigate potential risks and preserve the standard of living of citizens and the growth potential of the economy. Bearing in mind the mentioned risks, the Central Bank of Montenegro sees measures aimed at curbing inflation and ensuring fiscal sustainability as the economic policy priorities.**

## **1. RECOMMENDATIONS FOR THE ANTI-INFLATION PACKAGE OF MEASURES**

In the circumstances of unpredictable and prolonged extreme disturbances in the energy, food and production input markets as a result of the situation in Ukraine, as well as interruptions in supply chains at the global level which have led to price instability and short-term inflationary pressures, and with the aim of protecting the living standard of households and, in particular, vulnerable social categories, as well as the competitiveness and sustainability of businesses, entrepreneurs and individual agricultural producers, as well as preventing the development of an inflation spiral, **it is necessary to prepare a comprehensive anti-inflation package of measures.** This is supported by the fact that inflation in Montenegro has led to higher collection of budget revenues, which has generated additional sources of funds that the Government of Montenegro should use for intervention activities. In addition to the aforesaid external shocks on the supply side, the growth of inflation in Montenegro was partly influenced by the recovery of demand stimulated by the abolition of Covid-19 measures and the implementation of the "Europe Now" program. However, the unpredictable growth of "imported inflation is nevertheless the key source of growth in domestic inflation.

The Central Bank of Montenegro proposes that **anti-inflation measures be of a temporary nature** until the disturbances in the market have been resolved, and also to be carefully profiled in order to avoid the possible growth of informal economy. The following is suggested, inter alia:

- In the case of further growth of prices of basic foodstuffs, consider short-term price capping of products vital for people`s life and.
- Monitor the program of subsidies to socially vulnerable categories of the population and adjust it depending on external market disturbances;
- Reduce the VAT rate on electricity for corporate consumers in order to reduced inputs in the price structure of goods and services;
- Reduce the VAT rate on energy-efficient heating systems and building insulations in order to encourage energy savings;<sup>1</sup>
- Reduce or abolish the fee for renewable energy sources paid by consumers in order to reduce the price pressure on consumers;
- Freeze the price of electricity in the event of further extreme disturbances on the market;<sup>2</sup>
- Consider the possibility of reducing the VAT rate on oil and oil derivatives, in order to reduce retail fuel prices;
- Limit the export of pellets and firewood and limit their prices, and in case of any market surpluses, consider their purchase by the state for the purpose of commodity reserves;
- Set up a separate administrative body for commodity reserves and form commodity reserves with the aim of ensuring the security of supply of basic foodstuffs and the implementation of state intervention measures on the market;<sup>3</sup>

## **2. RECOMMENDATIONS FOR FISCAL POLICY**

The Central Bank of Montenegro welcomes the measures implemented by the Government of Montenegro in 2022 aimed at dealing with the consequences of the crisis caused by the situation in Ukraine that has led to an increase in the prices of food, oil and other energy products, construction materials and other raw materials. Solving long-standing problems and those emerging from the pandemic, as well as the consequences of the latest crisis caused by the situation in Ukraine, will require turning firm and clear commitments into vigilant fiscal management. Therefore, fiscal prudence through the application of sound fiscal policies will be necessary to strengthen the country`s macroeconomic sustainability and efficient access to financial markets. Bearing in mind the above, the Central Bank of Montenegro proposes the following:

- Preparation of a comprehensive analysis of social benefits, beneficiaries and poverty research, in order to evaluate the targeting of social benefits and the impact of social transfers on living standards. Special attention should be paid to the analysis of the impact of new social benefits, especially universal social benefits in order to properly direct social benefits and other social policy measures;

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<sup>1</sup> This measure was recommended by the European Commission within the REPowerEU plan.

<sup>2</sup> Law on Temporary Measures for Limiting the Prices of Products of Special Importance to Human Life and Health does not apply to products whose pricing is prescribed by a special law.

<sup>3</sup> In order to respond to the current economic situation, the Ministry of Economic Development and Tourism announced a public call for an independent consultant who would prepare a comprehensive Study on the justification of the re-establishment of state commodity reserves that had been abolished in 2003 when the Law on Intervention Procurement came into force.

- Considering the possibility of accelerated additional extraordinary adjustment of pensions, especially the lowest ones, in order to increase the minimum pension, with a view to improving the position of pensioners, as one of the most vulnerable categories of the society, and at the same time reduce the gap between the minimum and average pensions and earnings, bearing in mind the significant increase in earnings through the application of the program “Europe Now” and a significant inflation increase;
- A new legislation to be drafted and enacted as soon as possible to provide additional revenues planned under the 2022 Budget Law, which would reduce the deviation of collected revenues from those planned for the current year. This refers to the Law on Tax Administration, the Law on Games of Chance, a law that would regulate taxation of illegally acquired property, as well as a regulation related to fuel marking;
- Precisely determine the amount of liabilities of the Health Care Fund, clearly define the way to gradually settle those liabilities, with responsible further planning of budget transfers to the Fund, which will be settled in a timely manner, all with the aim of ensuring regular functioning of the public health care system;
- Consider the possibility of strengthening the powers of inspectors of the Revenue and Customs Administration in order to reduce the shadow economy;
- Consider the adoption of amendments to the 2022 Budget Law (budget revision) to regulate the absence of income due to the failure to pass the planned legislation, as well as the provision of additional funds for the needs of the health care system, as well as the settlement of obligations based on legal solutions for which no funds have been allocated in the original 2022 Budget Law;
- Provide fiscal reserves in a timely manner, either through domestic accumulation or, if this option is not possible, through borrowing on the international market or entering into an arrangement with the International Monetary Fund (IMF), given that the coming year will bring numerous uncertainties;

In order to continue the budget consolidation process and achieve fiscal stability, it is necessary to:

- Carry out fiscal consolidation with the main focus on the expenditure side (non-productive consumption), with the aim of balancing the budget and reducing the public debt (costs of consulting services, subject to prior analysis and assessment of their necessity; costs of legal services, through the use of internal resources, assistance from other consumer unit or the Protector of property and legal interests of Montenegro, and the like);
- Create a new Plan for deficit recovery and public debt reduction which will contain a fiscal consolidation plan and measures to reduce expenditures with a large share in total budget spending, as well as the collection of tax debts and the adoption of measures to combat tax evasion. The level of the planned deficit in 2022, as well as the level of public debt, obliges the Government of Montenegro to prepare a new Deficit recovery plan in accordance with the Law on Budget and Fiscal Responsibility;
- Accelerate activities towards the establishment of the Fiscal Council as an independent body for fiscal oversight, which will oversee the implementation of fiscal policy, the achieving of defined fiscal goals, but which will also provide clear guidelines and recommendations that will contribute to the achievement of such goals;

- Improve the public finance management system with reliable and transparent data management, reporting, monitoring and enforcement mechanisms. A stronger and more responsible management of public finances includes strengthening the management of public investments and continuation of the public procurement reform. More efficient public spending would boost growth and create fiscal space to support crisis recovery. The strengthening of fiscal institutions (including the establishment of an independent Fiscal Council) would enable higher quality spending to be maintained and debt to be reduced to levels prescribed by the fiscal rules defined by the law, which is the prerequisite for overcoming future shocks;
- Accelerate the development of a comprehensive debt management strategy with a view to defining a plan to reduce the level of public debt over the medium term. Credible fiscal and debt strategies and their implementation are critical to fiscal sustainability. Consider the possibility of restructuring a part of the public debt;
- Consider re-introducing profit tax benefits/exemptions in the case of reinvestment of profit on the territory of Montenegro, especially for investment in production activities and underdeveloped areas;
- Create a central registry of public sector employees (general and local government levels), including those employed in majority state-owned enterprises in order to identify redundancies and overlapping of responsibilities, and perform a functional review that would be useful for future optimisations;
- Consider amending the Law on Civil Servants and State Employees, which would enable the depoliticization and professionalization of the public sector. The efficiency and capacities of public administration can be strengthened by adhering to performance-based recruitment and promotion practices and by introducing control and accountability mechanisms for employees;
- The planned capital budget, as foreseen in the annual budget, should be implemented as scheduled in order to timely implement capital projects of priority for economic development. At the same time, improve the management of capital investments<sup>4</sup> by strengthening the oversight of capital expenditures, especially investment plans (cost-benefit analyses), all with the aim of more efficient use of budget funds. When planning the capital budget, strive for the selection of projects to be based on cost efficiency, in addition to technical and administrative justification;
- Public spending should focus on areas that bring the highest rate of social and economic growth. Greater investments in education and health care, along with labour market reforms, would improve employment and financial situation of young people and help create a more productive workforce;
- Propose an expert analysis and a model proposal for the construction of the remaining two sections of the highway to be created through EU funds, and particularly consider the realistic possibilities of a funding model that will not significantly increase the public debt;
- Ensure the support of government institutions from the central level to local self-government units in the development and implementation of public-private partnership programs of smaller scale and value;

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<sup>4</sup> In order to effectively manage the capital budget, implement the IMF recommendations communicated in the Public Investment Management Assessment (PIMA) document.



- Create a central registry of state aid to majority state-owned enterprises, which would enable greater transparency and accountability and/or mandatory registering of granted assistance in order to provide data for much-needed monitoring and evaluation of the effectiveness of state aid;
- Continue monitoring the social and economic situation of vulnerable groups in order to plan and implement adapted and effective interventions aimed at their protection as it is obvious that the crisis will continue throughout the next;

Considering all the above external and internal risks in the fiscal area, consider strengthening fiscal stability with Montenegro`s entry into an arrangement with the IMF.<sup>5</sup>

### **3. RECOMMENDATIONS FOR REAL ECONOMY**

After the deepest recession in the last few decades, Montenegro managed to partially restore macroeconomic stability in 2021. However, the new crisis induced by the situation in Ukraine has created a new challenge to maintaining stability and preserving growth. To that end, it is necessary to focus the investment policy on research and innovation, renewable energy sources and infrastructure, with due consideration of the country`s regional differences and/or needs. Also, it is necessary to provide support for strengthening the competitiveness of small and medium-sized enterprises by investing in digital and green transition, especially in priority sectors (agriculture, tourism, energy, and manufacturing industry), with the aim of increasing production and exports (import substitution), and preserving existing and/or creating new jobs.

#### **3.1. Agriculture**

In order to improve this sector, the following is proposed:

- Ensure better and more adequate support/assistance to farmers in the process of document preparation for grant application from the IPARD II and the future IPARD III program, while avoiding conflicts of interest to prevent those involved in the documentation preparation process to be involved in the funding approval process as well. At the same time, strengthen the control of the process of allocation and use of funds from international programs;
- Ensure effective assistance for the preparation of project and credit documentation for projects applying for credit support from banks and the Investment and Development Fund (the current model through the Employment Agency has proved ineffective because the current procedures are complicated for this type of clients);
- Promote the association of small agricultural producers into production organizations and provide logistics and distribution infrastructure for this purpose (appropriate cooling chambers and the like) with the aim of eliminating the lack of storage capacity for smaller producers, improving their position in supply chains, and increasing

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<sup>5</sup> The recommendations given in the fiscal policy segment were based on the current situation in which Montenegro does not have an arrangement with the IMF, so it should be borne in mind that in the event the country enters into such an arrangement, some of these recommendations could be in conflict with the conditions specified in the arrangement.

competitiveness when entering the market together. Also, promote forming vertical and horizontal clusters;

- Consider the possibility of establishing a (majority) state-owned company to deal with connecting agricultural producers with domestic customers from the tourism and catering sector (as well as others), i.e. ensuring safe purchase and placement of agricultural products (trade and catering companies) and required storage capacities;
- Encourage the development of centres for the processing and distribution of agricultural products;
- Provide more subsidies for the application of new technologies in order to increase competitiveness of Montenegrin farmers, given that agriculture is the only export sector that, according to the rules of the World Trade Organization, is allowed to be subsidized;
- Consider the introduction of tax reliefs for raw materials in agricultural production in crisis situations involving their high price growth on the international market;
- Organise regional training of the population with a view to implementing smart specialisation in the agricultural sector; use workshops to educate agricultural producers on the correct use of pesticides in order to obtain an ecologically safe product; encourage a greater volume of production of organic products, products with a label of origin, a geographical label;
- Subsidise agricultural producers in property/crop insurance and for the purchase of equipment for protection against natural disasters;
- Consider the development of a food donation system modelled on EU countries, bearing in mind large amounts of food wasted due to untimely control of the shelf life of agricultural products, on the one hand, and a large percentage of the population at risk of poverty, on the other. The system should have an established intermediary mechanism in the food donation chain, defined sanitary criteria that the donated food must meet, tax benefits for donated food, and the like;
- Subsidise programs for the use of food waste and other bio-waste in the production of renewable sources such as fertilizers, biofuels or bioenergy;
- Encourage sustainable water management programs (rainwater management, wastewater treatment for their reuse, and the like) which would reduce costs for small farms;
- Consider the introduction of a program of permanent monitoring of the state of agricultural land, which will enable obtaining a realistic picture of the parameters as the basis for systematic and planned management of this resource;
- Consider the model of leasing state-owned arable land for quality business projects at favourable prices to farmers or families for their own needs;
- Improve the infrastructure towards inaccessible or less accessible arable land, which would contribute to greater regional development and reduction of internal migrations.

### **3.2. Tourism**

Key measures should be aimed at implementing structural reforms that will promote sustainable and climate-friendly tourism, so the following is proposed:

- Work on further improvement of road infrastructure;
- Perform a development analysis and propose a model for expanding beach capacities, especially in places with most tourist visits;
- Complete and implement waste water management projects on the territory of the entire country;
- Increase financial support measures for the development of specially designed tourist products with the aim of developing Montenegro as a year-round tourist destination (use the potential for the development of cultural, religious, sports and other special types of tourism);
- Encourage the cooperation of the health and tourism sectors with the aim of improving the infrastructure of health institutions and the development of health tourism; work on the introduction of innovative business models and services in the field of health tourism in accordance with the Smart Specialisation Strategy of Montenegro 2019-2024;
- Promote offer of products that prioritize healthy lifestyles using the potential for the development of wellness and SPA tourism, adventure tourism, camp tourism, tourism in protected areas, and the like;
- Strengthen cooperation with domestic environmental protection organisations in order to discover and solve the problem of devastation of green zones and national parks. To that end, encourage green and greenfield investments, as well as access to international funds such as the Global Environment Facility (GEF) and the Green Climate Fund (GCF);
- Speed up the process of creating an information system that would enable comprehensive electronic monitoring of tourist traffic in real time;
- Develop tourism-related sectors related in order to reduce import dependence (food industry, agriculture, business services sector, construction, transport infrastructure) and identify potential synergies in order to use resources more efficiently.

### **3.3. Energy**

It is expected that the global energy crisis in Europe will reach its peak at the end of the year. It will lead to further growth of energy prices and limited supply. Therefore, the priority of economic policy should be the security of supply and the provision of sufficient quantities of energy for the domestic market. Taking into account the aforesaid, the following energy measures are proposed:

- Set up an interdepartmental working body with the aim of finding solutions and/or new regulatory rules that would ensure the sustainability of CEDIS and CGES operations;

- Revisit the regulatory framework and remove limitations to a more efficient implementation of the energy transition;
- Carefully balance the ratio of the share of electricity production from renewable and non-renewable sources, which has been actualized by the ongoing energy crisis, in such a way as not to jeopardize the realization of the goals from the National Strategy for Sustainable Development until 2030;
- Provide technical and regulatory conditions for undisturbed operation of thermal power plant Pljevlja, especially bearing in mind that the energy crisis has forced some EU countries to turn to coal-based electricity production despite the negative climate effects;
- Promote energy efficiency and rationalise energy consumption, i.e. apply energy efficiency measures at all levels of consumption (households, businesses, street lighting, business premises, etc.);
- Intensify activities to reduce losses in the transmission and distribution of electricity, i.e. increase energy efficiency in the final energy consumption, with the aim of reducing high energy intensity through: i) continuation of modernisation and revitalisation of the existing, and the construction of new electrical infrastructure for the production, transmission and distribution of energy based on the principles of international technical standards; ii) full transposition into the national regulation of energy efficiency standards for residential buildings and use of renewable energy sources; iii) accelerated removal of existing barriers and improvement of the organisational structure of the energy sector; iv) legal regulation of the obligation to introduce energy management in the public sector (at the state and local levels), as well as in large energy consumers; v) improvement of the funding model to support investments in energy efficiency;
- Improve the interconnection with neighbouring power systems in order to solve the problem of the lack of cross-border transmission capacities, which represents one of the obstacles for trading with surplus power and for a greater use of the opportunities available within the EU Economic and Investment Plan for the Western Balkans for modernisation of the existing and the construction of new transmission capacities;
- Create conditions for the full inclusion of the wholesale electricity market in Montenegro in the single EU market via, inter alia, improving the ability of the Montenegrin power exchange (BELEN) to manage the exchange and connect with neighbouring electricity markets;
- Consider the possibility of conditioning the issuance of new building permits, especially in coastal municipalities, with the installation of solar panels on new buildings.
- Consider the options for connecting Montenegro to international natural gas corridors, i.e. with the gas pipeline system of the region via the Ionian-Adriatic pipeline by creating legal and institutional conditions for the realisation of this priority task, as well as finding an adequate funding model for the construction of the gas pipeline, in order to provide access to natural gas.

## 4. RECOMMENDATIONS FOR GREEN ECONOMY

Although it contributes but slightly to global warming and does not have a significant impact on climate change, Montenegro belongs to the countries threatened by climate change and is particularly exposed to the risks of heat waves, droughts, forest fires, floods, and the like. The results of climate projections indicate a further increase in air temperature and a decrease in the average annual amount of precipitation. Climate change, through a negative impact on economic sectors that significantly contribute to Montenegro's GDP (tourism, agriculture, energy, etc.), affect economic growth, employment, inflation, public debt, and threaten macroeconomic and fiscal stability. Therefore, it is very important to direct all efforts towards climate change adaptation measures.

The goal set by the revised Nationally Determined Contribution of Montenegro to the reduction of greenhouse gas emissions by 35% by 2030 compared to 1990. This goal can be achieved with the fulfilment of the measures established in the key national strategies, plans and other documents in this area.

With a view to strengthening the aforesaid activities, the following is proposed:

- Implement the so-called “green tax reform”, i.e. consistently apply the “polluter pays” principle, additionally tax the polluters (carbon taxes), gradually abolish subsidies aimed at activities that have a negative impact on the natural environment, provide for tax breaks and various types of subsidies for the use of green technologies, subsidies for innovations in this area, as well as for innovations that contribute to lower consumption of materials and energy in production processes, stimulate the use of electric cars through preferential tax treatment and registration;
- Secure a certain amount of funds - fiscal reserves for the protection against future natural disasters, which will become increasingly frequent;
- It is necessary to form a pollutants registry that should contain data on the sources, type, quantity, method and place of discharge and disposal of harmful substances into the environment;
- It is necessary to begin with the urgent rehabilitation of some of the most endangered locations with a view to land recultivation;
- It is necessary to adopt a new strategy for the development of agriculture and rural areas, which will define measures to reduce greenhouse gas emissions from that sector;
- It is necessary to specialize in the cultivation of plant varieties that are more resistant to adverse climate conditions, especially drought;
- It is necessary to adopt a new Forestry Development Strategy which will define, inter alia, the fight against forest fires. Although the vision of the current National Forestry Strategy (2014 – 2023 Strategy with the Forests and Forestry Development Plan) in the field of forest fire protection specifies that the state will be capable of fighting forest fires by 2023, with the aim of reducing the extent of burned areas and destroyed biomass by 70%, this has not been ensured. It is necessary to improve the system for preventing and extinguishing forest fires<sup>6</sup> and, where possible, develop and maintain

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<sup>6</sup> More droughts and less rainfall in the previous period have led to large fires in which a large area of forest have burned - in 2021, forests burned by fire had about 2,000,000 m<sup>3</sup> of wood mass.

road and railway fire protection infrastructure. Due to the specificity of the terrain of Montenegro, Montenegro does not have the most effective protection from the air;

- Build a network of electric car chargers;
- Encourage the development of city transport in order to reduce the use of individual vehicles. Hydrogen and electric buses should be gradually introduced, as well as electric buses for public transport of tourists;
- Introduce more energy efficient public lighting;
- It is necessary to reach a national consensus on the construction of new hydropower plants, with due consideration of their great energy potential on the one hand, and the threat to biodiversity on the other. Also, in the conditions of pronounced climate change, the decision on the possible construction of new hydropower capacities must be preceded by an assessment of future water flows. Greater droughts and less precipitation lead to a decrease in the reservoirs of lakes and rivers, especially in the summer months when the reservoirs are available at a maximum of 40% of their capacity so there is a serious risk that due to the low water levels, these are not used for energy production;
- The construction of small hydropower plants should be suspended/restricted because they seriously damage the natural environment, jeopardize the traditional way of life, endanger certain plant and animal species, and have a negligible contribution to the overall production of electricity. Preference should be given to the construction of wind and solar power plants.

## **5. RECOMMENDATIONS FOR STATISTICS**

Statistics is very important because the quality of formulated economic policy measures largely depends on correct and timely statistical data. Therefore, it is of great importance to continue with further development of the statistical system in Montenegro. To that end and with a view to achieving full alignment of the official statistics with the relevant EU *acquis*, the following is proposed:

- Intensify activities on introducing the ESA2010 methodology into the government finance statistics, in line with planned amendments of the Law on Statistics and the System of Official Statistics and the supporting amendments to the MoU on cooperation signed by the official producers of statistics in the country;
- Improve the labour market statistics by providing comparable data. Frequent changes in methodology and incomparability of data reduce confidence in quality of the national statistics. In case of any amendments to the methodology, it is necessary to provide a revision of the earlier data for at least ten years. In addition, it is necessary to strengthen the supervision of conducted field research.
- Form a database/registry of traded real estate in Montenegro, following the example of all countries in the region and the EU, in order to improve real estate price statistics.

## **6. RECOMMENDATIONS FOR OTHER AREAS OF IMPORTANCE FOR THE ECONOMIC POLICY PURSUIT**

In addition to the previously identified areas that are crucial for a stable, sustainable and accelerated development of Montenegro's economy, other important improvements need to be made for the same purpose. Inter alia, we highlight the following:

- Initiate activities within the competent ministries to strengthen the broad legal, judicial and regulatory framework in order to speed up the resolution of accounts uncollectible outside the Central Bank's authority;
- Speed up the fulfilment of the requirements from the negotiation process in order to accelerate the country's EU integration process;
- It is necessary to adopt a strategy for reindustrialisation to carefully consider the industrial branches to be developed as a priority (such as the food and processing industry), as well as modalities of support for their development (foreign direct investments, connecting economic entities from this area with scientific and research institutions, and/or through formation of regional and domestic clusters, and the like). Diversification of the production structure based on digital transformation is imperative for the long-term development of the Montenegrin economy;
- Carry out more efficient preparation and rigid supervision of the projects funded with the EU funds and grants, as well as from other sources, especially when it comes to infrastructure projects, bearing in mind the limited possibilities of available domestic funding;
- Reconsider the possibility of returning the working Sundays, either permanently or during the tourist season, which could increase employment and expand the tax base, and indirectly affect exports. At the same time, it is necessary to strengthen the control of respect for the legal rights of workers;
- Consider the possibility of creating a national committee for structural reforms bearing in mind the decades-long numerous structural imbalances that exist in the Montenegrin economy;
- Include representatives of the private sector in the preparation of the Regulatory Impact Assessment, in order to obtain as objective analyses and assessment of the impact on the improvement of the business environment as possible;
- Improve the Central Registry of Commercial Entities (CPRS) by deleting all inactive companies in order to get a realistic picture of the state of insolvency, in parallel with ensuring the records of deleted inactive companies. Increase the efficiency of the work of the CRPS related to administrative procedures in order to respect the deadlines for processing requests and checking the business sector in accordance with international classification standards;
- Tighten the penalty policy for companies – repeated offenders (especially for those operating in the informal economy);
- Institutionalize the status of seafarers through the creation of a register of seafarers and consider the issue of the collective agreement for this category of employees;
- Encourage working remotely/from home whenever work processes allow it in order to achieve energy and other material cost savings, in accordance with international practices;

- Adopt the Regulation on the insurance of export loans against non-market risks in order to encourage the competitiveness of export-oriented economic entities in Montenegro. This would regulate the insurance of claims and export credits arising from the export of goods and/or services of Montenegrin origin against non-market risks (e.g. the Covid-19 pandemic);
- In order to attract IT experts and develop the ICT industry, create a unique offer for IT “nomads”. The offer would include a simple one-year residence registration, a subsidised internet package, and subsidised costs of accommodation;
- Starting from the strategic importance of AD Port of Adria (Luka Bar), the state should take over this company, i.e. nationalise it by purchasing 60% of the shares from the existing owner if the latter is interested in exiting the ownership structure;
- Provide adequate institutional, organisational and personnel capacities for the preparation of projects (including the improvement of procedures), the implementation of which is provided for by the EU Investment Framework for the Western Balkans and grants provided for projects in the field of transport that should contribute to the achievement of goals from the Connectivity Agenda (modernisation of common border railways stations, installation of signalling and telecommunication equipment on more than 100 km of railway, construction and modernisation of over 30 km of the highway), as well as improving safety on roads with a large number of traffic accidents, and also using other available funds from the EU pre-accession funds designated for these purposes;
- As soon as possible, eliminate highway bottlenecks by introducing additional toll ramps in the periods of higher traffic intensity or by introduce toll collection using the vignette system.